For the foregoing reasons, we will affirm, on partly different grounds, the order of the District Court. [15] As an initial matter, we hold that *§ 1643 of the TILA* does not provide the cardholder with a right to reimbursement. With regards to the specifics of the instant case, we find that Azur vested Vanek with apparent authority to use the Chase card and thus that Azur's *§§ 1643* and *1666* claims cannot stand. Finally, we hold that Pennsylvania's economic loss doctrine bars Azur's common law negligence claim.

15 We decline to reach the issue of notice under *§ 1666*. *See* note 9, *supra*.

 ¿Este caso pasa a engrosar los anales de la historia comercial estadounidense como ejemplo de un fraude millonario descarado y chulesco?

VI. ARTÍCULO 9 SOBRE LA PRENDA MOBILIARIA

A. LA CONSTITUCIÓN Y LA PERFECCIÓN DE LA PRENDA

LA CLASIFICACIÓN DE LOS BIENES, DERECHOS O ACCIONES QUE PUEDEN SER OBJETO DE GARANTÍA MOBILIARIA

 IN RE: ROBERT O. TROUPE, DAWN LYNN TROUPE, Debtors, LYLE R. SELSON, TRUSTEE, Plaintiff, vs. JOHN DEERE CREDIT a/k/a DEERE & COMPA-NY, Defendant. UNITED STATES BANKRUPTCY COURT FOR THE WESTERN DISTRICT OF OKLAHOMA 340 B. R. 86; 59 U. C. C. Rep. Serv. 2d 23 March 10, 2006, Decided March 10, 2006, Filed

OPINION BY: Weaver [*88] Presented by the parties' cross-motions for summary judgment is the issue of whether the debtors' tractor, in which the defendant has a purchase money security interest, is consumer goods under

Article 9 of the UCC. If it is, the defendant's security interest is perfected even though the defendant did not file a financing statement. If not, the defendant's security interest is unperfected and subject to avoidance. Because of representations in the security agreement regarding the debtors' intended personal use of the tractor, and for the other reasons herein stated, the court concludes that the tractor is consumer goods and that the defendant has a perfected security interest.

The Chapter 7 Trustee (the "trustee" or "plaintiff") brought this action against the defendant (the "creditor" or "Deere") seeking to avoid Deere's security interest in the tractor pursuant to *Sections 544* [**2], *549* and *550* of the Bankruptcy Code. [1] The trustee contends that Deere's admitted failure to file a financing statement renders Deere's purchase money security interest unperfected. The trustee asserts that the tractor was used and intended to be used for business, rather than personal, purposes and thus was not consumer goods under Article 9. The defendant maintains that the debtors' primary intended and actual use of the tractor was for personal, family and household purposes and hence was consumer goods. The parties acknowledge that a purchase money security interest in consumer goods is perfected upon attachment, without filing a financing statement. Conversely, they agree that with respect to non consumer goods, the filing of a financing statement is required for perfection of a non-possessory purchase money security interest.

1 Unless otherwise specified, all references are to Title 11 of the United States Code (the" Code").

Standard of Review

Summary judgment [**3] is appropriate "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show

that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Fed. R. Bankr. P. 7056*. On a summary judgment motion, the court is required to pierce the pleadings and evaluate the actual proof to determine whether summary judgment is appropriate. *Id.* at Advisory Committee Notes. Where, as here, the parties file cross-motions for summary judgment, the court is entitled to assume that no evidence needs to be considered other than that filed by the parties. See *James Barlow Family Ltd. Partnership v. David M. Munson, Inc., 132 F.3d 1316 (10th Cir. 1997)* (citing *Harrison Western Corp. v. Gulf Oil Co., 662 F.2d 690 (10th Cir. 1981))*.

Undisputed Facts

The following material facts are undisputed:

[*89] 1. On September 24, 2004 (the "petition date"), the debtors filed their voluntary chapter 7 bankruptcy petition.

2. On the petition date, Robert O. Troupe and Dawn Lynn Troupe (the "debtors") owned a 2001 John Deere 4300 [**4] MFWD tractor, with loader and blade, (collectively, the "tractor").

3. The debtors purchased the tractor from Deere's dealer on or about July 13, 2001.

4. At the time of the purchase, the debtors lived on a 10 acre tract of land in Colorado.

5. Prior to the purchase of the tractor, the debtors applied for credit with Deere and submitted a credit application dated July 2, 2001.

6. The credit application signed by the debtors stated that the debtor Robert O. Troupe ("Robert") was not self employed but was employed in a management position

with an automotive company earning a gross salary of $4,500 per month. The credit application also stated that the debtor Dawn Lynn Troupe ("Dawn") was employed as a professional auto body estimator earning a gross income of $36,000 per year.

7. The debtors each worked at least 60 hours per week at their respective places of employment. Dawn testified on deposition that she worked approximately 75 hours per week at her job as an estimator and two other part time jobs that she held at the same time.

8. Before purchasing the tractor, the debtors told the Deere's dealer's salesman that the debtors wanted to purchase a tractor to be used to fill [**5] irrigation ditches on their land. They also stated they wanted the tractor to be small enough to go through the gate of a horse stall. Dawn testified on deposition that she also represented to the salesman that they wanted to use the tractor for moving dirt, hay and snow.

9. Deere financed the debtors' purchase of the tractor. In connection with the financing, the debtors and Deere executed a security agreement by which the debtors granted to Deere a purchase money security interest in the tractor.

10. At the top of the first page of the executed security agreement, there were boxes labeled "Personal" and "Commercial", respectively. An "x" was placed in the box labeled "Personal", while the "Commercial" box was left blank.

11. The security agreement contained the following provision on the first page:

"Unless I otherwise certify below, this is a consumer credit transaction and the Goods will be used primarily for personal, family or household purposes." (bold type on security agreement).

12. The security agreement also contained on the first page a conspicuous rectangular box running the entire width of the printed page within which appeared the following:

[**6] "COMMERCIAL PURPOSE AFFIDAVIT. I/We being first duly sworn, affirm and represent to Seller and its assignees that this is a commercial credit transaction, as the Goods listed above will be used by the undersigned in his/her/its business primarily for commercial purposes and will not be used primarily for personal, family or household use.

Buyer's (Debtor's) Signature

Buyer's (Debtor's) Signature

The above signature lines were left blank.

13. The purchase price of the tractor was $16,539.00.

14. At the time of their purchase of the tractor, and for the several years thereafter, [*90] the debtors boarded horses and raised cattle and pigs on their acreage. This activity was done while they were working at their full time jobs.

15. The debtors testified that they intended their farming and ranching activity on their acreage to be profitable financially.

16. On the debtors' tax returns for the years 2001, 2002 and 2003, the debtors took a deduction for depreciation on the tractor. The tax returns reflected that the tractor was used 100 percent for business.

17. The debtors' tax returns for each of the above years showed a substantial loss from ranching.

18. Marketing information [**7] on the website of the defendant shows the subject tractor to be in the category of residential equipment.

19. In their affidavits submitted in support of the trustee's motion for summary judgment, the debtors represented that their actual use and intended use of the tractor was for the business purpose of farming and ranching.

20. The debtors' deposition testimony is that the tractor was used 90 percent of the time for personal purposes and 10 percent for business. They considered personal use as being work performed on the homestead as opposed to work done to make a living.

Conclusions of Law and Discussion

This court has jurisdiction over this adversary proceeding pursuant to *28 U. S. C. § 157*, *1334* and *11 U. S. C. § 544* and *550*. This is a core proceeding under *28 U. S. C. § 157(b)(2)(F)*.

The trustee brings this action asserting his rights under the "strong arm clause" of *§ 544(a)(1)*. Under this provision, the trustee has the rights and powers of a hypothetical lien creditor who held a judicial lien on the property in question at the time of the commencement of the [**8] bankruptcy case, whether or not there actually is such a creditor. By exercising these rights, a trustee may avoid liens on property that a lien creditor without notice could avoid. *Id.*

In bankruptcy proceedings, state law governs issues of validity and priority of security interests. *United States v. LMS Holding Company (In re LMS Holding Company), 50 F.3d 1526 (10th Cir. 1995)*; *In re Copper King Inn, Inc., 918 F.2d 1404 (9th Cir. 1990)*. The parties do not dispute that Colorado law applies here. [2] Under *C. R. S. § 4-9-*

317(a)(2), the holder of an unperfected security interest is subordinate to the rights of one who became a lien creditor before the security interest was perfected. A lien creditor includes a trustee in bankruptcy. *C. R. S. §4-9-102(a)(52)*. Thus, Deere must have held a perfected security interest to prevail over the trustee in bankruptcy. It is not disputed that if the tractor is classified as consumer goods under the UCC, Deere held a perfected purchase money security interest despite the fact that a financing statement was not filed. *C. R. S. §4-9-309(1)* [**9] If the tractor is not consumer goods, however, Deere is not perfected. *C. R. S. §4-9-310*.

2 The State of Colorado has adopted the Uniform Commercial Code. *See C. R. S. § 4-1-101 et seq.*

Consumer goods are "goods that are used or bought for use primarily for personal, family or household purposes." *C. R. S. §4-9-102(a)(23)*. The other possible classification for the tractor, and the one [*91] supported by the trustee is that of equipment. Equipment is defined as "goods other than inventory, farm products or consumer goods" *C. R. S. § 4-9-102(a)(33)*.

The classification of collateral is to be determined as of the time of the creation of the security interest. The classification does not change because of a later change in the manner in which the collateral is used. *Franklin Investment Co. v. Homburg, 252 A.2d 95 (D. C. 1969)*; *First Wisconsin Nat'l Bank v. Ford Motor Credit (In re Voluntary Assignment of Watertown Tractor & Equipment Co.), 94 Wis. 2d 622, 289 N. W.2d 288 (Wis. 1980)*; [**10] *Sears, Roebuck & Co. v. Integra Nat'l Bank (In re Fiscante), 141 B. R. 303 (Bankr. W. D. Pa. 1992)*. If the law were otherwise, a secured party would be required to continually monitor the use that was being made of the collateral.

From reviewing the affidavits of the debtors submitted in support of the trustee's motion for summary judgment, and their deposition testimony, it is not completely clear what oral representations the debtors may have made to Deere's dealer regarding their intended use of the collateral. Robert says he told the salesman that he needed a tractor that was large enough to move dirt to fill irrigation ditches on his land, but small enough to get through a horse stall door. Dawn says she told the salesman they wanted the tractor to do a number of other things on their land in addition to filling the irrigation ditches. Yet nowhere in the debtors' sworn testimony is there any evidence that they told Deere's representative that the tractor was to be used in any type of commercial activity.

The debtors state that they were in the farming and ranching business on their 10 acre tract. They testified that they boarded horses and raised some livestock. [**11] Their intention was to make a profit, they said. Their income tax returns reflected that they were involved in ranching, although it was not a profitable endeavor. While the tax returns indicated that the tractor was used 100 percent for business purposes, the debtors' deposition testimony is that 90 percent of the use was personal. [3] Assuming that all of this testimony is true, it nevertheless relates to events subsequent to the attachment of the security agreement. The focus, however, must be on the intended use of the collateral when the security interest was granted.

3 The debtors attempted to explain that they intended "personal" to mean work done on their homestead as opposed to work done to make a living.

At the outset, the debtors gave no indication to Deere that they were engaged in a business activity. Their credit application represented that they were both employed,

together earning $90,000 per year. Robert represented in the credit application that he was not self employed. They worked long hours [**12] at their jobs - Robert 60 hours per week and Dawn about 75 hours per week.

The security agreement that the debtors signed reflected that it was a "Personal" rather than a "Commercial" transaction. The body of the document stated unequivocally that it was a consumer credit transaction and that the tractor was intended to be used for personal, family or household purposes.

The case law is clear that where a debtor makes an affirmative representation in loan documents that he or she intends to use goods primarily for personal, family or household purposes, the creditor is protected even if the representation turns out to be erroneous. 1 Barkley Clark, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE P12-02 [*92] [3] (rev. Ed. 2005). (". just about every case that has dealt with this issue holds that the dealer can rely on the debtor's written 'consumer representation'"). In *Sears, Roebuck & Co. v. Pettit (In re Pettit), 18 B. R. 8 (Bankr. E. D. Ark. 1981)*, the debtor bought goods for use in his rental business. Yet the debtor did not inform the seller of his intended use. The security agreement "affirmatively and unambiguously represented" that the [**13] debtor was purchasing the collateral for personal, family or household purposes." *Id. at 9*. The bankruptcy court rejected the admission of extrinsic evidence to contradict the unambiguous representation in the security agreement of the debtor's intended use of the collateral. The *Pettit* court held that the seller's purchase money security interest was properly perfected without filing a financing statement, observing that the secured party was not required by the UCC to monitor the debtor's use of the collateral in order to determine its proper classification. In accord is *McGehee v.*

Exchange Bank & Trust Co., 561 S. W.2d 926, 930 (Tex. App. 1978) ("the intent of the debtor-purchaser at the time of the sale when. [the] security instrument attached to the collateral is controlling, and no creditor is required to monitor the use of the collateral in order to ascertain its proper classification.")

The rationale of *Pettit* is compelling. A debtor who makes representations in a security agreement regarding the intended use of the collateral should be bound by those representations. That is especially true where the debtors fail to inform the [**14] creditor that they intend to use the collateral for other than personal, family or household purposes. The classification of the collateral, for purposes of perfection of the security interest, is determined when the security interest attaches. The later use of the collateral for another purpose than as stated in the security agreement is irrelevant in determining whether the security interest is perfected.

According to the security agreement here, the debtors intended to use the tractor as consumer goods. Deere was entitled to rely on the debtors' representation. The debtors did not inform Deere of a different intended use. Therefore, Deere's purchase money security interest was perfected when it attached, and the filing of a financing statement was not required. The security interest remains perfected despite any subsequent use for purposes other than consumer, if indeed there was such other use.

The trustee argues that he should not be bound by the debtors' representations in the security agreement because the debtors did not know of the representations. However, one who signs an agreement is bound by its terms, although ignorant of them, absent fraud or false representation. [**15] *Elsken v. Network Multi-Family Security Corporation, 49 F.3d 1470 (10th Cir. 1995)*. As there is no

allegation of fraud or false representation regarding the security agreement, this argument is without merit.

For these reasons, the court holds that Deere has a perfected purchase money security interest in the tractor. Accordingly, the defendant's motion for summary judgment is granted, and the plaintiff's motion for summary judgment is denied.

The court will enter a judgment consistent with the foregoing.

 ¿En qué sentido emplea el derecho estadounidense el término técnico-jurídico del *security interest*?

B. LA PRIORIDAD EN EL PAGO A LOS ACREEDORES PRIVILEGIADOS

LA OPERACIÓN DEL DERECHO REGISTRAL

 In re: JOHN'S BEAN FARM OF HOMESTEAD, INC., Debtor. UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF FLORIDA, MIAMI DIVISION 64 U. C. C. Rep. Serv. 2d (Callaghan) 454 November 1, 2007, Decided

OPINION BY: ISICOFF Order granting trustee's motion for summary judgment and granting in part and denying in part William Klein's cross-motion for summary judgment

INTRODUCTION

This matter came before the Court on the Trustee's Motion for Partial Summary Judgment on Trustee's Objection to Claim No. 1 Filed by Bill Klein (CP # 36), and William Klein's Response and Cross-Motion for Summary Judgment (CP # 55). The matter under consideration is one of first impression in this district and concerns the degree of error necessary to render a financing statement

"seriously misleading" under revised *Uniform Commercial Code section 9-506*, as adopted in Florida. For the reasons set forth below, [*386] the Court finds that William Klein's financing statement is seriously misleading and, therefore, ineffective to perfect Klein's asserted security interest. Summary judgment is accordingly granted in favor of the Trustee on his motion for summary judgment. Summary judgment [**2] is granted to Klein on his cross-motion with respect to his holding an allowed unsecured claim; the balance of the cross-motion is denied.

JURISDICTION

The Court has jurisdiction over this matter pursuant to *28 U. S. C. §1334(b)*. This is a core proceeding within the meaning of *28 U. S. C. §157(b)(1)*.

