

SIMILARITIES BETWEEN THE PURCHASE MONEY SECURITY INTEREST CREDITOR AND THE EQUIPMENT LESSOR IN COMPETITION FOR LIEN PROTECTION AGAINST THE FLOOR PLAN SECURED CREDITOR

By: Anthony L. Lamm

In the typical business lease transaction, by the time a lessee contacts an equipment lease or finance company it already has secured financing with a bank. Frequently this obligation is in the nature of a Warehouse Line of Credit or a Promissory Note and a Security Agreement. Given this scenario, should an equipment lessor or equipment finance company elect to do business with such a lessee, the issue of lien priority becomes paramount. This article will focus on how an equipment lessor can perfect a first lien and establish priority in the individual items of equipment it leases or finances when a Floor Plan Secured Creditor or blanket lien holder has already filed a blanket lien.

The Security Agreements of most blanket lien holders typically describe collateral as follows:

"(a) All furniture, fixtures, machinery, supplies and other equipment. (b) All motor vehicles, tractors, trailers, implements, service parts and accessories and other inventory of every kind. (c) All accounts, contract rights, chattel paper and general intangibles. (d) All new and used tractors, equipment and other merchandise now owned or hereafter owned or hereafter acquired by debtor and in the proceeds, in whatever form, of any sale or other disposition thereof."

This language may create a problem in perfecting a lien for any subsequent equipment lessor or finance company. Since the financing statement filed by the Floor Plan Secured Creditor perfects a security interest in "all new and used equipment and other merchandise now owned or hereafter owned or hereafter acquired and in the proceeds, in whatever form of any sale or other disposition thereof", can an equipment lessor or finance company find a safe harbor in leasing specific items of equipment to a borrower or lessee who is already financed by a Floor Plan Secured Creditor?

Initially, the analysis must begin with an examination of the pertinent Uniform Commercial Code sections. Article 2A-307 addresses the Priority of Liens Arising by

Attachment or Levy on, Security Interest In, And Other Claims to Goods. Subsection (a) provides in pertinent part that, "Except as otherwise provided in Section 2A-306 (relating to priority of certain liens arising by operation of law), a creditor of a lessee takes subject to the lease contract. (emphasis supplied). Under subsection (b) of Section 2A-307, "...a creditor of a lessor takes subject to the lease contract unless: (1) the creditor holds a lien that attached to the goods before the lease contract became enforceable: (2) the creditor holds a security interest in the goods and the lessee did not give value and receive delivery of the goods without knowledge of the security interest; or (3) the creditor holds a security interest in the goods which was perfected (Section 9-303) before the lease contract became enforceable."

Since the security interest in favor of the Floor Plan Secured Creditor can only be perfected by the secured party taking possession of the leased goods, there is no interference with the lessee's leasehold interest unless the goods delivered to and received by the lessee were subject to a lien of the same Floor Plan Secured Creditor before the lessee received delivery, or if the lessee received the equipment or goods without consideration. Accordingly, Article 2A of the Uniform Commercial Code gives equipment lessors the freedom and security to lease goods in the ordinary course of business to lessees who already have blanket-lien financing.

However, the situation would not be as simple if: (1) the equipment lease agreement were deemed to be a disguised security agreement or an installment sales contract; or (2) the equipment financing was a purchase-money financing arrangement from the outset. In both of these situations, Section 9-312 of the Uniform Commercial Code governs.

For a clearer illustration of this situation, the facts of In re McClure, 108 BR 468 (U.S.Bkrpty.Ct.,MD.PA 1989) is helpful. In McClure, Ford Motor Credit and the debtor, executed a Tractor and Equipment Wholesale Plan Application for Wholesale Financing and Security Agreement on or about October 16, 1984 with the following collateral description: "the merchandise (new and used tractors, equipment and other merchandise) now owned or hereafter acquired by dealer and in the proceeds, in whatever form, of any sale or other disposition thereof." On June 16, 1986, Ford filed a UCC-1 Financing Statement in the office of the appropriate County Clerk and on July 21, 1986 in the Secretary of State's Office. Thereafter, on

June 9, 1988 and June 13, 1988 Kubota (a manufacturer and financier of tractors) filed a UCC-1 Financing Statement in the Secretary of State's Office and in the County Clerk's Office covering tractors and inventory. On June 16, 1988, Kubota and the debtor also executed a Security Agreement describing the particular collateral subject to their Financing Statements. Kubota never notified Ford of its Purchase Money Inventory Financing pursuant to the Uniform Commercial Code Section 9-312 (3)(b).

Prior to the October 16, 1984 Tractor and Equipment Wholesale Financing and Security Agreement with its after-acquired property clause, Ford and the debtor had entered into two additional Security Agreements on March 12, 1980 and January 3, 1983 describing the collateral as follows: "(a) All furniture, fixtures, machinery, supplies and other equipment. (b) All motor vehicles, tractor, trailers, implements, service parts and accessories and other inventory of every kind. (c) All accounts, contract rights, chattel paper and general intangibles." The Court ruled that a novation did not take place and the 1984 Tractor and Equipment Wholesale Financing and Security Agreement did not eliminate the general, blanket-lien security interest created by the 1980 and 1983 Security Agreements. Therefore, since Kubota did not deny that it failed to send Ford an inventory financing notice pursuant to UCC 9-312 (c)(2) and Kubota's financing statements were filed subsequent to the time that Ford filed its UCC-1's, the Court ruled that Ford had a perfected prior security interest in the disputed collateral in which Kubota also claimed a security interest.

Section 9-312 (3)(b) provides in pertinent part as follows:

"a perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if...(b) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the twenty-one day period where the purchase money security interest is temporarily perfected without filing or possession...."

If an equipment lessor or finance company with purchase money security interest status intends to provide equipment lease-financing to a customer for items of equipment that could be

determined under the Uniform Commercial Code (including, Article 2A), to be inventory, an equipment lessor or finance company should do the following to protect its interest before acquiring equipment on behalf of a customer and advancing monies:

1. Perform a UCC search and obtain the actual collateral description related to the financing statements filed by other lenders and lessors to determine whether a prior lender is advancing and perfected in equipment that could be classified as inventory of the customer and which would be the same type of equipment you wish to lease or finance for the customer, and
2. If there is a prior in time financing statement filed by a secured party as to the same type of equipment that you, as equipment lessor wish to finance, provide the prior secured creditor with notice of your intent before the beginning of the twenty-one day period where your purchase-money security interest is temporarily perfected without filing or possession.

Any equipment lessor who writes leases that are not strictly compliant with FASB-13 for "true lease" status, should perform a UCC search for similar types of equipment covered by inventory financing if this equipment lessor will also be financing equipment that could be considered inventory and, provide the "twenty-one day notice" to the prior-filed blanket-lien holder.

Anthony L. Lamm is a member in the law firm of Groen, Laveson, Goldberg & Rubenstone of Belsalem, Pa. He is the chair of the creditors rights and leasing department and may be reached at 215-638-9330.

Reprint from LJN Equipment Leasing Newsletter – February 2000