



Purchase-Money Security Interest Notice Best Practices

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The purchase-money security interest (PMSI) is a valuable risk management tool for those who finance a debtor's acquisition of goods. The PMSI provides the secured party with the first-priority security interest in the purchase-money collateral, even if other creditors hold earlier-perfected security interests.

As an exception to the general priority rules, the secured party must strictly comply with the statutory PMSI requirements to obtain PMSI priority. Even minor deviations from the statutory rules could leave the secured party's claim subordinate to the claims of other creditors.

Generally, compliance with PMSI perfection requirements simply requires the secured party to file a financing statement before the statutory deadline. However, some types of transactions require the secured party to take an extra step and send a notice to the holder of any conflicting security interest. The notice requirement adds complexity to the PMSI process and can create traps for the unwary lender.

This insight report seeks to help commercial lenders better understand the PMSI notice requirements with respect to inventory collateral. It explains when PMSI notices are required, who must receive them, and the best practices for sending such notices.



When PMSI notice is required

Not every PMSI transaction requires the secured party to send a notice. Notice is only required for three types of transactions. The first is when the PMSI collateral will be inventory in the hands of the debtor. Inventory is a defined term in Article 9¹. In a nutshell, the term means goods, other than farm products, that are held by a person for sale or lease. Inventory also includes raw materials, works in progress, or other materials consumed in a business. Most PMSI notices are sent in connection with inventory finance transactions.

The second type of transaction that requires notice is when the PMSI collateral consists of livestock. Livestock is a subcategory of farm products² and includes not just domestic farm animals, but also the products of aquaculture.

Finally, consignment transactions that fall within the scope of Article 9 require the secured party to send a PMSI notice. A consignment is a transaction where a party turns over goods to a merchant for the purpose of sale. To fall within the scope of Article 9, the merchant in the consignment transaction must deal in the goods of the kind, not be an auctioneer, and not be generally known by its creditors to be substantially engaged in selling the goods of others³.

A consignment transaction requires a PMSI notice because under Article 9, the interest of the consignor is a PMSI in inventory⁴. The consignor must comply with all the requirements for a PMSI in inventory. Otherwise, creditors of the consignee may establish claims against the consigned goods⁵.

Notice timing and effectiveness

A PMSI notice must be received by the holder of a conflicting security interest within five years before the debtor receives possession of the inventory⁶. Thus, the notice generally will cover ongoing deliveries of inventory during the five-year period after the notice is received.

Timing is everything when it comes to the PMSI notice. As a general rule, the secured party can only enforce its PMSI against inventory collateral delivered after all the creditors that hold conflicting security interests have received the notice. Inventory delivered before the notice arrives will be subject to the general first-to-file rules of priority, and the secured party may find its security interest subordinate to prior perfected interests of other creditors.

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Notice contents

There is no standard form of the PMSI notice set forth in statute. There are only two requirements: The notice must state that the person sending the notice has or expects to acquire a PMSI in the inventory of the debtor, and it must describe the inventory⁷.

Article 9 contains no special requirements for the sufficiency of PMSI notice collateral description. The general Article 9 rule applies that the description is sufficient if it reasonably identifies what is described⁸.

Notice search and recipients

The secured party must send a PMSI notice to the holder of a conflicting security interest. The first step of this process is for the secured party to file its PMSI financing statement and then run a Uniform Commercial Code (UCC) search on the debtor name.

The timing of the UCC search is important. The secured party should wait to run the search until the filing office through date⁹, which falls on or after the file date of the PMSI financing statement. Otherwise, there is a risk that the search would miss another creditor's financing statement filed during the gap between an earlier filing office through date and a PMSI file date. In that case, the other creditor may not receive the necessary notice.

The secured party, however, cannot wait too long to conduct its UCC search. The resulting notices must be received before the debtor receives possession of the inventory. The secured party, therefore, should conduct its search early enough to leave time to send the notices and verify receipt before the debtor receives the inventory collateral.

Once the search has been completed, the secured party must then determine which parties identified by the disclosed records are entitled to receive notice. However, not every creditor identified through a UCC search needs to receive the PMSI notice. The secured party only needs to send the notice to those who filed or perfected their interests before the secured party filed its financing statement.