BACKGROUND

On March 20, 2007, John's Bean Farm of Homestead, Inc. (the "Debtor") filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. William Klein (the "Creditor" or "Klein") filed a proof of claim on April 6, 2007, asserting a total claim in the amount of $152,000, claiming $120,000 was secured and $32,000 was an unsecured priority claim (Tr. Mot. Summ. J. Ex. B). On May 9, 2007, Barry E. Mukamal, in his capacity as Chapter 7 Trustee (the "Trustee"), filed an objection to the proof of claim and moved for summary judgment in his favor. Klein filed a cross-motion for summary judgment. From the affidavits, exhibits, and pleadings filed in connection with the motion and cross-motion, the material undisputed facts are as follows:

The Debtor, a Florida corporation, owned and operated a commercial bean farm in Homestead, Florida. (Tr.'s Mot. Summ. J. P 3.) On or about October [**3] 2005, Klein made a loan to the Debtor in the amount of $197,255.33, which the Debtor used to purchase a John Deere Spray

Machine Model No. 4720 (the "Equipment"). (Tr.'s Mot. Summ. J. P 4; Klein Resp. PP 1-3.) The loan was never memorialized in writing. (Tr.'s Mot. Summ. J. P 4.) When the Debtor defaulted and was unable to make full payment by the repayment date, Klein purported to take a security interest in the Equipment, evidenced by a Security Agreement and Secured Promissory Note dated July 28, 2006. (Tr.'s Mot. Summ. J. P 4; Klein Resp. PP 4-8.) In an attempt to perfect his security interest, Klein filed a UCC-1 Financing Statement with the Florida Secured Transaction Registry [1] on August 9, 2006, which identified the Debtor as "John Bean Farms, Inc." instead of the Debtor's actual name of incorporation, "John's Bean Farm of Homestead, Inc." (Tr.'s Mot. Summ. J. Ex. A; Klein Resp. P 10.) In fact, all of the documents evidencing the transaction used the name "John Bean Farms, Inc." Subsequently, the Debtor filed a Chapter 7 petition and, shortly thereafter, Klein filed his proof of claim. (Tr.'s Mot. Summ. J. Ex. B; Klein Resp. PP 13, 15.)

1 On October 1, 2001, Florida privatized [**4] its UCC filing office and designated the Florida Secured Transaction Registry as the office in which to file a financing statement to perfect a security interest. *Fla. Stat. §679.5011*.

The Trustee filed an objection to the claim (CP # 24) contending that Klein's financing statement, which misidentified the Debtor, fails to comply with the general rule governing the sufficiency of debtor names on financing statements [2] and the concomitant safe harbor provision [3] for minor errors, and that therefore Klein's claim, if any, is unsecured. The Trustee also objected to the Klein's priority claim of $32,000. Finally, the Trustee objected to the entire claim subject to Klein providing [*387] sufficient proof that the loan was actually funded. Trustee seeks summary judgment on the first two grounds of his objection -- that is,

that Klein's claim, if any, is neither secured nor entitled to priority status.

2 *Fla. Stat. §679.5031*

3 *Fla. Stat. §679.5061*

Klein filed a response to Trustee's motion arguing that while his financing statement failed to comply with the requirements for filing under the Debtor's actual name, the filing was, in fact, not seriously misleading and therefore, the financing statement [**5] was adequate to perfect his security interest in the Equipment. [4] Klein seeks, in his cross-motion for summary judgment, a determination that he did, in fact, fund the loan to the Debtor.

4 Klein conceded in his response that he is not entitled to a priority claim and therefore that issue is resolved in the Trustee's favor. (Klein Resp. n. 2).

It is undisputed that the Debtor's correct name was not provided on the financing statement filed. (Klein Resp. P 10.) Thus, the primary issue this Court must determine is whether the financing statement filed by Klein conforms with Florida's safe harbor provision or is seriously misleading. If the former, then Klein's lien is perfected; [5] if the latter, then Klein's lien is unperfected. A second issue is whether Klein's lien if perfected can be avoided, and the third, whether Klein has a claim at all.

5 This assumes the loan was funded since a creditor can only perfect a lien when the security interest attaches, and a security interest cannot attach until the loan is funded. *Fla. Stat. §679.2031(2)(a)*.

STANDARD OF REVIEW

Summary judgment is governed by *Fed. R. Civ. P. 56*, made applicable to bankruptcy cases pursuant to *Fed. R. Bankr. P. 7056*. Summary [**6] judgment is appropriate

where the "pleadings, depositions, answers to interrogatories, and admissions on file, taken together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a summary judgment as a matter of law." *Fed. R. Civ. P. 56(c)*; *Celotex Corp. v. Catrett, 477 U. S. 317, 323-24, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986)*. In determining whether a genuine issue of material fact remains for trial, the court must construe the facts and draw all reasonable inferences therefrom in the light most favorable to the party opposing summary judgment. *Cuesta v. Sch. Bd., 285 F.3d 962, 966 (11th Cir. 2002)*; *Loren v. Sasser, 309 F.3d 1296, 1301-1302 (11th Cir. 2002)*; *Andreini & Co. v. Pony Express Delivery Servs., 440 F.3d 1296, 1300 (11th Cir. 2006)*. However, the mere existence of a "scintilla of evidence" in support of the nonmovant's position will be insufficient to forestall summary judgment; "there must be enough of a showing that the jury could reasonably find for that party." *Loren v. Sasser, 309 F.3d at 1302* (quoting *Walker v. Darby, 911 F.2d 1573, 1577 (11th Cir. 1990)*); *Anderson v. Liberty Lobby, Inc., 477 U. S. 242, 252, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)*. [**7] Summary judgment relief under *Bankruptcy Rule 7056* applies in contested matters. *Fed. R. Bankr. P. 9014*.

PERFECTION OF SECURITY INTERESTS IN FLORIDA

With certain exceptions not applicable here, perfection of a security interest in Florida occurs only when a financing statement is filed in the appropriate place. *Fla. Stat. §679.5011*. All financing statements must be filed with Florida's official filing office, the Florida Secured Transaction Registry (the "Registry"). *See Fla. Stat. §679.5011(1)(b)*. The financing statement [*388] must provide three pieces of information to be considered sufficient for perfection: (1) the name of the debtor, (2) the

name of the secured party, and (3) the collateral covered. *Fla. Stat. §679.5021(1)*. Financing statements are indexed by debtor name; the debtor's name is the essential element to locating the financing statement. *Fla. Stat. §679.5031* cmt. 2 ("The requirement that a financing statement provide the debtor's name is particularly important. Financing statements are indexed under the name of the debtor and those who wish to find financing statements search for them under the debtor's name."). The Registry offers an online database that searchers [**8] can use to explore financing statements by the debtor name. A search under a debtor's name displays an alphabetical name list with twenty (20) entries and the exact or nearest match at the top of the Search Results screen. The commands "Previous" and "Next" appear on the results screen and direct a searcher to utilize the buttons to view "additional search results."

Section 679.5031 of the Florida Statutes sets forth the specific rules on how to sufficiently provide a debtor's name. For a debtor corporation this requirement is satisfied "only if the financing statement provides the name of the debtor indicated on the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized." *Fla. Stat. §679.5031(1)(a)*.

Although the Florida statute requires that the debtor's name be precise, Florida law contains a safe harbor provision:

A financing statement substantially complying with the requirements [of *Section 679.5031*] is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading.

Fla. Stat. §679.5061(1) (the "Safe Harbor provision"). An error is minor, and the financing statement [**9]

effective to perfect a creditor's security interest, " [i] f a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose" the creditor's financing statement. *Fla. Stat. §679.5061(2)*. Conversely, an erroneous debtor name makes a financing statement "seriously misleading" and precludes perfection if a search under the debtor's correct name would not disclose the financing statement. [6]

6 In fact, even if a financing statement using the debtor's incorrect name, is "disclosed by (i) using a search logic other than that of the filing office to search the official records, or (ii) using the filing office's standard search logic to search a data base other than that of the filing office," the financial statement would nonetheless be seriously misleading, and therefore, ineffective. *U. C. C. Code §9-506 cmt. 2 (2002)*.

"Perfect" Financing Statements before Article 9 was Revised

Under the prior statute, former *Fla. Stat. §679.402*, [7] a financing statement, in order to be effective, was sufficient if it included "the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured [**10] party from which information concerning the security interest may be obtained, gives a mailing address of the debtor, and contains a statement indicating the types, or describing the items, of collateral. .." *Fla. Stat. §679.402(1)* (repealed). The "seriously misleading" standard applied in determining if a mistake in the name of a debtor made a financing statement unenforceable but the statute provided no formal definition of what constituted seriously misleading. [8] [*389] So long as a financing statement substantially conformed to the requirements of the statute, minor errors were not presumed to be seriously misleading. [9]

7 (repealed Jan. 1, 2002), a codification of *former U. C. C. §402*.

8 *Fla. Stat. §679.402(7)* (repealed).

9 "(6) A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership, or corporate name of the debtor, whether or not it adds other trade names or names of partners. .. (7) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." *Fla. Stat. §679.402(6)-(7)*(repealed).

Absent a statutory definition, Florida courts, as well as [**11] many other courts around the country, implemented the 'reasonably diligent searcher' standard, a standard that required the reviewing court to determine, on a case-by-case basis, whether a hypothetical reasonable searcher would have been able to discover the non-conforming financing statement despite the error in a debtor's name. This "allowed judges to second-guess what searchers should or should not have been able to discover had they tried hard enough." Margit Livingston, "A *rose by any other name would smell as sweet" (or would it?); Filing and searching in Article 9's Public Records, 2007 B. Y. U. L. Rev. 111, 124 (2007)*. This standard created extensive litigation and fragmented or contradictory decisions. *See, e. G., Brushwood v. Citizens Bank of Perry (In re Glasco, Inc.), 642 F.2d 793 (5th Cir. 1981)* (holding that a financing statement that listed the debtor by the trade name in which it did business rather than its corporate name was not seriously misleading.).

Perfect Financing Statements Under Revised Article 9

A primary purpose of revised *section 9-506 of the UCC*, adopted in Florida as *Fla. Stat. §679.5061*, [10] was to replace the former reasonableness standard with a clearer standard

[**12] based on the computerized search logic of the filing office. This represents a significant shift from the prior law. Enacted to clarify the sufficiency of debtors' names in financing statements, the revision was "designed to discourage the fanatical and impossibly refined reading of statutory requirements in which courts occasionally have indulged themselves." *Fla. Stat. §679.5061* cmt. 2. *See In re Kinderknecht, 308 B. R. 71, 75 (B. A. P. 10th Cir. 2004)* ("The intent to clarify when a debtor's name is sufficient shows a desire to foreclose fact-intensive tests, such as those that existed under former *Article 9 of the UCC*")

10 *Article 9 of the Uniform Commercial Code* (the "UCC") was substantially revised in the 1990's. The changes to *Article 9* took years to develop, but within two years after the Uniform Rule was adopted by the National Conference of Commissioners on Uniform State Laws in 1998, virtually all states adopted these changes, albeit with some modifications, as states are wont to do when adopting a uniform rule.

Courts in other states that have adopted revised *Article 9* have recognized and emphasized the purpose and importance of this change in the search standard. The Supreme [**13] Court of Kansas analyzed its own state's adoption of revised *UCC sections 9-503* and *9-506* (which adoption is virtually identical to the Florida language) and noted the importance of the accuracy of the name and the reasons behind the shift in focus of the revised *Article 9*:

[T] he express provisions of the revised amendments read *in para materia,* and the Official UCC Comments are all in accord that the primary purpose of the revision of the name requirement is to lessen the amount of fact-intensive, case-by-case determinations that plagued earlier versions of the UCC, [*390] and to simplify the filing system as a whole. The object of the revisions was to shift the

responsibility to the filer by requiring the not too heavy burden of using the legal name of the debtor, thereby relieving the searcher from conducting numerous searches using every conceivable name variation of the debtor.

Pankratz Implement Co. v. Citizens Nat'l Bank, 281 Kan. 209, 227, 130 P.3d 57, 68 (Kan. 2006). Accord In re F. V. Steel and Wire Co., 310 B. R. 390, 393-94 (Bankr. E. D. Wis. 2004) ("A rule that would burden a searcher with guessing at misspellings and various configurations of a legal name would not provide creditors [**14] with the certainty that is essential in commercial transactions.")

Under revised *Article 9* what debtor misnomer is "seriously misleading" is statutorily defined as that which would not be discovered using the state's standard search logic. Thus, under the Safe Harbor provision, the discoverability of a financing statement expressly delimits permissible error. A financing statement is effective if a computer search run under the debtor's correct name produces the financing statement with the incorrect name. If it does not, then the financing statement is ineffective as a matter of law. This new standard is intended to

reflect [] a balance between the need for some flexibility to allow for human error on the part of filers.. And the avoidance of a rule that would cast an altogether inappropriate burden on searchers to have to try to divine potential errors and make searches under not only the correct name but also "foreseeable" or "likely" errors that a filer might have made [.]

Harry C. Sigman, [11] *Twenty Questions About Filing Under Revised Article 9: The Rules of the Game Under New Part 5, 74 CHI. KENT L. REV. 861, 862-63 (1999). See also* Steven O. Weise, [12] *An Overview of Revised Article* [**15] *9, in the New Article 9 Uniform Commercial Code 7* (Corinne Cooper, ed., 2d. ed. 2000).

Revised *Article 9*contains a statutory rule to determine when a mistake [sic] the debtor's name is so incorrect as to make the financing statement ineffective. The financing statement is effective if a computer search run under the debtor's correct name turns up the financing statement with the incorrect name. If it does not, then the financing statement is ineffective as a matter of law. The court has no discretion to determine that the incorrect name is 'close enough'.

Id. (as quoted in *In re F. V. Steel and Wire Co., 310 B. R. at 393-94*).

11 Mr. Sigman was a member of the Revised Article 9 Drafting Committee.

12 Mr. Weise was the ABA advisor to the Article 9 Drafting Committee.

Post-revision case law is fairly well settled that the burden is squarely on the creditor to correctly identify the name of the debtor. [13]

[*391] Revised *Article 9* requires more accuracy in filings, and places less burden on the searcher to seek out erroneous filings. The revisions to *Article 9* remove some of the burden placed on searchers under the former law, and do not require multiple searches using variations on the debtor's name. *Revised Article 9* [**16] rejects the duty of a searcher to search using any names other than the name of the debtor indicated on the public record of the debtor's jurisdiction of organization.

In re Summit Staffing Polk County, Inc., 305 B. R. 347, 354-55 (Bankr: M. D. Fla. 2003). See Receivables Purchasing Co. v. R&R Directional Drilling, LLC, 263 Ga. App. 649, 652, 588 S. E. 2d 831, 833 (Ga. 2003) (" [A] party filing a financing statement now acts at his peril if he files the statement under an incorrect name.")

13 The change in law has also altered the burdens in litigation. Under the former statute, a financing statement that contained errors of any kind, but was otherwise substantially compliant, was presumed enforceable unless those errors were found to be seriously misleading. The revised statute provides a financing statement that contains errors in the debtor's name is presumed unenforceable unless those errors are found not to be seriously misleading. The reversal of the presumption also switches the burden of persuasion. The former statute required the party contesting the enforceability of the financing statement to prove that the errors were seriously misleading. However, under the revised statute, [**17] once the contesting party meets his or her burden of production by showing the financing statement does not conform to the statute, the party advocating the efficacy of the financing statement must prove that those errors do not make the statement seriously misleading.

The majority of cases decided under revised *Article 9* are unforgiving of even minimal errors. [14] *In In re Tyringham Holdings, Inc., 354 B. R. 363 (Bankr. E. D. Va. 2006)*, the creditor filed a financing statement covering 65 pieces of jewelry totaling $310,925 worth of consigned inventory. However, the creditor listed the name of the debtor as "Tyringham Holdings" rather than the debtor's legal corporate name, "Tyringham Holdings, Inc." Although the name error merely omitted the corporate suffix "Inc.", an official search under the debtor's actual name did not reveal the creditor's financing statement and the court held that, therefore, the financing statement was ineffective to perfect the security interest. The *Tyringham* court reasoned:

[w] hile application of the filing office's standard search logic may lead to situations where it appears a relatively minor error in a financing statement leads to a security

interest becoming [**18] unperfected, it is not that difficult to ensure that a financing statement is filed with the correct name of the debtor. Little more is asked of a creditor than to accurately record the debtor's name, and according to the statute, failure to perform this action clearly dooms the perfected status of a security interest.

