1972

Secured Transactions (May 1972)

William & Mary Law School
Daniel Dealer, in the automobile business, had a current inventory of 20 new and 30 used cars. His inventory, turning over constantly, was financed on a continuing basis by Frigid Finance. His current debt to Frigid was $110,000 under a security agreement and a duly filed financing statement describing the collateral as "All automobiles and trucks, (new or used) held for sale now owned or hereafter acquired."

One night when Daniel was away and his nephew Ralph Reckless was on duty, Sid Shady showed up with a sharp-looking 1970 Ford Sports car. Ralph wanted to show his talent for business -- he had just taken in $3000 cash on a previous sale -- and made a deal to buy the Ford car for $1500, Sid handing over a certificate of title. Next day Ralph took a close look at the certificate and found that while it was in Sid's name and Sid had endorsed it, in "blank," there was a notation of a security interest in favor of GMAC.

Fortunately Daniel had gone out of town before he got back Ralph had resold the car to George Truehart for $1750, sending him on his way with the existing title certificate described above. The state has adopted the Code and 9-302(3) Alternative B; its Motor Vehicle Law is similar to Virginia's and to the Uniform Certificate of Title Act with regard to the effect of the certificate of Title and the procedure for inventory financing.

When George finally wakes up to the truth, he finds that Daniel Dealer is out of business and has disappeared.

(1) Discuss whether George took subject to the security interests of either or both Frigid Finance or GMAC.

(2) Suppose instead of a sport car we have been talking about a dump truck George was buying for his gravel hauling business. How would this affect the result?

A made a loan of $50,000 to Handy Housewares, Inc. (HH) pursuant to a security agreement which described collateral as follows:

2 Hansen screw machines, serial nos. 43728 and 43729 together with all other screw machines now owned or hereafter acquired.

A financing statement was properly filed which omitted the underlined words and described the collateral in these words:

2 screw machines, model 1967, made by Hansen

Actually these were Henson machines, model 1967, and the correct serial numbers were 43728 and 43729. They were the only screw machines in the plant.

60 days later A, being in need of funds, sold and assigned his right title and interest under the security agreement to X. By that time HH was itself in need of further financing, and X loaned it an
additional $50,000, with a memorandum signed by both parties showing that this was a supplemental loan under the original security agreement.

4 months later, Y, a manufacturer in another line of business, and desperately in need of screw machines, learned that MM, in addition to the two machines described, had just bought and paid for a new Bullard screw machine. He offered MM $175,000 cash for the three machines, which was a price so good MM could not refuse. It accepted the cash, delivered the machines and gave Y an unqualified bill of sale. Shortly thereafter MM closed up its business, leaving various unpaid bills; X learned of the sale and now seeks to recover the machines from Y who makes the following contentions:

1. As a buyer in ordinary course of business I am protected against security interests.

2. I had no knowledge of X's security interest; if I can show that the security interest was unperfected, then I will take priority even if I am not a buyer in ordinary course of business.

3. As to the first 2 machines the description in the security agreement and financing statement is so vague, inaccurate, inconsistent and misleading that it is invalid as notice to creditors, making the security interest therein unperfected.

4. X has no standing to claim the property because there was no filing as to his assignment from A who remains the creditor of record.

5. X has no security interest in the third machine because this is after-acquired property which was not mentioned in the financing statement.

6. If X has any claim, it is limited to the original $50,000 because the financing statement gave no notice of future advances.

Treat each of these as an independent defense without regard to the other contentions; answer each number by the beginning word "Right" or "Wrong" and explain why on each.

III - 42 Points

D, who had operated a retail hardware store for 10 years, embarked on a substantial business expansion, which gave rise to the following security interests:

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<tbody>
<tr>
<td>D</td>
<td>$17,000</td>
<td>A</td>
<td>2-1-70</td>
<td>Accounts receivable now owned or hereafter acquired, and proceeds thereof.</td>
</tr>
<tr>
<td>D</td>
<td>$45,000</td>
<td>B</td>
<td>2-15-70</td>
<td>Inventory of hardware, glass and paints, now owned or hereafter acquired, and proceeds thereof.</td>
</tr>
<tr>
<td>D</td>
<td>$8000</td>
<td>C</td>
<td>2-25-70</td>
<td>All machinery and equipment used in operation of retail hardware, glass and paint store, and proceeds thereof.</td>
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The foregoing are consistent with underlying security agreements, bearing the same respective dates, and all such agreements are binding and perfected.

