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Court Finds Security Interest Followed After Debtor Unloaded Loader

By Paul Hodnefield, Associate General Counsel for Corporation Service Company

Under certain conditions, a buyer of goods in the ordinary course of business can take free of a security interest created by the seller, even if the secured party did not consent to the sale. The "buyer in ordinary course" rule applies primarily to sales of inventory collateral by a person engaged in selling goods of that kind. Attempts to claim buyer in ordinary course status for other types of collateral often fail, leaving the buyer to face claims for conversion or replevin by the secured party. That was the situation in the recent case *In re: Taylor*, 2012 Bankr. LEXIS 2825 (Bankr. E.D. Ky. June 19, 2012).

In *Taylor*, Sunnytime Seeding and Landscaping (the "Debtor") purchased a Caterpillar Multi-Terrain Loader (the "Loader") on credit. The owner and manager of the Debtor, Taylor, personally guaranteed the loan. The Debtor granted a security interest in the Loader to Caterpillar Financial Services ("CFS"). CFS perfected its security interest by filing a financing statement with the Kentucky Secretary of State on June 19, 2006.

In May 2009, Taylor and/or the Debtor sold the Loader to Teague. Teague and Taylor agreed that Taylor would use the proceeds of the sale to pay off CFS. However, the sale occurred without the knowledge or consent of CFS.

The loan later became delinquent. CFS filed a complaint against the Debtor, Taylor, and others seeking payment of the amount due and recovery of collateral, including the Loader. CFS also made repeated formal and informal requests to Teague seeking the return of the Loader. However, Teague refused to turn over the Loader to CFS.

CFS filed a motion seeking judgment against Teague for the Loader and moved for summary judgment. The court first found that CFS held a valid perfected security interest in the Loader. Next, the court observed that a security interest continues in the collateral following disposition unless the secured party authorized the disposition free of the security interest.

Contrary to some of his earlier statements, Teague claimed that Taylor told him there was no lien on the loader and he was therefore unaware of the security interest. The court found that Teague's knowledge of the security interest, or lack thereof, made no difference. The only exception applicable in this case was if Teague was a buyer in ordinary course of business.

Unfortunately for Teague, the court found the requirements for the buyer in ordinary course exception were not met in this case. One of those requirements was that the purchaser must buy from a person in the business of selling goods of that kind. Neither Taylor nor the Debtor was in the business of selling heavy equipment, such as the Loader. They were in the business of commercial landscaping. While commercial landscaping companies use heavy equipment, they are not considered sellers of heavy equipment. Consequently, the court concluded that Teague could not prove he was a buyer of the Loader in ordinary course of business and took subject to CFS's security interest.

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The important thing to take away from this case is that once a secured party has properly filed its financing statement on non-inventory collateral, it has done all that is necessary to protect its interest. If the sale is not in the ordinary course of business, the security interest will follow the collateral without any further action by the secured party. It is not even necessary to amend the financing statement to add the buyer's name. It is usually the buyer in such cases that will suffer the consequences when the secured party seeks to enforce its rights in the collateral.

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