354 B. R. at 368. Similarly, in *Pankratz Implement Co. v. Citizens Nat'l Bank, 281 Kan. 209, 130 P.3d 57*, the debtor purchased a tractor from the creditor, signed a security agreement, and the creditor misspelled the debtor's name on the financing statement by omitting a "d"--listing the debtor as "Roger House" instead of his legal name "Rodger House." The Supreme Court of Kansas upheld summary judgment invalidating the prior interest represented by the faulty financing statement. In *Host Am. Corp. v. Coastline Fin., Inc., 2006 U. S. Dist. LEXIS 35727, 2006 WL 159614 (D. Utah 2006)* the court held that a financing statement was seriously misleading where the debtor, whose name was "K. W. M. Electronics Corporation" was identified in the financing statement as "K W M Electronics Corporation." [15]

14 The "single search" standard has been criticized as being hypertechnical and too unforgiving of minor errors. *See,* [**19] *generally, 2007 B. Y. U. L. Rev. 111*; Meghan M. Sercombe, Note, *Good Technology and Bad Law: How Computerization Threatens Notice Filing Under Revised Article 9, 84 TEX. L. REV. 1065 (2006)*.

15 Klein argues that cases from other states are inapposite because the search logic of those states is different than the Florida search logic. While the manner in which the searches are conducted may be different, the underlying purpose of the statutory change in each state, and the recognition that the bright line test may result in excluding what might have previously been considered

"minor" errors, are both illustrative of, and authoritative on, the issues presented in this case.

[*392] This canvas of history, commentary and application sets the background against which the adequacy of Klein's financing statement must be judged.

THE KLEIN FINANCING STATEMENT IS SERIOUSLY MISLEADING

Both the Trustee and Klein rely on *In re Summit Staffing Polk County, Inc., 305 B. R. 347*. In that case Chief Judge Glenn determined that a financing statement that identified the debtor as "Summit Staffing, Inc." rather than by the debtor's correct name of "Summit Staffing of Polk County, Inc." was not seriously misleading because, [**20] although using the standard search logic for Florida did not produce a page on which the financing statement appeared, the searcher only had to push the "previous" button one time and the financing statement was listed. Chief Judge Glenn held that the 'reasonably diligent searcher' standard survives in some part. "Although Revised *Article 9* does not require that a searcher exercise reasonable diligence in the selection of the names to be searched or the number of searches to conduct, the revisions to *Article 9* do not entirely remove the duty imposed on a searcher to be reasonably diligent." *Id. at 355*. In Chief Judge Glenn's view, some burden is placed on the searcher to employ "reasonable diligence in examining the results of the search." *Id.*

In the *Summit Staffing* case, a creditor, Associated Receivables, filed a financing statement listing the debtor as Randy A. Vincent and "Summit Staffing," a sole proprietorship, as an additional debtor. Summit Staffing was subsequently incorporated as "Summit Staffing of Polk County, Inc." The corporation later filed for relief under Chapter 7 of the Bankruptcy Code. The Chapter 7 Trustee

conducted a UCC search through the Florida Secured Transaction [**21] Registry website using the actual corporate name of the debtor, Summit Staffing of Polk County, Inc., and found no financing statement relating to the debtor's assets. The name "Summit Staffing" appeared at the top of the page displayed when a search under the debtor's correct name was made. By selecting the "previous" command to display the results page with alphabetical listings immediately prior to the page displayed, the Associated Receivables financing statement appeared. In determining the financing statement was not seriously misleading, and that Florida's standard search logic revealed the faulty financing statement, Chief Judge Glenn wrote:

> When a search is conducted in the Florida Secured Transaction Registry, a listing of debtors' names is produced. The listing is an alphabetical listing, and 20 names are displayed. If the debtor's actual name is produced, it is at the top of the list. If the debtor's name is not found, the next succeeding name on the alphabetical list is at the top of the list. To see the next preceding name on the alphabetical list, the searcher must use the "Previous" command on the screen. In fact, at the top of the list is the statement: "Use the Previous [**22] and Next buttons *to display additional search results.*" (Emphasis supplied.) This statement directs the searcher to use the "Previous" command to see the immediately preceding names on the alphabetical list.

Certainly the searcher should do this. Since the name immediately following Summit Staffing of Polk County, Inc. is [*393] produced at the top of the alphabetical list, and since the filing office's directions state that the searcher should use the "Previous" command to display additional search results, clearly a searcher should check the preceding names on the alphabetical list.

305 B. R. at 353-354. However, Chief Judge Glenn noted that the obligation to push the "previous" button is not limitless.

Although it is clear that a searcher should check the immediately preceding names as well as the immediately succeeding names on an alphabetical list if there is not an exact match of the debtor's correct name, the issue of "reasonableness" develops at some point because the listing is an alphabetical listing. Although only three names begin with "Summit Staffing," there are several screens of debtors' names, with 20 names per screen, that begin with "Summit." Moreover, since the listing is [**23] an alphabetical listing, it is conceivable that one could use the "Previous" command to go to back to the beginning of the alphabetical list. I*d. at 354*.

Here, the Trustee conducted a search of the Registry's online database. [16] Using the Debtor's correct name, the Trustee's search yielded no matches. (Tr.'s Mot. Summ. J. Ex. C P 3.) It is undisputed that when the Debtor's correct name was inputted as the search term, the listing of 20 names on the initial search result screen did not disclose the Klein financing statement. (Tr.'s Mot. Summ. J. P 21; Klein Resp. n. 25.) Klein's financing statement was only found by striking the "previous" command 60 times. (Tr. Mot. Summ. J. P 22; Dubon Aff. PP 4-5; Klein Resp. n. 25.)

16 The online database is not the official "records of the filing office." http://www. Floridaucc. Com/search_disclaimer, however, a search of the database certainly is a search of the Registry's records. Both the Trustee and Klein have relied on the online database search as the basis and support for the relief they seek, and accordingly, for the purposes of this case, are deemed to have stipulated that the search of the online database is the "search of the records of the [**24] filing office."

The Trustee relies on *Summit Staffing* arguing the case demonstrates that only the initial search result screen generated when the Debtor's correct name is input counts as the search result and, since Klein's financing statement did not appear on the initial page displayed, the financing statement is seriously misleading. Moreover, the Trustee argues, even if the search result goes beyond the initial result screen, then, as Chief Judge Glenn stated in *Summit Staffing,* the obligation to expand the search beyond the initial page displayed must be reasonable.

Klein also relies on *Summit Staffing.* Klein correctly points out that in *Summit Staffing,* the disputed financing statement did not appear on the initial page displayed, but rather the page displayed when the searcher pushed the "previous" command once. Thus, Klein argues, the results of "standard search logic" in Florida means something other than the initial result screen. However, Klein goes on to argue that Chief Judge Glenn improperly imposed a "reasonableness" requirement on the searcher's duty, that the statute is unambiguous, and has no "reasonableness" limitation. Since, by pushing the "previous" command (60 [**25] times) the Klein financing statement did eventually appear, Klein argues the financing statement is not seriously misleading.

The Trustee argues " [t] o require a secured creditor to search through numerous pages of names would defeat the salutary purpose of revised *Article 9* and set dangerous [*394] precedent." (Tr. Mot. Summ. J. P 23.) Klein counters that since the plain language of the statute has no reasonableness requirement the court cannot impose a requirement that the statute doesn't provide. "Adding a reasonableness requirement would inevitably result in a situation where courts would have to delve into a host of case by case factual issues that were never contemplated by the legislative, and indeed, would require the courts to

effectively rewrite the Safe Harbor Provision [*Fla. Stat. §679.5061*] in a manner that conflicts with the plain language." (Klein Resp. 11.) Thus, according to Klein's interpretation of the statute, any financing statement filed, no matter how far it may appear from the proper listing, would be sufficient so long as the statement could be found at some point in the pages preceding or following the initial displayed page. Under this interpretation, absent any reasonableness [**26] as to the distance between a proper and improper listing, a searcher would have to look through every page of the online database to determine whether or not a financing statement exists.

The crux of the dispute between the Trustee and Klein is what constitutes the search result using Florida's standard search logic. If my answer to this question is something other than the initial displayed page, then I must determine whether there is a limit on how much a searcher must search past the original display page. The debate between the Trustee and Klein centers on the meaning of "a search of the records of the filing office under the Debtor's correct name, using the filing office's standard search logic .." As noted, the Trustee argues this refers to the initial page result; Klein argues there is a difference between a "search result" and a "display".

The only "search logic" in Florida is statutorily defined as a search by the debtor's name or document number. [17] In order to determine what is the result of inputting that search logic, it is necessary and appropriate to understand what the Registry explains is a "result". The Registry, at its website, www. Floridaucc. Com, has a list of frequently [**27] asked questions. [18] One of the questions listed is "How do I do my own search on the Internet". The answer to that question is:

You can access the UCC filed records for the Florida Secured Transaction Registry on the Internet at: www. Floridaucc. Com. Click on the "Search" option. Choose one item in the "Select Search Type" box, then enter the appropriate data in the "Name/Document Number" box, and click on "search". *The exact name or number or the nearest alphabetical or numeric entry will be displayed.* Click on the number of the entry(ies) you are interested in

Florida Secured Transaction Registry, UCC Frequently Asked Questions, http://www. Floridaucc. Com/faq. Html (emphasis added). The same website has a Help menu that explains "UCC Filing Inquiry [*395] by Debtor Name". That section states in pertinent part:

These transactions provide a list of UCC filings on the Florida Secured Transaction Registry beginning with the name that is closest to the key entered. This list also includes the document number and the type of each record. There are several inquiry functions available using the Debtor's Name, all of these inquiry functions will provide the user with an alphabetic listing beginning with [**28] the name closest to the key entered.

17 Although proposed Model Administrative Rules for secured transactions have been promulgated by the International Association of Commercial Administrators, Florida has not adopted any type of rule or Administrative Code section to expand the statutory search logic.

18 The Court may take judicial notice of the Registry website, *Fed. R. Evid. 201*. A court ruling on summary judgment may rely on judicially noticed facts. *See Fed. Election Comm'n. v. Hall-Tyner Election Campaign Comm., 524 F. Supp. 955 (S. D. N. Y. 1981)*. *Accord Brown v. Brock, 169 Fed. Appx. 579 (11th Cir. 2006)*; *Bankers Ins. Co. v. Fla. Residential Prop. & Cas. Joint Underwriting Ass'n, 137 F.3d 1293 (11th Cir. 1998)*.

I agree with Klein that the statute is unambiguous. Moreover, I agree with Klein that the statute does not include a reasonableness requirement. Indeed, as explained in great detail above, the very purpose of this statute was to eliminate the need for, indeed, the ability of, a judge to inject himself or herself in the determination of what is seriously misleading. However, I disagree with Klein's assertion that the initial [**29] page displayed is not the result of applying Florida's standard search logic. Florida's standard search logic is set by statute. The search logic clearly leads to one result -- a single page on which names appear. For those, including Klein, that argue the search result is something more, the Registry website makes clear they are wrong. The Registry's own website unambiguously describes the page displayed when the search data is input as the result of the search. Nothing in the Registry's information page mentions the use of the "previous" or "next" page key in connection with conducting a search using the search criteria. Since it is undisputed that Klein's financing statement did not appear in the search result when the Debtor's correct name was input, the financing statement is seriously misleading and summary judgment in the Trustee's favor is appropriate.

Although I have found that *Fla. Stat. §679.5061* is unambiguous, and that there is no implicit or explicit obligation of a searcher to go beyond the search result, I feel compelled to address what I view as Klein's incredible argument that the Florida statute unambiguously requires a searcher to scroll through the pages of the [**30] UCC search until the nonconforming financing statement is located. If Klein is correct, that the "search result" means something other than the page displayed when the required data is input, it does not follow that the statute requires a limitless search through the UCC database.

Klein argues that the case law is clear -- when a statute is unambiguous on its face, it must be applied as written. However, Klein cavalierly casts aside as inapplicable the equally long and well established case law on statutory construction that reminds us -

When applying the plain and ordinary meaning of statutory language "produces a result that is not just unwise but is clearly absurd, another principle comes into the picture. That principle is the venerable one that statutory language should not be applied literally if doing so would produce an absurd result."

Miedema v. Maytag Corp., 450 F.3d 1322, 1326 (11th Cir. 2006) (quoting *Merritt v. Dillard Paper Co., 120 F.3d 1181, 1188 (11th Cir. 1997))*.

Klein's argument that Florida's Safe Harbor provision clearly recognizes his financing statement was not seriously misleading, notwithstanding that it was listed 60 pages prior to the displayed search result [**31] (that is 1,200 entries), asks this Court to apply a meaning to the Safe Harbor provision that is "clearly absurd". Such an interpretation would eviscerate [*396] the purpose of the statute -- that is, to create a framework for the perfection of security interests that is less arbitrary, that includes statutory guidance for simplifying the search, while allowing for "minor" errors.

Accordingly, if I am incorrect, and in fact, the Florida search result includes more than the initial page displayed, then, in order to interpret *section 679.5061* so as to avoid an absurd result, I would be compelled alternatively to hold, as did Chief Judge Glenn, that there is a reasonable limit to the search, which I find is no more than one page "previous" or "next" from the initial result screen. Since Klein's financing statement appears 60 pages from the initial display, not one page, it is seriously misleading.

KLEIN'S CROSS MOTION FOR SUMMARY JUDGMENT

Klein seeks a determination that he is entitled to a claim in the amount of $152,000. In support of his cross-motion, Klein submitted the affidavits of John Sizemore, the manager of the Debtor, and his own affidavit. Both affidavits attest that Klein lent the [**32] Debtor $197,255.33, by endorsing and transferring to Debtor three checks made payable to William Klein by DiMare Homestead, Inc. (Klein Aff. PP 2, 4-5; Sizemore Aff. P 3.) [19] The affidavits further state that, in July 2006, the Debtor executed a promissory note in the amount of $152,000 representing the unpaid balance of the loan. (Klein Aff. P 11; Sizemore Aff. P 8.) Both affidavits state that the Debtor never made any payments on the Note. (Klein Aff. P 15; Sizemore Aff. P 11.)

19 The Klein affidavit states one check was lost and replaced. (Klein Aff. at P 4.)

In response, the Trustee argues that because the checks (copies of which were attached to the Klein Affidavit) appear to have been deposited by Klein, rather than endorsed to Debtor, that "Klein has not made a sufficient showing .. that he actually provided any funds to the Debtor and a genuine issue of material fact exists with respect to whether the DiMare checks were actually transferred by Klein to the Debtor." (Tr.'s Reply and Resp. 8.) The Trustee does not provide any other information or affidavits regarding this issue.

Fed. R. Civ. P. 56(e), made applicable to this contested matter by virtue of *Fed. R. Bankr. P. 7056*, [**33] requires that when a party seeking summary judgment has provided affidavits in support of such relief as required by *Rule 56* "an adverse party may not rest upon the mere allegations or denials of the adverse party's pleading, but the adverse

party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party."

Klein has demonstrated that summary judgment in his favor is appropriate. The Trustee has failed to meet his burden under *Rule 56(e)*. Accordingly, Klein is entitled to summary judgment on the issue of his entitlement to an unsecured claim in the amount of $152,000.

CONCLUSION

Based on the foregoing, it is ORDERED and ADJUDGED as follows:

a. The Trustee's motion for summary judgment is granted. Klein does not hold a secured or priority claim. Because I have found that, as a matter of law, Klein does not hold a secured claim, I do not need to reach the third issue on the Trustee's motion for summary judgment regarding [*397] the avoidability of Klein's asserted lien on the Equipment.

b. Klein's [**34] cross motion for summary judgment is denied in part and granted in part. Although Klein does not hold a secured claim, he is entitled to summary judgment that he holds an unsecured claim in the amount of $152,000.00.

¿Cuán serio fue el error en el nombre del deudor a momento de realizarse el registro?

