Commercial Law I, 101A, Fall 2003—Professor Widen
For Monday, September 22, 2003

One Debtor, Two Debtor, Red Debtor, Blue Debtor

Red Company borrowed $100 from Red Bank secured by all of Red Company's equipment. Red Company signed an appropriate security agreement that included an after acquired property clause covering new equipment and a future advance clause. Red Bank properly filed a financing statement naming Red Company as debtor.

Blue Company borrowed $200 from Blue Bank secured by all Blue Company's personal property assets. Blue Company signed an appropriate security agreement. Blue Bank properly filed a financing statement naming Blue Company as debtor.

Assume that Blue Bank filed its financing statement on March 1, 200_ and that Red Bank filed its financing statement on June 1, 200_. Further, assume that both filings were made in the State of Utopia (the 51st state of the United States which has adopted the UCC without relevant amendments).

1. If Red Company sells a piece of red equipment to Blue Company on September 1, 200_, explain how we decide whether the security interest of Red Bank in the red equipment is senior or junior to the security interest of Blue Bank in the red equipment. In answering the question, you might consider the following subsidiary issues.
   a. Can a financing statement filed against Red Debtor be effective to perfect a security interest against Blue Debtor?
   b. What would you like to know about Blue Bank's security agreement?
   c. Does the fact that Blue Bank was the first to file its financing statement make a difference to the analysis?
   d. If Blue Bank had loaned Blue Company the money to purchase the red equipment, could Blue Bank claim a purchase money priority in the red equipment over Red Bank? Would your answer differ if the filing dates had been reversed, with Blue Bank filing its financing statement on June 1, 200_ after Red Bank filed its financing statement on March 1, 200_?
   e. Does it matter: Whether the sale of the equipment was a sale in the ordinary course of business? Whether the sale was a sale of inventory (i.e. assume Red Company was a seller of equipment)? Whether Red Bank knew about the sale? Whether Red Bank authorized the sale?
   f. Assume Red Bank had a negative covenant in its security agreement with Red Company that said "Red Company agrees that it shall not sell any item of equipment without the prior written consent of Red Bank. A breach of this covenant shall constitute an event of default that permits Red Bank to accelerate the maturity of its loan to Red Company." In this case, would the sale of red equipment to Blue Company be void or voidable if Red Company did not obtain written consent from Red Bank?

2. Provide an analysis of the interest of Red Bank in the sale proceeds received by Red Company from the sale of the red equipment. In answering the question, you might consider the following subsidiary issues.
    a. Does it matter: Whether the sale of the red equipment was a sale of inventory?
    b. Does it matter: Whether the sale proceeds were in the form of cash, a check, a wire transfer or an account receivable?
    c. Does it matter: If the sale proceeds initially were in the form of an account receivable that later was paid by Blue Company 30 days after delivery of the red equipment by Red Company to Blue Company?
    d. If the sale proceeds were in the form of a check that Red Company deposited in its bank account with Big Bank, does the security interest of Red Bank continue in the bank account? Must Red Bank obtain "control" over Red Company's deposit account at Big Bank in order to continue perfection in these proceeds?
    e. What if Red Company sold the red equipment to Blue Company in exchange for the transfer of stock certificates owned by Blue Company? For the transfer of a valuable copyright owned by Blue Company?

3. Provide an analysis of the results under Questions 1 and 2 above if Red Company is located in the State of Utopia and Blue Company is located in the State of Allemonde (the 52^{nd} state of the United States which also has adopted the UCC without significant amendment). In answering the question, you might consider the following subsidiary issues.
    a. Does Red Bank ever need to make an early, new financing statement filing in another jurisdiction or may it rely on the existing Utopia filing for the full 5 year duration of its initial financing statement to protect its interest in the red equipment transferred to Blue Company?
    b. Does your answer differ if Red Company sells the red equipment to Blue Company just one month prior to the expiration of Red Bank's initial financing statement?

4. Suppose that Red Bank loaned an additional $300 to Red Company on October 1, 200_ (i.e. after Red Company sold the red equipment to Blue Company). Does the red equipment secure repayment of only the $100 loan initially made by Red Bank to Red Company or does the red equipment secure both the $100 initial loan and the $300 future advance made after the transfer of the red equipment to Blue Company? In answering the question, you might consider the following subsidiary issue.
    a. Does it matter whether Red Company had rights in the red equipment at the time of the future advance?