Can I Enhance My Prospects for Payment Through a Purchase Money Security Interest?

A seller of goods may be able to gain priority over other creditors, and enhanced prospects for payment, by taking and perfecting a purchase money security interest (PMSI) in the goods it sells to a customer. This article will explain what a PMSI is, how it is perfected, and some of the issues that could affect its enforceability.

Key Issues

- **What is a PMSI?** Under the Uniform Commercial Code (UCC), a security interest in goods that is granted to a secured party by a debtor is a PMSI to the extent that the goods (which, under certain conditions, may include inventory and software) are purchase-money collateral with respect to that security interest. By way of example, a PMSI exists when a vendor extends credit to a customer to purchase goods and is granted a security interest in those goods by the customer as collateral to assure payment.
- **Why is a PMSI helpful?** As a general rule, but with some important exceptions, the priority of secured creditors is determined by who filed their UCC-1 financing statement first. A PMSI is one of those exceptions. A vendor with a valid and properly perfected PMSI comes ahead of other creditors with respect to its PMSI collateral, even if those other creditors perfected a lien on the same type of collateral first.
- **How does one get and perfect a PMSI?** To obtain a PMSI in goods other than inventory and fixtures:
  - The credit extended to the customer must have been used to purchase the collateral; and
  - The creditor must properly file a UCC-1 financing statement covering the collateral prior to the debtor receiving possession of the collateral or within 20 days thereafter. If the creditor does not meet the 20-day deadline, it will not get PMSI priority over other creditors.

  To obtain a PMSI in goods that are held by the debtor as inventory:
  - The PMSI must be perfected when the debtor receives possession of the inventory (which can be accomplished by properly filing a UCC-1 financing statement before delivery of the goods);
  - The purchase-money secured party must send an authenticated notification to the holder of any conflicting security interest;
  - The holder of the conflicting security interest must have received the notification within five years before the debtor receives possession of the inventory; and

- The notification must state that the person sending the notification has or expects to acquire a PMSI in inventory of the debtor and describe the inventory.

- **What happens to my lien when my customer sells PMSI collateral that it holds in inventory?** A properly perfected PMSI in goods held as inventory continues in cash proceeds of such inventory only to the extent the cash proceeds are both identifiable and received on or before the delivery of the inventory to a buyer. Where the proceeds of such a sale are not cash, but rather chattel paper or an instrument, the PMSI may also continue in such chattel paper or instrument, and in proceeds thereof.

Other Issues

- Complexities may arise where more than one creditor claims a PMSI in inventory.
- A consignor's security interest in its consigned goods is treated as a PMSI in inventory.
- Some oil and gas producing states provide for a PMSI in favor of interest owners to secure the purchase price obligation of the first purchaser of oil and gas production, which may be perfected without the filing of a financing statement.
- A PMSI may also be obtained in livestock.

Takeaway

While a creditor's rights will depend on the facts of each situation, a seller of goods may be able to gain priority over other unpaid creditors through a PMSI. Credit managers should consult with experienced in-house or outside counsel immediately upon learning that a customer against whom it holds a PMSI is in financial distress, insolvent, or considering bankruptcy.