LA SUSPENSIÓN CAUTELAR DE TODA FORMA DE EJECUCIÓN DE LA PRENDA

IN THE MATTER OF: GERALD LEWIS TARNOW, Debtor. COMMODITY CREDIT CORPORATION, Appelant UNITED STATES COURT

OF APPEALS FOR THE SEVENTH CIRCUIT 749 F.2d 464; 12 Bankr. Ct. Dec. 783 October 29, 1984, Argued December 3, 1984

OPINION BY: POSNER [*464] The facts, slightly simplified, are as follows. The Commodity Credit Corporation, a federal agency, made a farmer named Tarnow a loan secured by a lien on his crops and equipment. Tarnow went broke before the loan was repaid. He filed a petition for bankruptcy under Chapter 11 of the Bankruptcy Code, *11 U. S. C. §§ 1101 et seq.*, and the bankruptcy court fixed a deadline, the validity of which is not contested, for the filing of claims against the bankrupt estate. Although the Commodity Credit Corporation knew about the bankruptcy proceeding, it filed its claim against Tarnow two months after the deadline had passed. [**2] The bankruptcy judge not only disallowed the claim because it was late, but, for the same reason, declared the Corporation's lien extinguished. The district court, *35 Bankr. 1014*, affirmed the bankruptcy judge's order, and the Corporation has appealed the district court's judgment to us. But it has limited its appeal to the question whether the lien has been extinguished; it does not contest the disallowance of its claim as untimely.

The bankruptcy judge's order ended an adversary proceeding, and so was appealable to the district court; and the district court's order affirming the bankruptcy [*465] judge was a final order appealable to us. See the versions of *28 U. S. C. §§ 1293* and *1334* made applicable to this case by the Bankruptcy Act of 1978, Pub. L. 95-598, tit. IV, § 405(c)(2), 92 Stat. 2685.(The current provisions, *28 U. S. C. §§ 158(a)*, *(d)*, enacted last summer, carry the former ones forward with no changes relevant to this case.)

A long line of cases though none above the level of bankruptcy judges since the Bankruptcy [**3] Code was

overhauled in 1978, allows a creditor with a loan secured by a lien on the assets of a debtor who becomes bankrupt before the loan is repaid to ignore the bankruptcy proceeding and look to the lien for the satisfaction of the debt. See *Long v. Bullard, 117 U. S. 617, 620-21, 29 L. Ed. 1004, 6 S. Ct. 917 (1886)*; *Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 582-85, 79 L. Ed. 1593, 55 S. Ct. 854 (1935)*; *United States Nat'l Bank v. Chase Nat'l Bank, 331 U. S. 28, 33, 91 L. Ed. 1320, 67 S. Ct. 1041 (1947)* (dictum); *In re Woodmar Realty Co., 307 F.2d 591, 594-95 (7th Cir. 1962)*; *Dizard & Getty, Inc. v. Wiley, 324 F.2d 77, 79-80 (9th Cir. 1963)*; *Clem v. Johnson, 185 F.2d 1011, 1012-14 (8th Cir. 1950)*; *DeLaney v. City and County of Denver, 185 F.2d 246, 251 (10th Cir. 1950)*; *In re Bain, 527 F.2d 681, 685-86 (6th Cir. 1975)*; *In re Honaker, 4 Bankr. 415, 416 and n.3 (Bankr. E. D. Mich. 1980)*; cf. I*n re Rebuelta, 27 Bankr. 137, 138-39 (Bankr. N. D. Ga. 1983)*; *In re Hines, 20 Bankr. 44, 48 (Bankr. S. D. Ohio 1982)*. [**4] Of course if there is some doubt whether the collateral is adequate for this purpose the creditor may want to file a claim with the bankruptcy court, so that in the event the collateral falls short he will have a claim against the estate (though just as an unsecured creditor) for the shortfall. See *11 U. S. C. § 506(a)*. But unless the collateral is in the possession of the bankruptcy court (or trustee -- but there was no trustee here), which it was not in this case, the secured creditor does not have to file a claim. See 1 Norton, Bankruptcy Law and Practice § 28.27, at p. 28-18 (1983). It would be no favor to either the debtor or the other creditors to force him to do so on pain of losing his lien; it would just mean (unless as here the creditor was careless, and forgot to file) adding another unsecured creditor to the list.

The wrinkle here is that the secured creditor did file a claim. (This was true in *Dizard & Getty* also, but

apparently only in response to an order to show cause why the secured creditor's lien should not be voided; the court treated the case as one in which the secured creditor wanted to bypass the bankruptcy proceeding completely. [**5] See *324 F.2d at 79-80*.) If the filing had been timely but the bankrupt or his (other) creditors had contested the claim on the ground that the loan had never been made, or that it had been completely repaid, or that repayment could not be enforced because the loan was usurious, and if the bankruptcy judge had agreed that the bankupt had no legally enforceable obligation to the creditor and his decision was not disturbed on appeal, the lien would be extinguished by operation of the doctrine of collateral estoppel; the proceeding before the bankruptcy judge would have established facts and legal conclusions showing that the lien could not possibly be valid. We shall see that, since 1978, this possibility has been expressly recognized by the Bankruptcy Code. But it is not a possibility presented by this case. The Commodity Credit Corporation's claim was rejected for no other reason than that it was late, and this ground of rejection does not call into question the validity of the lien -- unless rejecting a claim, on whatever ground, automatically rejects the lien that secures it. As a matter of principle we would be very surprised if it did (we are even more surprised, [**6] however, that there are no cases dealing with the question). The destruction of a lien is a disproportionately severe sanction for a default that can hurt only the defaulter. Once the deadline for filing claims had passed, Tarnow and his (other) creditors did not have to worry that still other creditors might pop up later and try to establish a claim on the assets of the bankrupt estate; any late-filing creditors would be time-barred. They did have [*466] to worry (unless late filings really do extinguish liens) that Tarnow's secured creditors might try to seize and sell the security; but we have seen that secured creditors are allowed to

ignore the bankruptcy proceeding without endangering their liens.

So the Corporation could not have been trying to pull a fast one by its late filing; in any event its delay hurt only itself; and in these circumstances we cannot see why so drastic a sanction as was decreed here was necessary to protect anybody's interests. While no one wants bankruptcy proceedings to be cluttered up by tardy claims, the simple and effective method of discouraging [**7] them is to dismiss the claim (that is, the claim against the bankrupt estate, as distinct from the claim against the collateral itself), out of hand, because it is untimely -- which was done here, and about which the Commodity Credit Corporation does not now complain. If an ordinary plaintiff files a suit barred by the statute of limitations, the sanction is dismissal; it is not to take away his property. And a lien is property. See, e. G., *United States v. Security Industrial Bank, 459 U. S. 70, 76-77, 74 L. Ed. 2d 235, 103 S. Ct. 407 (1982)*.

However, the relevant statutory language that was in effect during the proceedings in the bankruptcy court, and the commentary on that language by the leading treatise, see 3 Collier on Bankruptcy para. 506.07, at p. 506-49 (15th ed. 1984), provide some, though only superficial, support for Tarnow's position. A provision added to the Bankruptcy Code in 1978, *11 U. S. C. § 506(d)*, provides that "to the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, [**8] unless -- (1) a party in interest has not requested that the court determine and allow or disallow such claim under section 502 [regulating the allowance of claims against the bankrupt estate] ." One purpose of *section 506(d)(1)* is simply to codify the rule of *Long v. Bullard* -- which previously had been purely a judge-made rule of bankruptcy law -- permitting liens to pass through

bankruptcy unaffected. See H. R. Rep. No. 595, 95th Cong., 2d Sess. 357 (1978); see also *id.* at 361; S. Rep. No. 989, 95th Cong., 2d Sess. 76 (1978); 3 Collier on Bankruptcy, *supra*, para. 506.07, at p. 506-49. But, read literally, the statute also seems to say that if someone requests the bankruptcy court to disallow a claim, and the court does so, the lien that secures the claim is voided; and Tarnow did request the bankruptcy court to disallow the Commodity Credit Corporation's claim, and the court did disallow it. But this is not the intended meaning. All that was sought to be accomplished was to allow the bankruptcy court to determine whether a creditor has a valid secured claim, and if he does not to make the lien -- the security -- fall with the claim. This makes perfectly good sense; [**9] if you do not have a good secured claim, you do not have a valid lien (security for the claim). But the Commodity Credit Corporation was not seeking confirmation of its status as a secured creditor; it was content to realize on its collateral outside the bankruptcy proceeding. All it wanted was to be an unsecured creditor for the amount by which Tarnow's debt to it might exceed its collateral. And while Tarnow or other creditors may well have thought the Corporation's lien invalid and may have wanted the bankruptcy judge to use his powers under *section 506(d)* to determine that it was invalid, the judge didn't do this. The basis for disallowing the Corporation's claim was not that the Corporation was not a genuine secured creditor of the bankrupt but that its claim against the bankrupt estate -- that is, its claim to be an unsecured creditor for so much of Tarnow's debt as could not be realized from the sale of the crops and equipment on which the Corporation had a lien -- had been filed too late." [A] party in interest may seek the allowance or disallowance of the claim *and the court will then determine the validity of the lien*." 1 Norton, *supra*, § 28.27, at p. 28-18 (emphasis [**10] added; footnote

omitted). The validity of the lien was not determined in this case.

There are two further if modest supports for our interpretation. First, the Senate version of *section 506(d)* had provided "that [*467] to the extent a secured claim is not allowed, its lien is void unless the holder had neither actual notice nor knowledge of the case ." S. Rep. No. 598, *supra, at 68*. This could have been read to mean that the lien would be extinguished whatever the basis for disallowing the claim. But Congress enacted the House version, see 124 Cong. Rec. 33997 (1978), which is less hospitable to such a reading. Second, in 1984 Congress enacted a new *section 506(d)(2)*, replacing the former 506(d)(1), and the new section preserves the lien if the claim "is not an allowed secured claim due only to the failure of any entity to file a proof of such claim ." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 93-353, § 448(b), 98 Stat. 374. The change was intended "to make clear that the failure of the secured creditor to file a proof of claim is not a basis for avoiding the lien of the secured creditor." S. Rep. No. 65, 98th Cong., 1st Sess. 79 [**11] (1983). As there is still no explicit reference to the situation where a claim is filed -- only late -- maybe the amendment does no more than codify (or recodify) the long-established rule of the *Long v. Bullard* line of cases. But at least it deprives Tarnow of his anyway rather threadbare textual argument based on the former version of *section 506(d)* and on Collier's brief and unilluminating commentary on that language -- provided we are allowed to look to the legislative history of an amendment to illuminate the meaning of the original statute. We are -- see, e. G., *Red Lion Broadcasting Co. v. FCC, 395 U. S. 367, 380-81* and n.8, *23 L. Ed. 2d 371, 89 S. Ct. 1794 (1969)* -- though there are pitfalls to this procedure. If a legislature decides to change a statute, some

of the legislators may wish to give its change retroactive force, by describing it on the floor or in a committee report as a merely "clarifying" change, though formally the change is only prospective and a majority of the legislature would not have voted to make it retroactive. But no one has suggested that this is what was going on when *section 506(d)* was amended last summer. The previous statutory [**12] language really was unclear, and the amendment merely brings it into phase with the logical implications of the *Long v. Bullard* line of cases, which we know Congress meant to approve when it first enacted *section 506(d)* in 1978.

REVERSED AND REMANDED.

 ¿La Ley Concursal federal paraliza temporalmente la ejecucion de las garantias reales existentes sobre los bienes del concursado en Estados Unidos?

EL FINANCIAMIENTO NUEVO CON EL OBJETIVO DE EVITAR LA INSOLVENCIA

 MBANK ALAMO NATIONAL ASSOCIATION, (Deposit Insurance Bridge Bank, substituted in the place and stead of MBank Alamo National Association), Plaintiff-Appellee, v. RAYTHEON COMPANY d/b/a Raytheon Medical Systems, De-fendant-Appellant. MBANK ALAMO NATIONAL ASSOCIATION, (Deposit Insurance Bridge Bank, substituted in the place and stead of MBank Alamo National Association), Plaintiff, E. I. DuPont De Nemours Company, Plaintiff-Appellee, v. RAYTHEON COMPANY d/b/a Raytheon Medical Systems, Defendant-Appellant UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT 886 F.2d 1449; 10 U. C. C. Rep. Serv. 2d 35 October 31, 1989

OPINION BY: REAVLEY [*1450] MBank Alamo National Association ("MBank") and E. I. DuPont de

Nemours Company, Inc. ("DuPont") pressed this conversion action against Raytheon Company ("Raytheon"), claiming that Raytheon collected certain accounts receivable, in which MBank and DuPont had security interests superior to those of Raytheon. Raytheon's defense was that it had a purchase money security interest in the accounts receivable. Concluding that Raytheon [**2] had no purchase money security interest in the accounts, the district court held that Raytheon's security interests were subordinate to those of MBank and DuPont, and granted MBank's and DuPont's motions for summary judgment. We affirm.

I. Background

MBank and DuPont entered various security agreements with Howe X-ray ("Howe"). By January 10, 1983, in accordance with these agreements, both DuPont and MBank held perfected liens in Howe's present and future accounts receivable. MBank also held a perfected security interest in Howe's present and after acquired inventory.

Beginning in January 1983, Raytheon, an x-ray equipment manufacturer, entered a series of transactions with Howe who was one of its distributors. Raytheon agreed to ship x-ray equipment to Howe after Howe contracted with one of its customers for the sale, delivery, and installation of certain Raytheon equipment. In exchange, Howe agreed to assign the specific accounts receivable to Raytheon. Subsequent to the assignments, Raytheon filed financing statements in specific accounts receivable of Howe. Between July 1983 and December 1984, Raytheon collected over $850,000.00.

By November 1984, Howe had defaulted [**3] on its obligations to MBank and DuPont. MBank and DuPont, pursuant to their security interests, demanded payment

from Raytheon from the accounts receivable that it had collected. Raytheon refused, claiming that it had a purchase money security [*1451] interest ("PMSI") in the accounts receivable and that its interests were therefore superior to those of MBank and DuPont.

In addition to its contention that it had a PMSI in the accounts receivable, Raytheon claimed that even if it did not have a PMSI in those accounts, MBank waived its security interest in the accounts. The district court granted MBank's and DuPont's motions for summary judgment, deciding that Raytheon had no PMSI in the accounts receivable and that Raytheon had not raised an issue of MBank's alleged waiver.

Raytheon appeals the district court's determination that it did not have a PMSI in the accounts receivable. In the alternative, Raytheon contends that if our construction of the PMSI statutory provisions excludes the Raytheon -- Howe transaction, the ruling should not apply to this case under the doctrine of nonretroactivity. Raytheon also appeals the district court's finding that Raytheon failed to produce [**4] sufficient evidence of waiver to overcome MBank's motion for summary judgment.

II. Analysis

A. Purchase Money Security Interests

The rules governing the rights of creditors are set out in Chapter 9 of the Texas Business and Commerce Code ("Code"), which essentially adopted the provisions of the Uniform Commercial Code -- Secured Transactions. *See Tex. Bus. & Com. Code Ann. § 9.101 et seq.* (Vernon 1989). [1] These provisions were enacted "to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty." *§ 9.101*, 1972 Official U. C. C. Comment. In keeping with

these goals, rules were enacted prioritizing conflicting security interests in the same property.

1 All statutory references in this opinion are to the Texas Business & Commerce Code unless otherwise indicated.

The general rule provides [**5] that the first perfected security interest to be filed has priority and other perfected interests stand in line in the order in which they were filed. *See § 9.312(e)*. PMSIs are excepted from the first-to-file rule and take priority over other perfected security interests regardless of the filing sequence. *§ 9.312(c)*, *(d)*. The district court found that Raytheon did not fall within the PMSI exception, that MBank had priority as the first to file, under *§ 9.312(e)(1)*, and that DuPont takes second priority since it filed next. [2]

2 The district court also found that because MBank had a continuously perfected interest in the inventory since January 17, 1980, MBank has priority in the accounts as proceeds of inventory under § 9.306(c). Because we reach our decision under *§ 9.312(e)(1)*, we need not discuss this finding.

Raytheon claims the district court erred by not recognizing its priority in the accounts receivable [**6] as a PMSI under *§ 9.312(d)*. [3] *Section 9.312(d)* provides that " [a] purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter."

3 Raytheon claims a PMSI in the accounts receivable and not in the inventory. Raytheon cannot claim a PMSI in this inventory because it did not comply with § 9.312(c)(2), which requires a PMSI holder to notify in writing the

holder of a conflicting security interest in the same inventory.

As a threshold matter, Raytheon must establish that it meets the statutory definition of a PMSI. Raytheon contends that it fits the statutory requirements of a PMSI under [**7] *§ 9.107(2)*, which provides:

A security interest is a "purchase money security interest" to the extent that it is

(2) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

To meet these requirements Raytheon must show: (1) that it gave value; (2) that [*1452] the value given enabled Howe to acquire rights in the accounts receivable; and (3) that the accounts receivable qualify as collateral within the meaning of the statute.

