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Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

LEWISTON STATE BANK, a Utah bank; corporation, Plaintiff/Appellee, **GREENLINE EQUIPMENT, L.L.C., a Utah limited liability company, JOHN DOES I-X AND JANE DOES I-X,** Defendants/Appellant.	**BRIEF OF THE APPELLANT** Appeal Case No 20050689

BRIEF OF APPELLANT

Appeal from a Final Summary Judgment to the Plaintiff by the Honorable Gordon J. Low, District Court Judge, in and for the County of Cache, Utah, Case No. 03101919, dated July 29, 2005.

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ORAL ARGUMENT REQUESTED

FILED
UTAH APPELLATE COURTS
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IN THE UTAH COURT OF APPEALS

LEWISTON STATE BANK, a Utah bank; corporation,	:	**BRIEF OF THE APPELLANT**
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	:	
Plaintiff/Appellee,	:	
	:	
GREENLINE EQUIPMENT, L.L.C., a Utah limited liability company, JOHN DOES I-X AND JANE DOES I-X,	:	Appeal Case No 20050689
	:	
	:	
Defendants/Appellant.	:	

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TABLE OF AUTHORITIES

STATUTES

CASES

OTHER REFERENCES

JURISDICTION

This court has jurisdiction pursuant to Utah Code Annotated 78-2-2(3)(j). The case was assigned to the Court of Appeals by the Utah Supreme Court pursuant to Utah Code Annotated Section 78-2-2(4) on or about August 16, 2005.

ISSUE ON APPEAL

Appellant asserts the following issue on appeal:

Did the District Court error in ruling that even though Defendant refinanced a purchase money security interest, the statutory provisions of Utah Code Annotated Section 70A-9a-103(6)(c) somehow do not apply and as a consequence "[t]hat Defendant's security interest in the collateral is junior to the priority secured position of Plaintiff as a matter of law."

PRESERVATION OF THE ISSUE IN THE TRIAL COURT

The priority of the Defendant's refinanced purchase money security interest was argued both by Memorandum and during the oral arguments of the hearing on summary judgment. The Defendant also supported the Utah Code Annotated Section 70A-9a-103(6)(c) argument by submitting affidavit testimony and exhibits, including affidavits indicating the intent of the refinancing parties to extend the purchase money priority and the UCC-1 filing documents demonstrating that intent.

STANDARD OF REVIEW

The issue of whether Utah Code Annotated Section 70A-9a-103(6)(c) provides purchase money security priority to a third party creditor who refinances a purchase money security interest presents an issue of first impression of law. Issues of law are subject to a correctness standard: *Smith v. Fairfax Realty, Inc.*, 2003 UT 41 (UT 2003);*Gerbich v. Numed, Inc.*, 1999 UT 37, 977 P.2d 1205 (UT 1999).

STATEMENT OF THE CASE

This case involves a dispute between creditors regarding the priorities of their respective security interests. Defendant asserts a priority premised upon Utah Code Ann. Section 70A-9-103(6)(c), which preserves purchase-money status upon purchase-money debt that is refinanced. Plaintiff upon Motion for Summary Judgment successfully asserted a nonpurchase money security priority premised upon (a) Plaintiff's filing of a general security interest on all of the debtor's crops and equipment prior to the Defendant's refinancing of the original purchase-money debt, and (b) the trial court's ruling that the Defendant's refinanced debt cannot be traced to the outstanding balance of the original purchase money debt within the meaning of Utah Code Annotated Rule Section 70A-9-103(6)(c), which preserves purchase-money status upon purchase-money debt that is refinanced.

STATEMENT OF THE FACTS

As a preface to this factual summary, the Defendant relies upon the well-established rule: "When reviewing a district court's grant of summary judgment, 'we view the facts and all reasonable inferences drawn therefrom in the light of the nonmoving party.'" *Nolan v. Hoopiianina*, 528 Utah Adv Rep. 15, 2005 UT App. 272, quoting *Wayment v. Clear Channel Broad., Inc.*, 2005 UT 25, 523 Utah Adv. Rep 39. As the court did in *Nolan*, "We recite the facts of the case accordingly." Id.