Special provisions

B's security agreement states "It is recognized that sales and replacements will necessarily involve variances in inventory value from time to time and D covenants that the carrying value of the inventory will at no time be less than $50,000 which is the approximate carrying value at the date of this loan."

C's security agreement provides that proceeds of collateral are pledged but that no sale or transfer of collateral shall be made without consent of C.

It is now February 1971. D has not prospered and is in desperate straits. The inventory covenant has been often broken -- the total has been up and down, with a low point of $20,000, though it is now slightly over $50,000 (only because he owes suppliers $65,000). Also the inventory figure includes $5,000 in a new line of Brushmore Paints which D was persuaded to take on. Brushmore was most anxious to obtain an outlet in this town and offered to put in the paint supply on credit. Brushmore and D signing an agreement whereby Brushmore retained a security interest in the $5,000 stock of paint, with D having the right to sell, for cash only, and the duty to apply proceeds to the debt. This agreement, in proper form for filing, was duly filed February 12, 1971 in lieu of a financing statement; D received the paints on February 15, 1971 and set them up in a separate display area as required by the agreement.

On February 16, 1971 D's biggest glass customer, Harvin's Millwork, told D that it was going to take over its own glass preparation; D offered to sell his glass cutting machinery and tools for $4,000 and Harvin accepted, giving $1,000 cash and $3,000 in the form of a bearer negotiable note secured by a conditional sale agreement. D quickly divided the $1,000 among his three employees on account of back wages; then he ran over to the bank who bought the note and agreement outright for $3,000 cash, knowing that Harvin's credit was good. The bank immediately filed the contract in lieu of a financing statement, it being in proper form for filing purposes. D, in a last hope of recouping, hurried to the race track that afternoon and lost the $3,000.

On February 20, a bankruptcy petition is filed as to D, and a Trustee is appointed. D owes, in addition to other debts, the amounts originally borrowed: $17,000 to A  
$45,000 to B  
$8,000 to C

Answer the following in this order:

A. Carrying value of general inventory unsold is $51,000  
Carrying value of Brushwell paints unsold is $4,000  
Estimated cash realizable on forced sale of above $25,000

Discuss the relative rights, if any, of B, C and Brushmore in the amount realizable on sale.

B. Accounts receivable owed to D by various account debtors total $11,000, all arising out of sales of general inventory after March 1970.

Discuss the relative rights of A and B in the above accounts.
C. The following amounts can be definitely traced as going into D's bank account, commingled with other proceeds, during the 10 days before bankruptcy:

Cash proceeds of accounts paid off $3000  
Proceeds of sales from general inventory $4000

Discuss the relative rights of A and B in D's bank account, which at bankruptcy filing date had a balance of $3500.

D. Discuss the validity of claims on behalf of any of D's creditors against D's employees for the $1,000 paid to them, or against the race track operator for the $3,000 lost at its pari-mutual windows.

E. (1) Discuss and decide the relative rights and obligations of Marvin, C, and the bank, asking yourself the following:

(a) To whom is Marvin obligated and for what?

(b) Does C have a fully protected security interest in the property sold to Marvin, or in the note and contract?

(c) Does the bank have a fully protected ownership interest in the note and contract?

(2) Suppose the bank instead of paying $3000 cash to D had simply given him a $3000 credit on his past due loan of $10,000. If the bank knew that D was insolvent, and all other elements of preference were present, would substituting the loan credit for the cash element in the question turn this into a transfer to be set aside in bankruptcy? Explain.

(3) Assume that the bankruptcy court, rightly or wrongly, voids the transfer of the note as set out at (2) on the ground of preference. Now discuss where this leaves Marvin, C, and the bank.

IV - 15 points

Explain briefly any three of the following: (5 points each)

(1) the function and scope of Article 6 (Bulk Sales).

(2) The nature and reason of the Code's rule on priorities in the same collateral, where the conflict occurs between the first to file and the first to attach. Identify the subsection concerned.

(3) Why do we make the rules of "secured transactions" apply to outright sales of accounts or chattel paper in some circumstances (which specify)?

(4) Why should a purchase money security interest have the opportunity of priority over a lien creditor or a transferee in bulk, and in fact run in favor of a financer who is not in reality the seller?