The value requirement is satisfied by any consideration sufficient to support a simple contract. *See Thet Mah and Assoc. v. First Bank of North Dakota, 336 N. W.2d 134, 138 (N. D. 1983)*; § 1.201(44)(D) (Vernon 1968). Assuming *arguendo* that Raytheon gave value by extending credit to Howe in exchange for Howe's promise to assign the accounts receivable to Raytheon, *see Thet Mah, 336 N. W.2d at 138*, Raytheon has failed to satisfy the other two requirements.

[**8] To create a PMSI, the value must be given in a manner that enables the debtor to acquire interest in the collateral. This is accomplished when a debtor uses an extension of credit or loan money to purchase a specific item. *See Ingram v. Ozark Prod. Credit Assoc., 468 F.2d 564, 565 (5th Cir. 1972)*; *In re Dillon, 18 Bankr. 252, 254 (Bkrtcy. E. D. Cal. 1982)* (PMSI lien attaches to item

actually purchased); Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 Yale L. J. 1143, 1165 (1979) (PMSI priority limited "to loans that can be traced to identifiable, discrete items of property.").

The collateral at issue here is the accounts receivable. In an attempt to force its interest into the PMSI mold, Raytheon has characterized the transaction as follows: "Raytheon, by agreeing to extend credit on its equipment, enabled Howe X-Ray to enter into subsequent contracts of sale with its customers, [**9] thereby acquiring rights in the contract accounts which, upon the specific advance and delivery of equipment, blossomed into a right to the collateral accounts receivable." Raytheon, however, cannot force this transaction to fit. To accept this characterization, we would have to close our eyes to the true nature of the transaction.

Raytheon, in essence, is claiming that it advanced x-ray machines to Howe on credit, which then enabled Howe to purchase accounts receivable from its customers. This, however, does not comport with our view of commercial reality. While, as Raytheon suggests, it may be theoretically possible to create a PMSI in accounts receivable by advancing funds for their purchase, *see Northwestern Nat'l Bank Southwest v. Lectro Systems, 262 N. W.2d 678, 680 (Minn. 1977)*; Gilmore, *The Purchase Money Priority*, 76 Harv. L. Rev. 1333, 1372 (1963), the same cannot be done by advancing x-ray machines. We view this as a two-step transaction in which Raytheon first advanced machines to Howe for retail sale and, once these machines were sold, Howe then assigned the accounts receivable to Raytheon. Through the credit advance, Howe acquired an [**10] interest in the machines, not the accounts receivable. Raytheon's credit advance, therefore, did not enable Howe to acquire an interest in the accounts receivable, as collateral within the meaning of the statute.

Additionally, in its characterization of the transaction, Raytheon is attempting to benefit from the PMSI's preferred status in a manner that was not contemplated by the U. C. C. drafters. PMSIs provide an avenue for heavily burdened debtors to obtain credit for specific goods when creditors who have previously loaned money to the debtor may be unwilling to advance additional funds. Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 Yale L. J. 1143, 1145 & n. 9 (1979). By giving a PMSI holder a priority interest in the specific goods purchased, there is some incentive for a lender to advance funds or credit for the specific transaction. The scope of a PMSI holder's preferred interest, however, is specifically limited by the Code.

Under *§ 9.312(c)*, a PMSI inventory is limited to that inventory or to "identifiable cash proceeds received on or [**11] before the delivery of the inventory to a buyer. ." The drafters noted that general financing of an inventory business is based primarily on accounts resulting from inventory, chattel paper and other proceeds. *§ 9.312*, Official U. C. C. Reasons for 1972 Change comment (4). Reasoning that "accounts financing is more important in the economy than the financing of the [*1453] kinds of inventory that produce accounts, and [that] the desirable rule is one which makes accounts financing certain as to its legal position," *id.*, they specifically excluded accounts resulting from the sale of inventory from the protections of a PMSI. Thus, financing statements that are filed on a debtor's accounts take precedence over any subsequent claim to accounts as proceeds of a PMSI in inventory. Additionally, to protect lenders who make periodic advances against incoming inventory, the PMSI holder is required to notify other secured parties before it can take priority. *§ 9.312(c)(2)*; *see id.*, 1972 Official U. C. C. Comment comment 3.

The priority scheme, however, differs in the context of [**12] collateral other than inventory. Under *§ 9.312(d)*, a PMSI in collateral other than inventory entitles the holder to a superior interest in both the collateral and its proceeds regardless of any intervening accounts. The differing entitlement to proceeds is due to differences in the expectations of the parties with respect to the collateral involved.

Collateral other than inventory generally refers to equipment used in the course of business. *See id.*, Official U. C. C. Reasons for 1972 Change comment (4); Gilmore, *The Purchase Money Priority*, 76 Harv. L. Rev. 1333, 1385 (1963). Since, unlike inventory, "it is not ordinarily expected that the collateral will be sold and that proceeds will result, [the drafters found it] appropriate to give the party having a purchase money security interest in the original collateral an equivalent priority in its proceeds." *§ 9.312*, Official U. C. C. Reasons for 1972 Change comment (3).

Howe's business primarily involved the sale of inventory, [**13] which included the Raytheon x-ray machines. *See* § 9.109(4). [4] The accounts receivable are proceeds resulting from the sale of the machines. MBank and DuPont took security interests in the accounts receivable, in accordance with their expectation that sale of the inventory would generate the accounts. If we were to accept Raytheon's argument that it holds a PMSI in Howe's accounts receivable, we would be giving Raytheon a priority interest in the proceeds of inventory, in direct contravention to the express intent of the drafters. Additionally, Raytheon would have successfully avoided the notice requirements of *§ 9.312(c)(2)*.

4 "The principal test to determine whether goods are inventory is that they are held for immediate or ultimate

sale." § 9.109(4), 1972 Official U. C. C. Comment comment 3.

Raytheon argues, however, that the policies underlying PMSIs actually favor recognizing Raytheon's priority interest [**14] in Howe's accounts. It points out that Howe could find no other source of financing besides Raytheon and that "MBank and DuPont benefited by the financing arrangements because the extension of [credit] by Raytheon helped Howe X-ray stay in business thereby servicing its debts." Raytheon also contends that if the Code is interpreted to limit the security interests of creditors, such as Raytheon, to a mere promise of repayment and the grant of a PMSI in inventory, a "valuable source of credit" to similarly encumbered debtors would "dry up." This is because the risk of default is too great in the face of prior liens on the debtor's accounts.

The Code itself, however, answers this argument. The drafters were apparently well aware that the failure to extend a PMSI holder's priority status to the resulting accounts would provide less incentive for inventory financiers to provide credit. *See § 9.312*, 1972 Official U. C. C. Comment comment 8. Yet, they did not extend the protections of a PMSI and merely noted that "many parties financing inventory are quite content to protect their first security interest in the inventory itself, realizing that when inventory is sold, someone else will [**15] be financing the accounts and the priority for inventory will not run forward to the accounts." *Id.* The drafter's recognition of the problem and the statutory favoring of accounts financing demonstrate that the drafters were not overly concerned that this source of financing would "dry up."

Additionally, Raytheon had alternative means of securing its right to receive payment. Besides obtaining a PMSI in the [*1454] inventory by complying with the *§*

9.312(c)(2) notice requirements, it could have entered subordination agreements with MBank and DuPont on the specific accounts resulting from the sale of Raytheon's x-ray machines. It also could have sold the machines to Howe's customers who would have paid Raytheon directly, with Howe receiving a commission on the sale. If Raytheon had followed either of these courses, it would not have subverted the notice and filing requirements of the Code. As this transaction goes beyond that contemplated by the PMSI provisions, we decline "to expand the scope of special protection afforded a purchase money security interest, lest in so doing we defeat the underlying purposes of the Code: to bring predictability to commercial transactions. [**16] " *Mark Prod. U. S., Inc. v. Interfirst Bank Houston, N. A., 737 S. W.2d 389, 393* (Tex. App. -- Houston [14th Dist.] 1987).

Since Raytheon did not have a PMSI in Howe's accounts receivable, the first-to-file priority rules govern. *See Ford Motor Credit Co. v. First State Bank of Smithville, 679 S. W.2d 486, 487 (Tex. 1984)*. As the last to file, Raytheon's interest is subordinate to those of MBank and DuPont.

B. The Doctrine of Nonretroactivity

Having concluded that Raytheon did not have a PMSI, Raytheon now contends that because this case presented a novel question of law, the doctrine of nonretroactivity should apply. Under the doctrine of nonretroactivity a court deciding a question of first impression, in a manner that was not clearly foreshadowed, makes the ruling inapplicable to the parties before it. *See Chevron Oil Co. v. Huson, 404 U. S. 97, 92 S. Ct. 349, 355, 30 L. Ed. 2d 296 (1971)*. This is no case for nonretroactivity. The holding that Raytheon did not have a PMSI in the accounts receivable is required by the statute and commentary, given

the PMSI restrictions and the Code's clear mandate that first-to-file rules [**17] establish the priorities in accounts resulting from the sale of inventory. The goal of providing predictability in commercial transactions is furthered by the present application of our holding. Moreover, we find no inequity in applying the rule to Raytheon. Raytheon's credit managers were well aware of the first-to-file rule yet, at no time, attempted to notify MBank or DuPont about its purported interest in the accounts. It did not pursue alternative means of securing payment, but merely claimed a priority right in the absence of any authority to do so.

C. Waiver

Lastly, Raytheon contends that the district court erred in holding that Raytheon failed to produce sufficient evidence that MBank waived its security interest in the accounts to overcome MBank's motion for summary judgment. To support its claim, Raytheon presented evidence that MBank was informed that Howe and Raytheon were engaged in ongoing credit negotiations and that Howe was assigning the accounts receivable to Raytheon. Additionally, while MBank was aware that it was not receiving full payment of Howe's accounts receivable, MBank never requested that the accounts proceeds be segregated or held in trust for [**18] the bank.

Waiver is a valid defense to an action to enforce a security interest. *Weisbart & Co. v. First Nat'l Bank of Dalhart, Texas, 568 F.2d 391, 396 (5th Cir. 1978)*; *Montgomery v. Fuquay-Mouser, Inc., 567 S. W.2d 268, 270 (Tex. Civ. App. 1978)*. Under Texas law, "waiver is the intentional relinquishment of a known right or intentional conduct inconsistent with claiming it, with full knowledge of the material facts." *Montgomery, 567 S. W.2d at 270*.

Although Raytheon's evidence suggests that MBank knew about the assignment of the accounts receivable, the

assignment alone did not interfere with MBank's rights, because any assignment would be subordinate to MBank's security interest. MBank's rights were not infringed until Raytheon collected the accounts receivable. To raise the issue of whether MBank intended to relinquish its security interest in the accounts receivable, Raytheon would at least have to present evidence that MBank knew Raytheon [**19] was collecting the accounts. Raytheon did not do so. The district [*1455] court properly granted the motions for summary judgment. *See Anderson v. Liberty Lobby, Inc., 477 U. S. 242, 248-49, 106 S. Ct. 2505, 2510-11, 91 L. Ed. 2d 202 (1986)*; *Washington v. Armstrong World Indus., 839 F.2d 1121, 1122-23 (5th Cir. 1988)* (per curiam). The judgments for MBank and DuPont are AFFIRMED.

DISSENT BY: GOLDBERG What we confront today is another nettle in the thicket of the Texas Uniform Commercial Code. A thorny question of statutory interpretation that could cause scratch and abrasion if not reconnoitered under the illumination provided by the Texas Supreme Court. After examining the relevant statutes and commentaries, however, I believe that the majority has not construed the code as would the Texas Supreme Court in the face of the same problem. So because the scratch of a thorn may cause infection if not properly treated, I must respectfully DISSENT.

The nettle of this case is whether an account receivable should be considered "collateral" in the words of the purchase money security interest statute so that [**20] the purchase money interest has priority over a security interest previously perfected in an identical account. My belief is that accounts receivable are an appropriate form of collateral because they can be used to invigorate marginal businesses. I would thus hold that Raytheon established a purchase money security interest in the specified accounts of Howe x-ray.

I. THE FACTS

Both MBank and DuPont had loaned money to Howe, a dealer in medical equipment including expensive x-ray machines. To guard themselves against the possibility that Howe would default on these loans, MBank, whose loan was made before DuPonts, perfected a security interest in Howe's accounts receivable then existing and subsequently arising and also perfected a similar security interest in Howe's inventory. DuPont's security interest was also perfected in Howe's accounts receivable then existing and subsequently arising but was filed after MBank's interest.

While the MBank/DuPont loans were outstanding, Raytheon entered into a series of transactions with Howe. Each transaction was executed according to a preexisting distribution agreement which allowed Howe to contract with customers for the sale of Raytheon [**21] x-ray machines. Under this agreement, Raytheon promised to supply an x-ray machine to Howe in exchange for Howe's promise to assign the account receivable that arose from the sale of the machine to Raytheon. Raytheon gave notice of its security interest in each account by filing a financing statement within the applicable 20 day period after the creation of the account. The structure of this agreement between Howe and Raytheon arose because Howe had begun to experience difficulty in obtaining additional financing and was spiraling down toward bankruptcy, its final fate.

II. DISCUSSION

Before I get involved in the details of Raytheon's purchase money security interest, however, a momentary step back is in order to scan the general landscape of security interests. As a general observation, the usual method for growth in the area of commercial law has been the daring creativity of a company pushing out beyond the

boundaries of "normal practice" in response to business exigencies. The history of trust receipts, the factor's liens, and the eventual adoption of Article 9 of the Uniform Commercial Code illustrates this general observation in the area of security interests. *See* G. [**22] Gilmore, *Security Interests in Personal Property*, Ch. 1-8 (1965).

"The idea which the draftsmen [of Article 9] started with was that the system of independent security devices [developed in different area of commerce] had served its time; that the formal differences which separated one device from another should be scrapped and replaced with the simple concept of a security interest in personal property; that *all types of personal property*, whether held for use or for sale, should be recognized [*1456] as available for security." *Id. at 290* (emphasis added).

Article nine was thus intended to be a flexible statute that could respond to divergent commercial needs.

The facts of this case present exactly the type of problematic situation which demands a creative solution. Raytheon, as a manufacturer of expensive x-ray equipment, often does not seek out customers itself but instead uses local distributors such as Howe to make sales. But Howe had to borrow money for it to function as a merchant of medical equipment. MBank and DuPont provided this money protecting themselves by with security interests in the collateral Howe had available, Howe's [**23] present and future accounts receivable and inventory. This type of security interest in a borrower's intangibles such as accounts receivable is extremely common. The key to who has priority is to determine who filed the security interest in the collateral first. First in time, first in line goes the rhyme.

The problem with this situation is that a manufacturer will not loan or give a heavily indebted merchant any goods to sell on credit because once the merchant sells the goods,

the banker, not the manufacturer, will have priority in the resulting accounts under the first in time first in line principle. Raytheon would thus not advance any x-ray machines to Howe because MBank and DuPont would have priority in any accounts that arose from the sale of the machines. Yet it is these very sales which would enable Howe to make profits to pay off its loans to MBank and DuPont. So how does an indebted merchant, who is unable to pay a manufacturer for goods that the merchant must sell to service the banker's loan, stay in business? Often what occurs is a scenario where the banker's loan is not paid, the merchant goes out of business, and the manufacturer loses an opportunity to distribute [**24] its goods on the market.

Article 9 provides a solution: the purchase money security interest. This device, with its root in the Railroad Car Trusts of the Nineteenth Century, has priority over security interests filed earlier because of its specific transaction oriented function. *Id. at 743-53* (citing *U. S. v. New Orleans R. R., 79 U. S. (12 Wall.) 362, 364-65, 20 L. Ed. 434 (1871)* (pre *Erie* commercial case giving priority to the later in time party)). The purchase money security interest operates outside the notice principle which favors early interest holders over later ones. Notice is not the driving force behind the purchase money security interest.

It was this purchase money device that allowed Howe an opportunity to continue doing business to the benefit of MBank, DuPont and Raytheon. Howe did not have enough money to purchase a $140,000 x-ray machine for inventory but Raytheon would not advance a machine on credit to Howe. A creative alternative was necessary. Raytheon agreed to advance a machine to Howe in exchange for Howe's enforceable purchase order or account receivable. Raytheon thus used the account as a vehicle to ensure Howe's payment for [**25] the machine. It was a creative solution to the meeting of two creditors, a manufacturer of

expensive equipment, and a heavily indebted retailer, that allowed commerce to continue to flow.