On March 5, 1998, the Pali Brothers (the debtor) purchased two combines from Case and financed them through New Holland Credit. New Holland filed a purchase-money security interest on this purchase-money debt on 3/5/1998 (See attached Exhibit

1, 2, 3, and 4, to Pickrel's First Affidavit). This UCC filing constituted an original purchase-money obligation. The parties agree the New Holland's purchase-money security interest was entitled to a security priority to Plaintiff's security interest because it both (a) predated the Plaintiff's nonpurchase money security interest in all the crops and equipment of the debtor; and (b) constituted a valid purchase-money security interest that was senior in status to Plaintiff's security interest regardless of the filing date.

On February 22, 2000 and again on February 26, 2001 Plaintiff (Lewiston State Bank) filed a nonpurchase money security interest on all of the debtor's crops and equipment. When Plaintiff filed these general security interests a substantial balance remained on New Holland's senior purchase money security interest. Accordingly, in extending debtor credit in 2000 and 2001, as a matter of financial reality Plaintiff could not have relied upon the equity interest in the subject combines that is in dispute in this case that can be traced to the outstanding balance on the New Holland debt.

In early 2002 the Pali Brothers became delinquent in their payments to New Holland Credit on the purchase-money obligation for the disputed two combines. To avoid default upon New Holland's purchase-money security interest, on February 20, 2002 the Pali Brothers as debtors negotiated a refinance of the outstanding balance of the original purchase money debt, $67, 654.79, with the John Deere on behalf of Defendant Greenline. According to the terms of their refinance agreement, the Defendant agreed to pay the outstanding balance owed to New Holland on the combines of $67, 654.79 (Exhibit 10 of Pickrel's First Affidavit), then refinance the same equipment for the same outstanding balance with the Pali Brothers. The only essential difference between the original purchase money debt and the refinanced debt was that the Defendant agreed to (a) delay payments for a year to give the Pali Brothers a chance to recover from their financial difficulties, and (b) refinance the same debt at a lesser interest rate.. (Exhibit 11 of Pickrel's First Affidavit: a four page Variable Rate Loan Contract and Security Agreements between the debtor and the Defendant as refinancing creditor). Prior to completing the refinance transaction, Defendant requested a lien release from New Holland for the combines (Paragraph 6 of Braegger's Affidavit).

In return for their more favorable refinance terms, the Pali Brothers as debtors agreed to give the Defendant "a purchase money security interest in the combines in connection with this purchase and resell." (Paragraph 4 of Pickrel's Second Affidavit). The Defendant was well aware that the debtors were having financial difficulties in making payments to New Holland on the purchase-money debt. According to the Affidavit testimony of Defendant's Jay Pickrel, Defendant would not have refinanced the combines without insuring that Defendant would have first priority lien. Indeed, Pickrel testified that as store manager he would never finance equipment for anything approaching "$70,000 without ensuring Greenline a first priority lien position such as a purchase-money security interest." (Paragraph 4 of Pickrel's Third Affidavit). Melisa Braegger as Defendant's office manager also testified that "Greenline would not have purchased the two combines from the Pali Brothers and then financed them with John Deere Credit if they did not believe they had a purchase money security interest in the combines." (Paragraph 5 of the Braegger Affidavit).

The refinancing agreement between the debtor and the Defendant Greenline also provided as the only "add-ons" to the amount of the original purchase-money debt would be (1) a $10 UCC filing fee to preserve the purchase-money status of the collateral being refinanced, and (2) a $150 origination fee (Exhibit 11 to Pickrel's First Affidavit). On March 6, 2002, within twenty days of the February 20, 2002 refinancing agreement between the Pali Brothers as debtors and the Defendant as refinancing creditors, the Defendant filed the agreed upon UCC purchase-money security interest, for which the Pali Brothers had agreed to pay as a $10 "add-on." This agreement and filing was intended to ensure that the refinanced collateral received the same purchase money priority that the previous creditor, New Holland, was entitled to as the previous purchase-money creditor (Exhibit 8, to Pickrel's First Affidavit).

