It's a Bird, It's a Plane, It's . . . Super Priority! A Brief Primer on Purchase Money Security Interests

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BY: JAMIE WATKINS BRUNO

What is a “Purchase Money Security Interest”?

A “purchase-money security interest” (or “PMSI”) is a security interest securing a “purchase-money obligation”, or an obligation incurred by a debtor to buy collateral (known as “purchase-money collateral”). Such obligation can be in the form of seller financing or a third-party loan. A lender is eligible for a PMSI if (1) it provides a loan that enables the debtor to acquire goods, and (2) the loan proceeds are in fact used to acquire such goods.

Can a PMSI Exist in Any Type of Collateral?

A lender may *only* have a PMSI in goods (including fixtures) or software.

Why is a PMSI Special?

A PMSI has *super priority* over conflicting security interests in the same collateral, provided the secured lender follows the requirements prescribed by the Uniform Commercial Code (set forth in UCC § 9-324). The lender’s security interest in identifiable proceeds of the underlying goods also has super priority if the PMSI is properly perfected.

Who Bears the Burden of Proving a PMSI Exists?

The short answer is: the lender. Since the lender has the burden of proving that the funds were used as intended (i.e., to acquire the collateral), tracing the use of loan proceeds is critical. The best practice for lenders is to either (1) pay the loan proceeds directly to the seller to finance the acquisition of the goods, or (2) issue a check jointly payable to the debtor and seller for such acquisition. Either method provides sufficient proof that the loan proceeds were actually used by the debtor to purchase the goods. In addition, the burden will be on the lender to demonstrate when the debtor took possession of the goods – beware that relying on the date of the contract may not be sufficient.

How Does a Lender Obtain a PMSI?

PMSIs are obtained much like a regular security interest: (1) the lender and debtor must execute a security agreement to *create* the security interest (note that this should be a prospective agreement, and may not cover prior debts); (2) the security interest must be perfected by *filing* a UCC financing statement in the appropriate jurisdiction; (3) the UCC financing statement must be filed (a) *prior to* the debtor receiving the goods, or (b) *within 20 days* after such receipt (note that for goods that are to become fixtures, the filing must occur prior to or within 20 days of such goods actually becoming fixtures); and (4) if the goods are **inventory or livestock**, the lender must give *written notice* to the holder of any conflicting security interest (stating that the lender expects to acquire a PMSI in certain goods of debtor and describing those goods with particularity), which notice must be received by the other secured creditor *prior to* the debtor's receipt of the goods (up to 5 years prior to such receipt with respect to inventory and up to 5 months prior to such receipt with respect to livestock).

Further, if the goods are **inventory or livestock**, the UCC financing statement must be filed prior to debtor's receipt of the collateral; the trailing 20 day window does not apply. For this reason, the best practice is for the lender to always file the UCC financing statement *before* delivery of the collateral to the debtor. The UCC permits filing a UCC financing statement in advance of the delivery of the security agreement or the attachment of the security interest

Which Creditors Must Receive Notice?

To determine which parties must receive a PMSI notice, the secured party must conduct a UCC search. The lender is responsible for providing notice to *all required parties.* As with all other PMSI requirements, the lender has the burden of proving when the notice was received by a competing creditor. The best practice is to send notices by a method that provides a signature as proof of delivery, such as certified mail or overnight courier.

Does a PMSI Expire?

A PMSI is valid for 5 years. No further notice must be provided during such 5 year period to other creditors who already have been notified of the PMSI. The secured lender can send a new notice before the end of the 5 year period to extend the coverage.

If the goods are livestock, notice is only effective for 6 months.

Conclusion

The PMSI provides tremendous benefits for the secured lender; however, the lender must be careful to strictly comply with the PMSI requirements of the UCC.

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- Jamie Watkins Bruno – 804.420.6922 – jbruno@williamsmullen.com

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