But for the law to recognize this creativity, it must be determined whether Raytheon has complied with the elements of the Texas purchase money security interest statute. Admittedly this arrangement does not present a paradigmatic purchase money security interest, but I believe that creativity, when in harmony with the statutory requirements, should be encouraged.

A. THE VALUE REQUIREMENT

Purchase money security interests are defined in *section 9.107* of the Texas Uniform Commercial Code. [1] *Section 9.107*, states, in pertinent part:

A security interest is a "purchase money security interest" to the extent that it is (2) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire [*1457] rights in or the use of collateral if such value is in fact so used.

1 *Tex. Bus. & Comm. Code Ann. Section 9.107* (Vernon 1968 and West Supp. 1989).

[**26] Under the statute, Raytheon must satisfy three requirements. Raytheon must demonstrate that: (1) it gave value to Howe by making advances or incurring an obligation; (2) its extension of value enabled Howe to acquire rights in the collateral -- the account receivable in each particular transaction; and, (3) the Texas U. C. C. recognizes an account receivable as collateral for the purposes of a purchase money security interest.

There is no question that Raytheon extended value. Raytheon gave value when it shipped, according to the purchase order, an x-ray machine that a particular customer had ordered. This interpretation of the value requirement is consistent with the definition of value as set out in section

1.201(44) of the Texas Uniform Commercial Code. Section 1.201(44) is applicable through the direction of the definitional cross reference of *section 9.107*. It states in pertinent part, that: " [a] person gives 'value' for rights if he acquires them (D) generally, in return for any consideration sufficient to support a simple contract." Raytheon satisfied section 1.201(44) because the advance of the x-ray machine in exchange for a promise from Howe to assign an accounts [**27] receivable arising from the sale of that x-ray machine is consideration sufficient to support a contract. Moreover, under *section 9.107(2)* itself, "'A secured party may give value by committing to supply goods or [by] actually supply [ing] the goods.'" *Thet Mah and Associates Inc. v. First Bank of North Dakota, 336 N. W.2d 134, 138 (N. D. 1983)* (citing 1 Bender U. C. C. Service, Secured Transactions, section 4.05(4) p. 304 (1983). [2]

2 *See* Gilmore, *The Purchase Money Security Priority*, 76 Harv. L. Rev. 1333, 1375 (1963) ("The something [given as value] need not be a purse of gold or its present day negotiable equivalent.").

This advance also satisfied the limitation on the type of value that may be given as defined in comment 2 of *section 9.107*. [3] Comment 2 states, in pertinent part:

"this section provides that the purchase money party must be one who gives value "'by making advances or incurring an obligation'": the quoted language excludes from [**28] the purchase money category any security interest taken as security for or in satisfaction of a preexisting claim or antecedent debt."

This antecedent debt limitation is satisfied here because Howe's debt to Raytheon was not preexisting but was instead created by the advance of the machine. Only then was Howe indebted to Raytheon for the machine's value. In

turn, the debt was secured by the accounts receivable that Howe assigned to Raytheon pursuant to their agreement.

3 *Texas Bus. & Comm. Code Ann. section 9.107* (Vernon 1968 and West Supp. 1989).

B. THE ENABLING REQUIREMENT

The second element of a purchase money security interest is the requirement that Raytheon give value "to enable" Howe to acquire rights in the particular account receivable. [4] This requirement means that the advance made by Raytheon must have made it possible for Howe X-ray to obtain the collateral. [5] In the present case, the enabling requirement is satisfied because Raytheon's agreement with Howe, which preceded all of [**29] the particular transactions, was that Raytheon would advance an x-ray machine to Howe in exchange for an accounts receivable generated by Howe's sale of the machine to a customer. This preexisting agreement, together with the advance of the machine by Raytheon, enabled Howe to make the sale. At the same moment in time, in the twinkling of an eye, the sale created the particular account receivable payable to Howe which Howe then assigned to Raytheon pursuant to their preexisting agreement. "If the loan transaction appears closely allied to the purchase transaction, that should suffice. The [*1458] evident intent of paragraph (b) [*U. C. C. 9-107(b)*] is to free the purchase-money concept from artificial limitations; rigid adherence to particular formalities and sequences should not be required." G. Gilmore, I *Security Interests in Personal Property*, 782 (1965). [6]

4 Howe's rights in the collateral, the accounts receivable that Howe assigned to Raytheon, have not been contested.

5 *See* Gilmore, *supra* note 2 at 1373 (1963).

6 *See In re McHenry, 71 B. R. 60, 62 (Bkrtcy. N. D. Ohio 1987)* (debtor acquires collateral based on preexisting agreement that funds will subsequently be advanced to pay for the collateral); *In re Sherwood, 79 Bankr. 399, 400 (Bkrtcy. W. D. Wis. 1986)* (preexisting loan agreement enabled debtor to acquire collateral even though loan funds disbursed after collateral acquired); *Thet Mah and Associates v. First Bank of North Dakota, 336 N. W.2d 134, 138 (N. D. 1983)* (enabling requirement satisfied by loan commitment which allowed debtor to purchase collateral even though the actual funds were received after the installation of the collateral). *But see Northwestern National Bank Southwest v. Lectro Systems, 262 N. W.2d 678, 680 (Minn. 1977)* (creditor did not establish a purchase money security interest because the funds were not used to acquire a receivable but were instead used for the performance of an already existing contract).

[**30] C. THE COLLATERAL REQUIREMENT

The thorny question in this case centers on whether accounts receivable should be considered collateral for the purpose of a purchase money security interest under *Section 9-107(b)*. To my mind, Raytheon has jumped this hurdle. [7]

7 MBank and DuPont argue that Raytheon does not have purchase money security interest in the accounts receivable of Howe. They contend that the proper way to characterize the transaction between Raytheon and Howe is to view Raytheon as having advanced credit to Howe. This credit, the argument continues, allowed Howe to purchase inventory from Raytheon in the form of the x-ray machine. Thus, according to MBank and DuPont, the x-ray machine served as collateral to secure the advance of the credit from Raytheon. Howe then sold the x-ray machines to its

customers. The sales created accounts receivable which Howe assigned to Raytheon.

The implication of MBank and DuPont's characterization of the transaction between Raytheon and Howe is that MBank and DuPont have priority in the accounts receivable over Raytheon because Raytheon would not be able to claim a valid purchase money security interest. Raytheon would not be able to claim a purchase money security interest under *section 9.312(d)* because this section requires that the interest be taken in collateral other than inventory. *Section 9.312(d)* states that "A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter."

Raytheon would thus have to claim a purchase money security interest under another section because according to MBank and DuPont, the collateral in the transaction was inventory. The purchase money security interest would have to be justified under *section 9.312(c)* which applies to purchase money security interests in inventory. *Section 9.312(c)(2)* requires "the purchase money secured party [to give] notification in writing to the holder of conflicting security interests if the holder has filed a financing statement covering the same type of inventory." Raytheon, however, failed to give any notice to MBank or DuPont and could not, therefore, establish a valid purchase money security interest under this section.

Because Raytheon would be precluded from claiming a purchase money security interest under *section 9.312(c)* or *section 9.312(d)*, MBank and DuPont would have priority over Raytheon in the accounts receivable of Howe under *section 9.312(e)*. *Section 9.312(e)* states that "conflicting

security interests rank according to priority in time of filing or perfection." Therefore, because both MBank and DuPont filed notice of their claims prior to Raytheon, they would have superior interests under *section 9.312(e)*.

This analysis, however, suggested by MBank and DuPont begs the question. The question is whether Raytheon established a purchase money security interest in the accounts receivable of Howe not whether Raytheon properly perfected a purchase money security interest in the inventory of Howe. The analysis of whether Raytheon properly perfected a security interest in the inventory of Howe assumes that MBank and DuPont's characterization of the transaction is correct. But the very question to be decided is how to characterize the transaction for the purposes of defining a purchase money security interest. Nothing in the code mandates that Raytheon to claim a purchase money security interest in Howe's inventory. Raytheon claimed a purchase money security interest in the accounts receivable of Howe. The question is thus whether accounts receivable may be considered collateral for the purposes of a purchase money security interest.

[**31] Under section 9.105(a)(3), which is listed in the definitional cross references of *section 9.107*, collateral is defined as "the property subject to a security interest and includes accounts and chattel paper which have been sold. ." Moreover, under section 9.106, which is also listed in the definitional cross references of *section 9.107*, [*1459] "account means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance." The comment to 9.106 states that the section is referring to "ordinary commercial accounts receivable." By reading these two definitional sections in tandem, it is clear that an account receivable can be

collateral for the purposes of a purchase money security interest under *section 9.107*.

There is, however, no other authority to our knowledge that expressly states that accounts receivable should be considered collateral for the purpose of a purchase money security interest. The Supreme Court of Minnesota has suggested that a purchase money security interest in accounts could validly arise. *See Northwestern National Bank Southwest v. Lectro Systems, 262 N. W.2d 678, 680 (Minn. 1977)* [**32] ("This is not a case in which funds were advanced and used for purchase of a receivable."). And, Professor Grant Gilmore, one of the original drafters of article 9, has stated in his treatise on security interests, that the purchase money concept might apply to intangible property in occasional cases. G. Gilmore, I *Security Interests in Personal Property*, 781 (1965) ("There seems to be no reason, however, why the term 'collateral' should have other than its normal meaning: the purchase-money concept may thus, in an occasional case, apply to intangible property. .").

MBank and DuPont have asserted that accounts receivable should not be considered collateral for the purpose of defining a purchase money security interest under *Section 9.107(2)*. Their argument, adopted by the majority, is that because accounts receivable financing has been accorded a special importance by the Texas Uniform Commercial Code, its legal position should not be made less certain by the operation of *Sections 9.107(2)* and *9.312(d)*. Once a security interest has been created under *section 9.107(2)*, *section 9.312(d)* grants it special status. *Section 9.312(d)* states that "a purchase money security interest [**33] in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security

interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter." [8]

8 *Tex. Bus. & Comm. Code Ann. section 9.107* (Vernon 1988 and West Supp. 1989).

The significance of this special priority granted to purchase money security interests in subsection (2) becomes apparent when compared to the general priority rule in *section 9.312(e)*. Under *section 9.312(e)(1)*, conflicting security interests in the same collateral rank according to the time of filing. The first party to file notice of its interest in an account has priority over any subsequently filed interests in the identical account.

Because of the operation of *section 9.312(d)*, however, the first party to file notice of a security interest in an account would not necessarily have priority under *section 9.312(e)(1)*. *Section 9.312(d)* would grant priority [**34] over any interest filed previously in the same account if purchase money status in the account was first established under *section 9.107*. The legal position of accounts receivable financing might thus be made less certain if a purchase money security interest could be claimed in accounts receivable under *section 9.107(2)*. Diminished certainty could result in the sense that the first party to file notice of its interest in an account under *section 9.312(e)* would be uncertain as to whether it had priority in the account or whether another party has priority because the latter established purchase money status in the same account under 9.107(2).

MBank and DuPont argue that this uncertainty in the legal position of accounts receivable financing should be prohibited because of the special importance accorded to accounts receivable financing under the code. They find this importance in the history of *section 9.312(c)* which prohibits the establishment of purchase money security

interests in accounts receivable, derivatively, as proceeds of inventory. The argument points out that this prohibition was created due to the importance of accounts [*1460] receivable financing in the economy. [**35] Based on these premises, the argument concludes that the possibility of a purchase money security interest in accounts receivable under *section 9.107(2)* should also be prohibited. The fallacy of this logic, however, is that it equates the value of accounts receivable as applied to a problem that arose in the area of inventory financing with the values behind the *section 9.107* purchase money security interest.

The argument thus rests upon MBank and DuPont's interpretation of *section 9.312(c)*. *Section 9.312(c)* provides that "a perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in any identifiable cash proceeds received on or before the delivery of inventory to a buyer." [9] This section of the code was changed in 1972 to address the problem of priority conflicts between a claim to accounts receivable derivatively as proceeds of inventory and a claim to the accounts established by the filing of a direct security interest. [10] The conflict arose between inventory financiers who claimed priority in the accounts as proceeds of the inventory that they helped the debtor to acquire and lenders [**36] who had taken a direct security interest in the accounts as collateral for money loaned to the debtor.

9 *Tex. Bus. & Comm. Code Ann. section 9.312(c)* (Vernon 1988 and West Supp. 1989).

10 *Id.*

Section 9.312(c) offered a solution to this conflict. It states that a prior right to the inventory of a debtor does not confer a prior right to any proceeds that arise from the sale of the inventory except for identifiable cash proceeds.

There is no prior right to accounts receivable as proceeds from the sale of the inventory. Under this section, it would not be possible to establish a purchase money security interest in inventory and then claim a purchase money security interest in any of the accounts that arose from the sale of that inventory. This exclusion of accounts receivable as proceeds of inventory under *section 9.312(c)* rests upon the assumption that accounts receivable financing is more important in the economy than the financing of the types of inventory that produce accounts when sold.

MBank [**37] and DuPont thus argue that a purchase money security interest in accounts receivable should not be permitted under *section 9.107(2)* because a purchase money security interest in accounts receivable may not be claimed derivatively as proceeds of the sale of inventory under *section 9.312(c)*. However, when this argument is examined in light of the policy interests underpinning *section 9.107(2)*, the argument's core assumption, the importance of accounts receivable financing in the economy, dictates precisely the opposite result.

The most important policy justification for a purchase money security interest under *section 9.107(2)* is the protection that it gives to a debtor who is unable to raise additional funds to remain in business. Creditors who have previously loaned money to the debtor and taken a security interest in the debtor's goods may be unwilling to advance additional value or funds. [11] These additional funds, however, could enable a debtor to purchase goods, make sales, and in turn, generate profits. Profits which could not only be used to create more business, but also, to allow the debtor to pay off the creditor's loans. The purchase money security provisions thus enable [**38] a leveraged debtor who is able to find a new lender to give that new lender a

first claim on the new collateral purchased notwithstanding a prior filing by another creditor. [12]

11 Jackson and Kronman, *Secured Financing and Priorities Among Creditors*, Yale L. J. 1143, 1165 (1979) (economic analysis suggesting that purchase money security interests may be used to free debtor from creditor's situational monopoly).

12 White and Summers, *Uniform Commercial Code*, 1043 (1972).

The arrangement between Raytheon and Howe exemplifies the use of accounts receivable to advance the policy rationale behind the purchase money security interest. It was the use of the accounts receivable by Raytheon as collateral for the x-ray [*1461] machines that allowed Howe to continue to do business. The additional business that Howe was able to generate with the advance of the x-ray machines, at minimum, gave Howe an additional opportunity to stay in business. This opportunity was a benefit to creditors such as MBank [**39] and DuPont whose loans would not be repaid unless Howe had the ability to generate profits. It also demonstrates the importance of accounts receivable financing in another forum, the creation of purchase money security interests.

The use of accounts receivable as collateral in this case also benefited MBank and DuPont as creditors because the consequences of an unpaid account were relatively greater to Raytheon. Raytheon, MBank and DuPont would each have been harmed if Howe's customers failed to pay their accounts. If an account receivable were to remain unpaid, Raytheon would lose the entire value of the x-ray machine advanced to Howe. In contrast, it is unlikely that the failure of one account would drive Howe into bankruptcy so that Howe would be unable to repay MBank and DuPont. Yet it is this additional risk taken by Raytheon which allowed

Howe a profit that could be used to fund its business to the advantage of MBank and DuPont.

Finally, any obligation imposed on MBank and DuPont to determine whether Howe was using its accounts receivable to collateralize purchase money security transactions is diminished in two respects. First, as stated, it is these very purchase money [**40] transactions that allowed Howe an additional opportunity to service its debts to these creditors. Second, MBank and DuPont as creditors had already established relationships with Howe. In future transactions, it would not have been difficult for them to ascertain whether Howe was using any accounts to collateralize purchase money transactions with other creditors and draft the loan contracts accordingly.

D. THE LIMIT OF RAYTHEON'S PURCHASE MONEY SECURITY INTEREST

I would, however, posit a serious limit on the extent of Raytheon's purchase money security interest. Under *section 9.107*, a security interest has purchase money character only to the extent of the value given to acquire the collateral. In the present case, the value given by Raytheon was the price of the x-ray machine as measured by the difference in the price Howe charged customers and the price Raytheon charged Howe. This price measures the extent of Raytheon's purchase money security interest in the specific accounts receivable of Howe. I do not mean to imply that the value given to a distributor such as Howe will always be measured by the wholesale price. In some situations, it could be the retail price depending [**41] upon what the debtor was meant to gain by the transaction. I would leave these transactional details for the district court.

