**Priority: Purchase Money Security Interests**

Welcome to this podcast on Priority: Purchase Money Security Interests brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is which party will prevail in a competition for collateral as between sellers or lenders having a purchase money security interest (“PMSI”) and other creditors with a security interest in the debtor’s assets. While secured parties might expect to prevail with respect to their collateral most of the time, those sellers and lenders that have a purchase money security interest also have expectations. This podcast will examine the nature of a PMSI and the rules that come into play to determine which creditor has priority under § 9-324, which you should read carefully. These rules are commonly tested on law school and bar examinations so pay close attention.

A PMSI is simply a specific type of security interest. In order to attach the interest, the attachment rules of § 9-203 still apply, meaning value, rights in the collateral and an authenticated security agreement or other validating device. However, a PMSI is a particular type of security interest where there is a relationship between the acquisition of the collateral and the secured obligation itself. Purchase money collateral is simply goods or software that secures a purchase money obligation with respect to the collateral. A purchase money obligation is an obligation incurred for part of the price of collateral or for value given to enable a debtor to acquire rights in the collateral, but only if the value is so used. A security interest is a PMSI if there is purchase money collateral and a purchase money obligation.

Let’s look at an example. I need a new refrigerator and go to Sears, which agrees to sell me a refrigerator on credit, so long as the refrigerator is collateral for the loan. The purchase money collateral here is the refrigerator, and the purchase money obligation is the value given to enable me to acquire the refrigerator. Sears as the seller of the refrigerator would have a PMSI in the refrigerator. Alternatively, if I had gone to First Bank and took out a loan and used the money to purchase the refrigerator, First Bank would have a PMSI because they loaned me the money that enabled me to acquire rights in the collateral.

You may wonder how we know whether money loaned was used to acquire the collateral. This is a tracing problem. For example, if First Bank loaned money to me, and I put the money in my bank account, and then withdrew money from my bank account to pay Sears, I did not necessarily pay Sears with the money I got from First Bank. To avoid this problem, First Bank might give me a two-party check, payable to me and Sears. I would then have to indorse it and give it to Sears, which would ensure First Bank that the money was used to acquire the collateral from Sears.

Attaching a security interest for a PMSI is much like attaching any security interest. When it comes to perfection, though, the secured party will also follow the typical methods of perfection, but there are some exceptions and some additional steps to gain priority over a secured party who already has a perfected security interest in that type of collateral. A primary exception to the filing requirement is where there is a PMSI in consumer goods, which perfects upon attachment without any further action of the lender.

Let’s look at the rules for how the purchase money security interest gets priority under § 9-324. We begin with the general rule that provides a sort of super priority to creditors having a PMSI. The general PMSI priority rule of § 9-324(a) states that a perfected PMSI in goods other than inventory has priority over a conflicting security interest in the same goods so long as it is perfected when the debtor receives possession of the collateral or within 20 days thereafter. Basically, this rule provides a creditor with a PMSI priority over a prior perfected secured lender.

Let’s look at an example. Copperco sells Kitchenware a pressing machine on credit. First Bank had a prior perfected security interest in the equipment of Kitchenware, including after-acquired equipment. Because it has a PMSI, so long as Copperco perfected its security interest before Kitchenware got possession of the machine or within 20 days thereafter, Cooperco would have priority in the pressing machine over a prior perfected security interest of Bank.

The exception to this rule comes with a seller of inventory on credit. A seller that wants to claim a PMSI in inventory will have to comply with the rules of Article 9 to obtain priority in the goods they sell. To obtain the super priority, § 9-324(b) requires not only that the seller perfect a security interest when the debtor receives possession of the inventory, but also that the seller send an authenticated notification of the seller’s security interest to the holder of a conflicting security interest within five years before the debtor receives possession of the inventory. That five year rule may sound complicated, but what it boils down to is that once the notice is given, it is good for every sale for the next five years. A seller that has a long-term relationship with the buyer will have to renew the notification every five years. A seller that fails to take the required action will not have priority over a prior perfected secured party in inventory.

Presume that Copperco contracted to sell Kitchenware copper sheeting on credit secured by the copper sheeting. First Bank had a prior perfected security interest in the inventory of Kitchenware, including after acquired inventory. In order for Copperco to have priority over First Bank for its PMSI in the copper sheeting, Copperco would need to perfect its PMSI in the inventory by filing a financing statement prior to Kitchenware receiving possession of the copper sheeting and Copperco would need to send a notification to First Bank that it expects to acquire a PMSI in the copper sheeting sold to Kitchenware.

It is worth noting that sometimes there are multiple PMSIs. For instance, in order to purchase the pressing machine, Copperco as the seller might advance part of the purchase on credit, and First Bank as a lender might advance part of the purchase money. Obviously, we can’t give super priority to multiple creditors. Section 9-324(g) provides that if there are multiple PMSIs, then a PMSI seller will have priority over a PMSI lender. In our hypothetical, Copperco and First Bank both have a PMSI. However, Copperco as seller will have priority over First Bank as lender. In the event that both PMSIs are of the same type, meaning both lenders or both sellers, then the ordinary rules of priority under § 9-322 apply to determine priority.

One last topic before we conclude -- purchase money priority in proceeds. What happens, for instance, if Copperco has a PMSI in the pressing machine, but Kitchenware sells it to Steelco on credit? The rules regarding proceeds in 9-315(d) apply and Copperco will have to continue its perfection in the proceeds as required (the Steelco transaction would create an account). But, what happens to the PMSI nature of the security interest? Well, § 9-324(a) makes clear that the PMSI priority extends to the collateral or its proceeds. So, even if another lender had a prior perfected security interest in the accounts of Kitchenware, Copperco’s PMSI would extend to the account, and it would have priority. There is one exception to this rule regarding inventory under § 9-324(b), for which the PMSI status for proceeds only extends to chattel paper, instruments and cash proceeds.

At this point, you should be able to identify and describe what a PMSI is, how a secured party can create and perfect a security interest in purchase money collateral, and the rules governing priority of PMSIs. You should also be able to apply the rules related to purchase money security interests, including those related to proceeds.

I hope you’ve enjoyed this podcast on Purchase Money Security Interests.

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