

"PMSI" - THE GOLDEN PRIORITY

Suppose you are a seller who wants to sell inventory on credit to a retailer. The retailer's credit history is sufficiently checkered that you would like to have the assurance of being a secured creditor in the event your buyer becomes insolvent. Unfortunately, in most cases, a local bank already holds a security agreement from your customer and has filed a financing statement on all of the retailer's inventory and proceeds, as well as its accounts receivable.

In all likelihood, a secondary lien on the inventory will not be worth anything should the debtor become insolvent. But if you are seeking priority over the bank's lien, you may leapfrog over the bank's earlier filed financing statement, and obtain that golden edge known as a purchase-money security interest, or PMSI.

Section 9-312 of the Uniform Commercial Code gives the perfected PMSI priority in inventory over all other conflicting security interests in the same inventory, as well as identifiable cash proceeds thereof, so long as the PMSI financier satisfies two requirements: 1) the purchase-money security interest must be perfected (that is, recorded in the proper public records) at the time the debtor receives possession of the inventory, and 2) the purchase-money secured party must provide written notice to the holder of any conflicting security interest on which the holder has filed a financing statement covering the same types of inventory. (In our example, this "holder" would be the bank).

This notice has to be sent before the financing statement is filed in the public record or before the beginning of the 21-day period wherein the purchase-money security interest is temporarily perfected without filing. (Editor's note: This 21-day period may be shorter in your customer's jurisdiction — so check with local counsel.) In addition, the holder of the conflicting security interest must receive the notification before the debtor receives possession of the inventory, and the notice must state that you have or expect to acquire a purchase-money security interest in inventory of the debtor, and describe the inventory by item or type.

This means the bank could file its financing statement four days or four years prior to your purchase-money filing and your lien will still come first as to your merchandise, so long as you file it within the 21 days you have to perfect a purchase-money interest and you have given notice to the bank prior to filing and prior to your buyer's receipt of the goods.

It is advisable to do a chattel lien search (that is, check the UCC filings) before perfecting a purchase-money security interest, or you may miss a party (to whom you must send notice in order to take priority) who has also filed on your customer's inventory. It is never good practice to rely upon the debtor for this information.

As a practice tip, we also recommend taking a blank lien on all inventory and proceeds at the same time you take a security interest in the inventory that you are supplying. Although you will only have priority as to your purchase-money goods if there are previous filings on inventory, in the event that a secondary lien is later worth something, you might thereby be in a position to recover that much more if your customer suffers insolvency.

This publication is not a legal opinion of Greene & Cooper nor any partner thereof. You should consult with legal counsel prior to relying on any information contained herein.