In connection with this refinance, the $67, 519.85 in refinanced debt can be clearly traced to the outstanding amount of the original purchase-money debt of $67,544.79. The $10,626,43 finance charge identified in the refinancing documents as the potential total cost of refinancing the debt over the life of the loan, rather than being an "add on," was less than the finance charges that would have been assessed under the original New Holland debt obligation because the refinance agreement provided a lower interest rate than the New Holland agreement (Exhibit 11 of Pickrel's First Affidavit). Also, even though the Plaintiff was aware that Defendant had refinanced the combines, "Lewiston Bank made no claim on the combines when they were purchased from New Holland and resold to the Pali Brothers under the March 6, 2002 purchase-money security interest and at no time [following the refinancing] did Lewiston ever attempt to take possession of the combines under what they claimed was a priority security interest." (Paragraph 8 of Pickrel's Third Affidavit).

As a consequence of Defendant's refinance of New Holland's purchase money security, the Plaintiff was in the same secured situation they had been prior to the transaction: their 2001 and 2002 general security interests in all crops and equipment remained subordinate to the same amount of purchase-money priority in the exact same collateral that they had been subordinated to prior to the refinance. The only differences between New Holland financing and the Defendant's refinancing were: (1) the "add-ons" refinanced included a $150 origination fee and a $10 fee for filing the UCC purchase money security interest; (2) the debtor Pali Brothers, who at the time of the refinancing were delinquent in their payments on the combines to New Holland, obtained a delay in making any payments for a year; and (3) the Defendant's total finance exposure over the course of the loan, the $10,626.43 finance charge, was less than would have been incurred had the New Holland financing agreement.

As a matter of economic reality, the Defendant's refinancing New Holland's purchase-money obligation benefitted all the parties, including the Plaintiff, by (1) removing an immediate default and repossession by New Holland Credit of the two combines, (2) providing the Pali Brothers with additional time, resources, and lower finance charges, and (3) providing the Plaintiff with the benefit of an additional year of crops over which they held a security interest from the continued use of the combines. Moreover, the extension of the purchase-money priority over the same debt did not disadvantage the Plaintiff's security interest which had always been subordinated to the New Holland purchase money security interest. The Plaintiff gained, rather than lost, as a consequence of the the refinancing even with Defendant retaining purchase money priority in the refinanced debt.

The Pali Brothers made no payments to Defendants under the refinancing agreement, and defaulted when the first payment became due. The defendant repossessed the combines, repaired them for resell, and sold the first combine on June 20, 2003 for $36,500 and the second combine for $41,500. This litigation followed contesting the respective priorities of the two creditors with respect to the $78,000 received from the sale of the combines. The Plaintiff in this action, who furnished none of the funds to either purchase or refinance the disputed two combines, claims a windfall of the $78,000 they would not have been entitled to if the New Holland debt had not been refinanced. They successfully argued in the summary judgment hearing that the purchase-money priority New Holland enjoyed in the combines was "transformed" by the refinancing into non-purchase-money debt, thereby justifying a windfall to them in the amount of the refinanced debt contributed by Defendant. The Defendant claims under Utah Code Annotated Section 70A-9-103(6)(c) a refinance security priority only in the amount that can be traced through their refinancing to the collateral that had been subject to the original purchase-money security interest.

SUMMARY OF ARGUMENTS

ARGUMENT

THE COURT ERRED IN HOLDING THAT AS A MATTER OF LAW DEFENDANT GREENLINE, AS A NEW REFINANCING CREDITOR, IS NOT ENTITLED TO PURCHASE MONEY PRIORITY UNDER UTAH CODE ANNOTATED 70A-9a-103(6)(c) OVER DEFENDANT'S NONPURCHASE MONEY SECURITY INTEREST.

Several legal issues, as well as most factual issues, related to this dispute over security priorities in this case are uncontested.