The difference between the price Raytheon charged Howe and the price Howe charged its customers would

thus not be a part of Raytheon's purchase money security interest. There is evidence to the effect that Howe used a portion of this difference, Howe's profit margin, to pay a preexisting debt owing from Howe to Raytheon. This money could not be a part of Raytheon's purchase money security interest because a purchase money security interest may not be used to secure a preexisting debt. [13]

13 *Tex. Bus. & Comm. Code Ann. section 9.107* (Vernon 1988 and West Supp. 1989) (comment 2).

There is also evidence which suggests that Raytheon may have loaned money to Howe to cover Howe's costs of installing the x-ray machine. Any such money would not be a part of Raytheon's purchase money security interest. There should not be any additional opportunities created under the code to give simple [**42] loans purchase money character. [14]

14 White and Summers, *infra* note 12 at 1045 n. 5 (1972).

To my mind, Raytheon has established a valid purchase money security interest under *section 9.107(2)* of the Texas Uniform [*1462] Commercial Code. The x-ray machine advanced by Raytheon constituted the value that enabled Howe to acquire accounts receivable, the collateral, for the purposes of *section 9.107(2)*. As such, this case should be reversed and remanded, where the issue of waiver could be examined with a headlight's incandescence and the retroactivity issue appropriately explored. I therefore respectfully DISSENT.

¿ En qué sentido emplea el derecho estadounidense el término técnico-jurídico del *purchase money security interest*?

IN RE: JOSEPH D. WHITE and SUSIE J. WHITE, Debtors. UNITED STATES BANKRUPTCY COURT

FOR THE SOUTHERN DISTRICT OF INDIANA, NEW ALBANY DIVISION 417 B. R. 102; 70 U. C. C. Rep. Serv. 2d 522 September 29, 2009, Decided September 29, 2009, Filed

OPINION BY: LORCH This matter comes before the Court on the Objection to Proof of Claim filed by the Debtors on March 16, 2009 [Docket No. 22], and the Response to Objection to Claim filed by AmeriCredit Financial Services, Inc. on April 14, 2009. The parties subsequently submitted the issue to the Court's discretion based upon a Joint Stipulation of Facts filed on August 31, 2009.

Background

The facts, as stipulated by the parties, are fairly straightforward. The Creditor, AmeriCredit Financial Services, Inc. ["AmeriCredit"] holds a secured claim dated January 7, 2009, in the principal amount of $22,081.96. That claim represents amounts financed to purchase a vehicle for the Debtors' personal use within 910 days of the bankruptcy filing and it includes $7,000.00 which represents a "negative trade-in" in that transaction. AmeriCredit asserts that the entire amount of $22,081.96 is a purchase-money secured interest ["PMSI"] by virtue of *section 1325(a) of the Bankruptcy Code*. [**2] The Debtors object to AmeriCredit's claim and have filed an Amended Plan which proposes to bifurcate the claim into secured and unsecured parts, treating the negative equity as an unsecured claim.

Discussion

This Court previously considered the treatment of negative equity under the "hanging paragraph" of *section 1325(a)* in *In re Gibson, Case No. 07-90752-BHL-13, 2007 Bankr. LEXIS 4621 (October 25, 2007)*. In that case, it was held that *section 1325(a)* protects only those funds

advanced toward the purchase price of the vehicle as a PMSI. The creditor was therefore found to have a PMSI in the vehicle only to the extent of the purchase price and excluding any amounts used to pay for negative equity on the debtors' trade-in or insurance. Because case law is rapidly evolving on this issue, however, it seems prudent to revisit the matter in light of developing precedent.

Various circuit courts or B. A. P. S have recently considered this question and a definite trend appears to be emerging as to the treatment of negative equity. The earliest court to rule on the issue was *In re Penrod, 392 B. R. 835 (B. A. P. 9th Cir. 2008)*, which held that negative equity is not part of the PMSI protected by the 910-day rule in *section 1325(a)*. [**3] Since then, every other circuit which has weighed in on this point has concluded otherwise. *In re Callicott, 580 F.3d 753, 2009 WL 2870501 (8th Cir.)*; *In re Dale, 582 F.3d 568, 2009 U. S. App. LEXIS 20065, 2009 WL 2857998 (5th Cir.)*; *In re Ford, 574 F.3d 1279 (10th Cir. 2009)*; *In re Price, 562 F.3d 618 (4th Cir. 2009)*; *In re Padgett, 408 B. R. 374 (B. A. P. 10th Cir. 2009)*; *In re Graupner, 537 F.3d 1295 (11th Cir. 2008)*; [*104] *In re Peaslee, 547 F.3d 177 (2nd Cir. 2008) cert'd, Matter of Peaslee, 913 N. E.2d 387, 13 N. Y.3d 75, 885 N. Y. S.2d 1, 2009 WL 1766000 (N. Y. 2009)*.

Courts within the Seventh Circuit, however, are split. Some bankruptcy courts, including this one, have found that the negative equity is not part of the purchase-money security interest. *See, e. G., In re Gibson, supra; In re Crawford, 397 B. R. 461 (Bankr. E. D. Wis. 2008)*; *In re Hernandez, 388 B. R. 883 (Bankr. C. D. Ill. 2008)*. Yet other courts have found to the contrary. *See, e. G., In re Myers, 393 B. R. 616, 2008 WL 2445214 (Bankr. S. D. Ind. 2008)*; *In re Dunlap, 383 B. R. 113 (Bankr. E. D. Wis. 2008)*; *In re Smith, 401 B. R. 343, (Bankr. S. D. Ill. 2008)*;

In re Morey, 414 B. R. 473, 2009 Bankr. LEXIS 2757, 2009 WL 2916685 (Bankr. E. D. Wis. Sept. 9, 2009).

Taking a fresh look at the question, this court continues to believe that the minority position, so well expressed by [**4] Judge Markell in *In re Penrod,* [1] is the better reasoned course. That position is essentially premised on the finding that negative equity simply does not fit within the U. C. C. definition of a "purchase-money obligation" or "price" of the collateral, in light of Official Comment 3 to the U. C. C., [2] which reads in part:

[T] he definition of "purchase-money obligation," the "price" of collateral or the "value given to enable" includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.

The concept of "purchase-money security interest" requires a close nexus between the acquisition of collateral and the secured obligation. Thus, a security interest does not qualify as a purchase-money security interest if a debtor acquires property on unsecured credit and subsequently creates the security interest to secure the purchase price.

Admittedly, the foregoing list of obligations "incurred in connection with acquiring rights in the collateral" is illustrative [**5] and not exhaustive. But it is noteworthy that it does not include value given to pay off an existing debt, which is a significant and ever-recurring theme in the business of new-car financing. [3] The Comment is silent as to existing debt, it would seem, because the drafters did not intend to include that type of expense within the confines of the statute. Negative equity is clearly not in the nature of or in any way similar to the types of expenses cited in the

Comment. It is neither an expense "incurred in connection with acquiring rights in the collateral" nor is it similar to sales taxes, finance charges, freight, or administrative charges. As noted by another court, the nature of the expense items listed in Official Comment 3 are closely connected with the purchase of the vehicle itself and include costs normally associated with the enforcement of the security interest. *In re Sanders, 377 B. R. 836, 855* [*105] *(Bankr. W. D. Tex. 2007)*. [4]

1 *392 B. R. 835*.

2 See, e. G., *In re Callicott, 386 B. R. 232 (Bankr. E. D. Mo. 2008)*; *In re Riach, 2008 Bankr. LEXIS 461, 2008 WL 474384 (Bankr. D. Or. 2008)*; *In re Look, 383 B. R. 210 (Bankr. D. Me. 2008)*; *In re Johnson, 380 B. R. 236 (Bankr. D. Or. 2007)*; *In re Acaya, 369 B. R. 564 (Bankr. N. D. Cal. 2007)*; [**6] *In re Bray, 365 B. R. 850 (Bankr. W. D. Tenn. 2007)*.

3 Judge Markell notes that between 26% to 38% of all new car financing involves "negative equity" per GMAC. *In re Penrod, 392 B. R. at 842* (citing *In re Peaslee, 358 B. R. 545, 554 (Bankr. W. D. N. Y. 2006)*).

4 *Rev'd* by *In re Sanders, 403 B. R. 435 (W. D. Tex. 2009)*.

This court, together with the minority, finds that negative equity is merely the debtor's antecedent debt which is assumed by the auto seller.

Context thus bolsters the conclusion that "price of the collateral" need not be given some exotic meaning or treated as some peculiar argot to sweep up more than the common understanding of the phrase is intended to convey. One may borrow money to buy something *(e. G,* a new vehicle), and also borrow additional money for some other purpose *(e. G.,* to pay off the balance of a loan for the

trade-in vehicle). The part used to buy something is purchase money obligation. The part used for some other purpose is not. We can tell what part was used to buy something by simply looking at the price of the thing purchased.

In re Sanders, 377 B. R. at 853. *See also, In re Wear, 2008 Bankr. LEXIS 208, 2008 WL 217172 (Bankr. W. D. Wash. 2008)*; *and see, In re Westfall, 365 B. R. 755, 762 (Bankr. N. D. Ohio 2007)*(questioning [**7] whether a doctor's fee could be viewed as an enabling expense if a debtor would not have made it to the dealer's lot without an emergency appendectomy"). As stated by the Court in *Padgett,* [5] "without the payment of items such as taxes, title fees, duties and freight charges, an individual generally cannot acquire title to a vehicle. The same cannot be said about the payment of negative equity in a vehicle that is to be traded in." "Negative equity", as the dissent noted in *Ford,* [6] "is not a transaction cost, but a transfer of money for value. Much like a home equity loan used to pay a preexisting credit card debt, the portion of the auto loan attributed to negative equity is not used for the purchase of some new piece of collateral or the costs inherent in the purchase. It is used for another purpose altogether."

5 *389 B. R. 203, 210 (Bankr. D. Kan. 2008)*, *rev'd, 408 B. R. 374 (B. A. P. 10th Cir. 2009)*.

6 *574 F.3d at 1289*.

Courts that include negative equity as part of the purchase price for purposes of *section 1325(a)*'s "hanging paragraph" often rely upon the concept of *in pari materia* as support for their position. Those courts create a hybrid definition of "price" by borrowing from state sales [**8] and finance laws and grafting it onto the UCC. The state statutes which those courts draw from, however, are designed to inform consumers of the true cost of credit and

have absolutely nothing to do with secured transactions or the function of the cited bankruptcy statute, which is to establish relative preferences among creditors. As the court concluded in *In re Acaya, 369 B. R. 564, at 568-71 (Bankr. N. D. Cal. 2007)*, " [w] ith such different effects and goals, the two provisions -- one based on disclosure and the other on preference -- are not in pari materia." *See also, In re Mierkowski, 580 F.3d 740, 2009 WL 2853586 (8th Cir. 2009)* (Bye. J., dissenting).

Still other courts assert that the financing of negative equity is "value given to enable the debtor to acquire rights in the collateral" under *UCC § 9-103(a)(2)*. But this court finds that such monies are not "in fact so used" as further required by the statute. The monies are used to extinguish a pre-existing debt. Although the financing may be part of a single transaction and both rolled into one amount, such a reading elevates form over substance. Financing negative equity may well be made "integral" to the purchase agreement, [*106] depending on the circumstances [**9] or preferences of the parties, but that does not change the character of the transaction. That "package deal" approach utilized by some of the majority courts, [7] taken to its logical conclusion, bears illogical results. For instance:

If the [debtors] were unable to drive themselves to the dealership, we would not consider the cost of a taxi as part of the price of the new truck, even if the dealer were willing to pay for it and fold it into the sales contract. If [they] did not qualify for a car loan because their resources were strained by too much credit card debt at high interest rates, they could not fold those debts into the PMSI for a new car even if the attendant lower interest rate solved their credit problem and enabled them to obtain the car loan.

In re Ford, 574 F.3d 1279, 1291 (Tymkovich, J., dissenting). It still remains both a refinancing of pre-

existing debt and the extension of credit for the purchase price of the new car.

7 *In re Graupner, 537 F.3d at 1302*; *In re Price, 562 F.3d at 625*; *In re Ford, 574 F.3d 1279*.

Admittedly, the hanging paragraph was drafted with a view toward providing protection to those creditors who extend credit to the debtor within 910 days of the [**10] bankruptcy for the purchase of a vehicle. It does that by preventing the "cramdown" of a debt owed to a purchase-money secured creditor if they have financed a vehicle for the debtors' personal use within 910 days of filing bankruptcy. But, given that the statute does not define a "purchase-money security interest", the protection it affords must necessarily be interpreted in deference to Article 9 of the Uniform Commercial Code. Because Congress chose not to alter or expand the traditional meanings of purchase money obligation and PMSI, this Court has no authority to expand that meaning to include negative equity financing. In considering this issue, it is well to remember that a "purchase money security is an exceptional category in the statutory scheme that affords priority to its holder over other creditors, but only if the security is given for the precise purpose as defined in the statute." *Matthews v. Transamerica Fin. Servs. (In re Matthews), 724 F.2d 798 (9th Cir. 1984)*.

The majority opinions, by including negative equity within the formula for PMSI, essentially transform one creditor's unsecured claim into a secured claim at the expense of the debtor's general unsecured creditors. [**11] Lenders are given an incentive to roll in as much negative equity as possible in constructing "package" transactions. Such a reading of the statute, giving a "super purchase-money secured claim" to the lender, totally upends the existing priority scheme in bankruptcy. By artificially

enlarging the Article 9 concept of a purchase money obligation, these courts have allowed the lenders to take a higher percentage of plan payments and have undercut the distribution scheme designed by Congress.

Conclusion

Based upon a careful review of existing case law, this Court continues to hold that negative equity is not protected by the "hanging paragraph" of *section 1325(a) of the Bankruptcy Code*. It is neither "all or part of the price" of a new car nor is it "value given to enable the debtor to acquire rights in or the use of" a new car. As such, it does not fit within the definition of a PMSI under applicable Article 9 guidelines. The Debtor's Objection to the Claim of AmeriCredit is, therefore, SUSTAINED. [*107] The Debtor's Amended Plan which bifurcates the claim into secured and unsecured portions is, accordingly, approved. The Trustee is hereby ordered and directed to file an Order Confirming the [**12] Debtor's Amended Plan, in accordance with the foregoing findings of the court.

IT IS SO ORDERED.

¿ Por qué tiene el *puchase money security interest* una prelación preferente frente a otros acreedores privilegiados?

VAN DIEST SUPPLY CO., Plaintiff-Appellant, v. SHELBY COUNTY STATE BANK, Defendant-Appellee. UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT 425 F.3d 437; 59 U. C. C. Rep. Serv. 2d 1089 September 15, 2004, Argued October 3, 2005, Decided

OPINION BY: WILLIAMS [*438] Van Diest Supply Co. and Shelby County State Bank ("Shelby") both assert a security interest in proceeds of accounts resulting from inventory Van Diest sold to Hennings Feed and Crop Care

("Hennings"). This case arose after Hennings filed for bankruptcy and was unable to pay for certain inventory it had purchased from Van Diest. Pursuant to a loan agreement with Hennings, Shelby had received the proceeds of many Hennings accounts receivable. Van Diest claimed a first, perfected purchase money security interest in proceeds of inventory it sold to Hennings and sued Shelby for conversion, seeking to recover the proceeds of inventory it sold to Hennings. The district [**2] court, in granting Shelby's motion for summary judgment, ruled that Van Diest had not presented evidence sufficient to carry its burden of identifying the proceeds. We agree and so affirm the decision of the district court.

I. BACKGROUND

At issue here are the proceeds of certain inventory that Van Diest Supply Co. sold to Hennings Feed and Crop Care. Hennings was a retail dealer in agricultural products, including chemicals, fertilizer, and limestone who purchased inventory from multiple suppliers, including Van Diest. In 1983, Van Diest and Hennings executed an agreement that granted Van Diest a purchase money security interest in inventory supplied by Van Diest, and the proceeds from such inventory. We concluded in an earlier case that the security interest did not extend to all Hennings inventory; instead, it was limited to inventory Van Diest supplied to Hennings. *Shelby County State Bank v. Van Diest Supply Co., 303 F.3d 832, 840 (7th Cir. 2002)*.