In general, creditors that filed financing statements after the secured party perfected its PMSI do not require notice. In such cases, the general Article 9 rules would give the secured party priority over those later perfected creditors.

When it comes to selecting the holders of conflicting prior security interests that should receive notice, the secured party should err on the side of caution. If there is any question whether a party should receive a PMSI notice, the secured party should send it. Omitting even one party that was entitled to notice could cost the secured party its PMSI priority.

One common error secured parties make when sending a PMSI notice occurs when the search discloses a financing statement that includes a UCC-3 assignment. An assignment made by filing a UCC-3 record does not assign the security interest. All it does is assign some or all of the secured party's power to amend the financing statement¹⁰. It does not delete or replace the assignor, even when the record appears to be a full assignment¹¹.

Those who interpret PMSI search results sometimes assume the assignor secured party is no longer entitled to receive notice. As noted, however, the assignor remains a secured party of record. Therefore, the PMSI secured party should send notices to both the assignor and assignee secured parties for any financing statement that includes a UCC-3 assignment.

Notice communication method

As the beneficiary of an exception to the general priority rules, the secured party generally has the burden of proving that it complied with all the PMSI notice requirements. That includes proving that each notice was received before the debtor received possession of the inventory collateral. Thus, the notice should be sent by a method that provides proof of delivery.

The most common communication methods used to obtain proof of delivery are overnight delivery service, such as FedEx® or UPS®, or certified mail. These methods generally obtain a signature as

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proof of delivery. However, just about any method that provides sufficient proof that the notice was delivered will work.

What happens, however, if delivery is refused or the notice is returned as undeliverable? In those situations the secured party has generally met its burden, assuming it sent the notice to the secured party names and addresses listed on the filed UCC records¹².

Continuation of the PMSI financing statement

As previously noted, a PMSI notice covers deliveries of inventory collateral for a period of five years from the date of receipt. That five-year duration coincides with the initial effective period for the financing statement filed to perfect the PMSI. If the financing statement is to be continued, the secured party will need to resend the notice to maintain its PMSI priority in ongoing deliveries of inventory collateral.

Unlike a financing statement, there is no six-month window during which the secured party must resend its PMSI notice. The secured party can send new PMSI notices anytime. The resent notices then cover deliveries of collateral for five years from the new delivery date. However, secure parties must be sure to send the new notices so that the holders of conflicting security interests receive them before the fifth anniversary of the last notice delivery date.

When resending notices, secured parties generally follow one of two options for determining the list of recipients. One option is to simply send notices to all of the creditors that received the previous

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notices. As before, there is no need to send to any creditors that filed their financing statements after the PMSI secured party filed. The other option is to run a new UCC search. This allows the secured party to purge from the notice list those prior recipients that allowed their financing statements to lapse.

Summary of best practices

In an ideal world, secured parties would always follow four steps in the proper order when sending PMSI notices. Step one is to file the PMSI financing statement. Step two is to conduct the PMSI search, ensuring that the filing office through date will reflect the PMSI financing statement and leave enough time to send the notice for receipt before the debtor receives the inventory collateral. Step three is to send the notice by a method that will provide proof of delivery. Finally, step four is to collect and maintain proof of delivery for each notice. If the secured party chooses to continue the PMSI financing statement, the proof of delivery will help determine the timetable for resending any required notices.

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About the Author

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References:

¹The full definition is found in U.C.C. § 9-102(a)(48).

²U.C.C. § 9-102(a)(34)(B).

³U.C.C. § 9-102(a)(20)(A).

⁴U.C.C. § 9-103(d).

⁵See U.C.C. § 9-319 cmt. 2.

⁶U.C.C. § 9-324(b)(3).

⁷U.C.C. § 9-324(b)(4).

⁸See U.C.C. § 9-108(a).

⁹Through date means the last day for which all submitted records have been processed and indexed by the filing office.

¹⁰U.C.C. § 9-514(b).

¹¹See U.C.C. § 9-514(b) (a person remains a secured party of record until the filing of an amendment that deletes the party).

¹²See U.C.C. § 9-324 cmt. 6 (because the address on the financing statement is held out by the secured party as the place for receipt of communications related to the security interest, a person is deemed to have received communications sent to that address).



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