Assignment 29
Lien Creditors vs. Secured Parties: Future Advances

Reference: Understanding Secured Transactions § 14.02[C]

Hypo: Future Advances

- Debtor has a $1MM line of credit from Bank
  - Bank has perfected SI in all of Debtor’s equipment
- Creditor (who has judgment vs. Debtor for $200,000) levies on Debtor’s crane on Feb. 1
- On Feb. 1, outstanding balance of line of credit = $100,000
- On Mar. 1, Debtor borrows additional $900K (maxing out its line of credit)
- Debtor later defaults; collateral is worth $1MM

Distribution of Sale Proceeds?

Bank’s Argument
- Bank has “first-in-time” priority, both for $100K balance due on Feb. 1 and for $900K future advance
- Thus, Bank gets all $1MM of sale proceeds
- Creditor gets nothing

Creditor’s Argument
- First $100,000 to Bank
  (which had priority as to balance due on Feb. 1)
- Next, $200,000 to Creditor
- Remaining $700,000 to Bank

§ 9-323. Future Advances

(a) [Omitted]
(b) [Lien creditor.] Except as otherwise provided in subsection (c), a security interest is subordinate to the rights of a person that becomes a lien creditor to the extent that the security interest secures an advance made more than 45 days after the person becomes a lien creditor unless the advance is made:
  1. without knowledge of the lien; or
  2. pursuant to a commitment entered into without knowledge of the lien.
Hypo: Future Advances

- In this hypo, Bank gets the same priority for the $900,000 in future advances as it did for the original $100,000 balance (the amount outstanding on the day of Creditor’s levy)
  - $900,000 in future advances were made within 45 days after levy [§ 9-323(b)]
- Why does this result make sense?

Future Advances: Hypo #2

- Debtor has a line of credit from Bank
  - Bank has perfected SI in all of Debtor’s equipment
- Creditor (who has judgment vs. Debtor for $200,000) levies on Debtor’s crane on Feb. 1 at 10:00 am
- On Feb. 1, at 5:00 pm, Debtor makes the following “draws” on its line of credit:
  - $50,000 (for Debtor’s monthly payroll)
  - $25,000 (for Debtor’s monthly utility costs)

Problem 29.4: Facts

- Debtor borrows $50K from Secured Party
  - SP takes/perfects SI in the collateral
  - Agreement: collateral secures future advances
- J levies on collateral (judgment = $100K)
- 60 days later, and aware of that J has levied on the collateral, Secured Party advances Debtor an additional $25,000
- Debtor defaults, Secured Party forecloses on collateral, which sells for $160,000. How would proceeds be distributed?
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Future Advances: § 9-323(b)

- If SI has priority over lien creditor (LC) for the original loan [§ 9-317], and SI secures future advances, SI has priority over LC for:
  - (1) Advances made before LC acquires its lien
  - (2) Advances <= 45 days after LC acquires its lien
  - (3) Advances >> 45 days after LC acquires its lien, if made w/out knowledge of LC’s lien
  - (4) Advances made >> 45 days after LC acquires its lien, but pursuant to commitment made w/out knowledge of LC’s lien

Problem 29.4: “Split Priority”

- SP’s SI has priority as to the original $50,000 loan
- SP’s SI will probably be subordinate to J’s lien with respect to the $25,000 future advance [§ 9-323(b)]
  - Advance was made > 45 days after J’s lien arose, and SP knew of J’s lien at time of advance
  - SP couldn’t claim first priority for this advance unless it became obligated to make the advance before it knew of J’s lien

Assume collateral sells for $160,000 total. How are proceeds distributed?
Problem 29.4

• If the future advance had been made only 30 days after J acquired its lien, SP would have gotten same priority for the $25,000 future advance as it had for original loan
  – SP’s priority for future advances during first 45 days following J’s lien is absolute (knowledge of J’s lien is irrelevant during this period)

Lien Creditor v. Secured Party: Priority Rules (Summary)

• § 9-201(a) (general rule): SI has priority unless Article 9 says otherwise
• § 9-317(a)(2)(A): SI takes priority over lien creditor if SI is perfected when the other creditor becomes a lien creditor

• § 9-317(a)(2)(B): SI that attaches AFTER lien creditor acquires its lien has priority only if, before judgment lien arose, UCC-1 was filed and security agreement signed
• § 9-317(e): PMSI perfected w/in 20 days after debtor takes possession of collateral has priority over intervening judgment lien creditor
• § 9-323(b): SP that has priority for original loan also gets priority for future advances made w/in 45 days after judgment lien arose (or after, if made w/out knowledge or pursuant to commitment)