Although Hennings had multiple suppliers, it did not (1) segregate inventory by supplier, (2) track inventory by supplier, or (3) know on any given day how much inventory it had on hand from any supplier. On May 16, 1998, Hennings [**3] and Shelby signed a "Draw Note-Fixed Rate" agreement that allowed Hennings to draw up to $4 million at a time, and Shelby made advances to

Hennings under the Note in exchange for Hennings's accounts receivable. Shelby then collected the receivables. Shelby purchased Hennings's receivables from May 1998 until either December 14, 1998 or January 7, 1999 and received payments totaling over $2 million.

In late March or early April 1999, Van Diest received a financial statement from Hennings dated September 30, 1998. Based on the financial statement, Van Diest's credit manager believed Hennings was insolvent. Van Diest had already shipped additional product to Hennings, and payment was not due until June 11, 1999. Hennings was still current on its obligations, and Van Diest did not take any steps to enforce its rights under its security agreement with Hennings.

April 1999 also marked the first time that Hennings conducted a physical inventory. At the time, Hennings's computer records listed an inventory of approximately $7 million, but a check of the physical inventory revealed a missing $2.5 million in inventory.

Hennings first defaulted on a payment to Van Diest on June 11, 1999 and [**4] that day, Van Diest sent a demand letter to Hennings requesting payment in full. Van Diest did not learn of Shelby's factoring arrangement with Hennings until July 1, 1999. Hennings filed for bankruptcy the next month, on August 23, 1999. Van Diest then demanded payment of the funds [*439] paid to Shelby from the accounts factored under the Note, and Shelby refused to pay Van Diest.

Van Diest filed suit against Shelby, alleging that Shelby converted its property. The district court granted summary judgment in favor of Shelby, and Van Diest now appeals.

II. ANALYSIS

Our review of a district court's grant of summary judgment is de novo. *Dumas v. Infinity Broad. Corp., 416 F.3d 671, 676 (7th Cir. 2005)*. Summary judgment is proper only when "there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." *Fed. R. Civ. P. 56(e)*; *Celotex Corp. v. Catrett, 477 U. S. 317, 322, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986)*. We will review all the facts and draw all reasonable inferences in favor of Van Diest, the non-moving party. *Dumas, 416 F.3d at 676*. To defeat a motion for [**5] summary judgment, the non-moving party cannot rest on the mere allegations or denials contained in his pleadings, but "must present sufficient evidence to show the existence of each element of its case on which it will bear the burden at trial." *Robin v. Espo Eng'g Corp., 200 F.3d 1081, 1088 (7th Cir. 2000)* (citations omitted). "However, neither presenting a scintilla of evidence, nor the mere existence of some alleged factual dispute between the parties or some metaphysical doubt as to the material facts, is sufficient to oppose a motion for summary judgment The party must supply evidence sufficient to allow a jury to render a verdict in his favor." *Id. at 1088* (internal citations omitted).

Van Diestsued Shelby under a theory of conversion, a dispute governed by state law. In diversity cases, we apply the substantive law of the state in which the district court sits. *Erie R. R. Co. v. Tompkins, 304 U. S. 64, 82 L. Ed. 1188, 58 S. Ct. 817 (1938)*. Here, Illinois law governs the dispute. In order to recover for conversion in Illinois, a plaintiff must show: (1) a right to the property; (2) an absolute and unconditional right to the immediate [**6] possession of the property; (3) a demand for possession; and (4) that the defendant wrongfully and without authorization assumed control, dominion, or ownership

over the property. *Cirrincione v. Johnson, 184 Ill. 2d 109, 703 N. E.2d 67, 70, 234 Ill. Dec. 455 (Ill. 1998)*.

Van Diest held a perfected, first priority purchase money security interest in the inventory it sold to Hennings. Shelby, also a secured party, claimed a security interest in all inventory, accounts receivable, and equipment of Hennings. Van Diest contends that Shelby converted its property when Shelby received the proceeds from the sale of inventory Van Diest had supplied to Hennings. Van Diest does not challenge the district court's finding that the funds Hennings paid to Shelby directly by check written on Hennings's bank accounts are not at issue. Still at issue, though, are the direct payments to Shelby from Hennings's customers which did not pass through Hennings's bank account. After Hennings drew on the Note, and Shelby received accounts, Hennings customers either paid Shelby directly or wrote checks to Hennings, which Hennings delivered to Shelby. Van Diest contends it can show that each of [**7] these payments came from the sale of its collateral by showing the proportion of Hennings's inventory on the date of each transaction that was attributable to product that Van Diest had provided to Hennings.

The conduct that forms the basis of Van Diest's complaint occurred before July 1, 2001 and before the Illinois legislature enacted a revised version of Article 9 to its Uniform Commercial Code. *See* Ill. P. A. [*440] 91-893 § 5 (July 1, 2001). The parties do not dispute that the Code as it existed prior to July 1, 2001 applies in this case. At the time relevant here,the Code defined "proceeds" to include "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." *810 ILCS § 5/9-306(1)* (West 1994). Significantly here, the Code also provided that a party continued to have a security interest in the proceeds of the sale of inventory to the extent that the

proceeds were "identifiable." *810 ILCS § 5/9-306(2)* (West 1994).

It is clearin Illinois that commingling does not necessarily make proceeds unidentifiable. First,*810 ILCS § 5/9-205* (West 1994) [**8] specifically provides that "a security interest is not invalid by reason of liberty in the debtor to use, commingle, or dispose of all or part of the collateral or to use, commingle, or dispose of proceeds."In addition, *section 9-306(2)* (West 1994) states that a security interest "continues in any identifiable proceeds." Finally,the Illinois Supreme Court recognized in *C. O. Funk & Sons, Inc. v. Sullivan Equip., Inc., 89 Ill. 2d 27, 431 N. E.2d 370, 372, 59 Ill. Dec. 85 (Ill. 1982)* that a security interest could continue in a commingled account if the proceeds were identifiable. *See also Brown & Williamson Tobacco Corp. v. First Nat'l Bank, 504 F.2d 998, 1001-02 (7th Cir. 1974)*. Therefore, so long as the proceeds were identifiable, Van Diest's security interest in the proceeds of the sale of the inventory it supplied to Hennings continued.

The Code does not define the term "identifiable." It does, however, direct that its provisions should be supplemented by "principles of law and equity." *810 ILCS § 5/1-103* (West 1994). Like many other courts, the Illinois Supreme Court has construed this provision to allow a party to identify proceeds [**9] using a tracing theory known in the law of trusts as the "lowest intermediate balance rule." *See Funk, 431 N. E.2d at 372-73*.

In this case, the district court concluded that Van Diest did not present evidence sufficient to allow it to identify its proceeds. Therefore, it concluded that Van Diest had not presented evidence that it had an ownership interest in the proceeds Shelby received from the sale of Hennings's inventory, an immediate right to possession of those proceeds, or that Shelby assumed wrongful control over

those proceeds. Because Van Diest had not presented sufficient evidence on elements for which it had the burden at trial, the district court granted Shelby's motion for summary judgment.

On appeal, Van Diest contends the district court erred when it found it could not trace its proceeds. Unfortunately, Hennings's commingling of the inventory it purchased from multiple suppliers makes this case difficult. Hennings purchased the same product from more than one supplier, but it did not segregate the inventory it received by supplier. In addition, although Hennings maintained records of the products it sold, these records did not track the company that [**10] had supplied Hennings with the product sold.

Funk is the only Illinois Supreme Court case to consider whether proceeds of collateral were sufficiently identified to subject them to a security interest. In that case, the court placed the burden of identification on the party seeking to identify the proceeds, stating, "Since Funk is claiming a prior security interest in property which is otherwise identified as collateral belonging to the bank under its after-acquired *property clause*, the burden of identifying the proceeds is properly upon Funk." *431 N. E.2d at 373*. The court then found that Funk failed to identify the proceeds, stating:

[*441] Funk argues that it established a *prima facie*case by showing that secured property was sold, that the proceeds were deposited into an account, and that other items of inventory were purchased from that account, and that upon such showing the burden should shift to another to segregate the wrongfully commingled funds. Were we concerned here with the rights of Funk against Sullivan this argument would have considerable merit. The bank, however, was neither responsible for Funk's position nor

for the commingling and is at least [**11] as innocent as Funk. We find no principles in law or equity which dictate that the innocent third party must suffer the consequences of Funk's predicament. *Section 9-306* says that the security interest attaches to identified proceeds Funk failed to offer the proof required to identify the claimed proceeds and is not now entitled a second opportunity to do so. *Id.*

Funk makes clear that Van Diest has the burden of identifying the proceeds from the sale of the inventory it supplied. *See id.* Van Diest has admitted that it "cannot at this time state the amount of its pro rata share in the mass of inventory." It contends, however, that the amount of its pro rata share is an issue of fact for trial or relevant only to damages. We disagree thattracing of Van Diest's proceeds is only a means to calculate damages and is not relevant to liability, as *Funk* clearly states that a security interest continues only in "identifiable proceeds." *431 N. E.2d at 372*. When it recently considered the same argument, the Eighth Circuit explained,"tracing is not a measure of damages. It is the primary means of demonstrating the plaintiff's rights, and therefore [**12] the defendant's liability, in cases involving commingled accounts Without equitable tracing, [the plaintiff] cannot make out a claim for conversion because it cannot establish that the funds allegedly converted were identifiable proceeds in which it had a security interest." *General Elec. Capital Corp. v. Union Planters Bank, N. A., 409 F.3d 1049, 1059 (8th Cir. 2005)*.

We also disagree with Van Diest that it has presented sufficient evidence to survive summary judgment and that only an issue of fact as to the amount of its pro rata share remains. To carry its burden of identifying proceeds, Van Diest has chosen to employ a pro rata tracing method that it contends was used in *In re San Juan Packers, Inc., 696 F.2d 707 (9th Cir. 1983)*, and *GE Bus. Lighting Group v.*

Halmar Distribs., Inc. (In re Halmar Distribs., Inc.), 232 B. R. 18 (Bankr. D. Mass. 1999). Although Illinois courts have not considered whether proration is an appropriate means of tracing where more than one creditor has a security interest in commingled proceeds, *cf. Funk, 431 N. E.2d at 372-73* (recognizing lowest intermediate balance rule as an appropriate method of tracing), other courts have [**13] recognized that proration can be used to trace commingled proceeds. *See Halmar, 232 B. R. at 26*; *Gen. Motors Acceptance Corp. v. Norstar Bank, N. A., 141 Misc. 2d 349, 532 N. Y. S.2d 685 (N. Y. Sup. Ct. 1988)*; *Bombardier Capital, Inc. v. Key Bank of Maine, 639 A.2d 1065 (Me. 1994)*. Shelby agrees that, as a general matter, the pro rata method of tracing is an acceptable methodology for tracing collateral. It contends, however, that the method is not appropriate here.

The court in *Halmar* describedthe proration method of tracing proceeds as an approach where "a court may consider identifiable proceeds as a prorata share of the commingled account, the share being determined by the percentage of collateral owned by the secured creditor before the proceeds were commingled." *232 B. R. at* [*442] *26*. In this case, as a result of the Note agreement between Hennings and Shelby, Hennings's customers either paid Shelby directly or wrote checks to Hennings which Hennings delivered to Shelby. Van Diest maintains it can demonstrate that each payment resulted from the sale of its collateral by showing the proportion of Hennings's inventory [**14] on the date of each transaction attributable to inventory Van Diest had supplied to Hennings. As the district court explained, Van Diest's approach posited that if, "for example, on October 1, 1997, Van Diest had supplied Hennings with 10% of its inventory in Product A, then Van Diest would have had a security interest in 10%

of the total inventory in Product A on that day, and 10% of the proceeds from the sale of Product A on that day."

The problem with the methodology Van Diest has employed is that it requires it to present evidence at some point in time of the percentage of Hennings inventory supplied by Van Diest. Van Diest, however, has presented no such evidence. To the contrary, Van Diest acknowledges that "It was not possible to know the total amount of any particular product that was on hand on any particular day. No records exist that show the various percentages of products supplied by different suppliers as of any particular day." (Undisp. Facts 11.)

If there was evidence of the proportion of Hennings inventory attributable to Van Diest, then to show the proportion of sale attributable to Van Diest product on any given day, Van Diest could present evidence of increases [**15] and decreases in Hennings's inventory over time as Hennings purchased more inventory from suppliers and sold inventory to customers. Without an initial percentage, however, Van Diest's methodology fails.

In an effort to present the necessary evidence, Van Diest submitted the affidavit of Douglas Main, a paralegal, numerous records, and reports Main produced from these records. Main selected October 1, 1997 as the starting point for determining Van Diest's interest in inventory it supplied to Hennings. He then created reports, including a report summarizing Hennings's purchases by product during the period from October 1, 1997 through December 9, 1998. This report detailed the total dollars of all purchases, the total dollar of purchases from Van Diest, and the resulting percentage of Van Diest's purchases to the total of all purchases. For each product detailed, Main then multiplied this percentage against every account for which an invoice appeared on Shelby's records, regardless of when the

account was generated or whether the account had been paid by check from an account debtor or by Hennings from its general deposit account. Main concluded that Shelby received $5,095,034.15 [**16] from the sale of Hennings's inventory and that 18.66%, or $950,477.55, was the proportionate share subject to Van Diest's security interest.

Main stated that in arriving at his conclusions, he made several assumptions. These assumptions included that the data he received concerning Hennings's purchases of inventory was accurate and that "Van Diest's shares of the beginning product inventories were in the same proportion to its shares of those same products which it supplied during the period of 10/1/97 through 12/9/98." The district court concluded that neither assumption had support in the record.

Van Diest contends that the district court's determination that the records were unreliable constituted a factual or credibility determination not proper at the summary judgment stage. It is undisputed, however, that on any given day in 1998 or 1999, Hennings did not know how much inventory it had in its warehouse from any supplier. Moreover, Hennings did not [*443] check its records against a physical inventory until April 1999. It is also undisputed that the physical inventory count revealed that the computer records used by Main, which listed inventory of $7 million, overstated the actual [**17] inventory by $2.5 million.

Significantly, even if Hennings's records accurately recorded the inventory as of October 1, 1997, Van Diest has not presented any evidence of the amount of that inventory that was subject to its security interest. Main assumed that Van Diest's proportion of Hennings's inventory on that date was the same as the proportion in which it supplied Hennings thereafter, but there is nothing

in the record to support that assumption. Van Diest cannot overcome a motion for summary judgment with speculation. *See Packman v. Chi. Tribune Co., 267 F.3d 628, 637 (7th Cir.2001)*. Because the starting balances of each product necessarily affect later percentages, speculation as to the starting proportions means that all future percentages Main calculated were also merely speculative. Showing the amount of product supplied to Hennings after October 1, 1997 is not sufficient when there is no evidence of the starting proportion.

Although the court in *Halmar* found a creditor had identified proceeds using the pro rata method, *Halmar* does not help Van Diest. In *Halmar*, the parties agreed on the quantity of inventory before commingling and agreed on [**18] the proportion of starting inventory subject to the secured creditor's claim. *232 B. R. at 25*. From there, the secured creditor presented evidence of the total product shipped to a company and calculated the percentage attributable to it. *Id.* Unlike the plaintiff in *Halmar*, however, Van Diest has presented no evidence of the percentage of inventory it supplied before the goods were commingled.

In short, Van Diest had the burden of identifying its proceeds, and it has not presented evidence to show that it could do so under the only methodology it presented. Of course, this is a difficult result for Van Diest, as Hennings, one of its long-time customers, failed to pay it for inventory it had ordered. Noticeably absent from this case, of course, is Hennings. Hennings's inability to pay its debts means that there are insufficient funds to pay both Van Diest and Shelby. Under Illinois law, however, the burden fell to Van Diest to identify its proceeds. *See Funk, 89 Ill. 2d at 33* ("We find no principles in law or equity which dictate that the innocent third party must suffer the consequences of Funk's predicament Funk failed to offer the proof [**19]

required to identify the claimed proceeds and is not now entitled a second opportunity to do so.") Because Van Diest did not present evidence that it could do so, we are compelled to affirm.

III. CONCLUSION

For the foregoing reasons, the decision of the district court is AFFIRMED.

 ¿Cuál fue el impedimento exacto parase proceda a la ejecución del derecho real de prenda?