First, the original creditor, New Holland, prior to the refinancing of the subject combines held a perfected purchase-money priority over Plaintiff's security interest under Utah Code Annotated 70A-9a-324. New Holland's security filing on March 5, 1998 held priority over Defendant's general security interests filed on February 22, 2000 and February 26, 2001, both because under Utah Code Annotated 70A-9a-322 New Holland security interest enjoyed a "priority in time of filing," and also a priority in status by qualifying as a purchase-money security interest under Utah Code Annotated 70A-9a-103(1)(b). It is therefore uncontested that had the Pali Brothers defaulted to New Holland when they began to suffer financial difficulties in early 2002, then Plaintiff's general security claim would have been clearly subordinated to New Holland's outstanding balance of $67,544.79.

Second, the Plaintiff in extending financial assistance to the Pali Brothers in 2000 and 2001 could not have relied upon the subject combines as collateral to the extent that they were subject to New Holland priority security interest in excess of the $67,544.79 that was later refinanced.

Third, as recognized by the trial court in its Memorandum decision, New Holland at any time could have formally assigned its perfected security interest to the Defendant or anyone else and the assignment would have extended New Holland's security priority in the collateral. In this regard, the UCC does not bar one creditor from assigning the financing of the purchase-money security interest, even if that assignee later refinances the security interest. *In re Schwartz*, 52 B.R. 314, 315 (Bankr. E.D.Pa. 1985(in a refinance case, the court held that "[t]he fact that a purchase-money security interest was assigned to one other than the original financer does not cause the security interest to lose its purchase-money status").

Fourth, New Holland could have refinanced the outstanding balance on the purchase money security interest debt on the exact terms contained in the Greenline refinancing agreement, without losing its security priority under the express provisions of Utah Code Annotated Section 70A-9a-103(6)(c).

Fifth, according to the uncontested affidavit testimony of Defendant witnesses Jay Pickrel and Melissa Braeger, the Defendant's business practice was to require a first-lien priority before entering into any purchase or refinance arrangement. Consistent with that business practice, the Defendant conditioned their agreement to refinance the Pali Brother's outstanding purchase money debt upon the Pali Brothers agreement to accept and pay the $10 UCC filing fee to preserve the Defendant's purchase money priority status in the two combines. The Pali Brothers accepted this condition. Pursuant to that agreement the Defendant did in fact file the UCC-1 purchase-money security interest within twenty days of the date the debtor and Defendant entered into their Variable Contract and Loan and Security interest with the Pali Brothers. In accordance with that agreement, the Defendant throughout this controversy has always claimed a purchase-money priority.

Given these undisputed legal issues and facts, the only issue remaining is whether, notwithstanding Utah Code Annotated 70A-9-103(6)(c), Defendant's UCC-1 filing of a purchase money security interest, and the intent and expectations of the refinancing parties, the Defendant's refinancing of the purchase money debt somehow transformed the security interest into a non-preferred security interest? Should the technical fact that Plaintiff's nonpreferred security interest predated Defendant's refinancing of an earlier existing purchase-money security interest entitle Plaintiff to a priority windfall it would not have been otherwise entitled under any other assignment or refinance scenario? Should form override substance in this case? In answer to this single issue, the Defendant argues that it is entitled to a purchase-money priority over the Plaintiff's general security interest under (1) the plain meaning of Utah Code Annotated 70A-9a-103(6)(c); (2) the legislative intent of Utah Code Annotated 70A-9a-103(6)(c); (3) the common law justification of the "dual-status" rule adopted by Utah Code Annotated 70A-9a-103(6)(c); (4) the policy reasons underlying Utah Code Annotated 70A-9a-

103(6)(c) and the "dual status" rule; and (5) the rationale underlying the purchase money priority rules generally.

I. The Plain Meaning of the Applicable Statute Utah Code Annotated Section 70A-9a-103(6)(c) provides for the extension of the original purchase money priority to the Defendant in this case.

Utah Code Annotated Section 70A-9a-103(6)(c) expressly applies to the refinancing transaction between the Pali Brothers as debtors and the Defendant as the refinancing creditor. Even the trial court in his Memorandum Decision characterized the subject transaction between the Pali Brothers and the Defendant as a "refinance" of the original purchase-money debt, but he nonetheless denied the security interest priority status within the meaning of Utah Code Annotated Section 70A-9a-103(6)(c). The court in essence held that notwithstanding the agreement between the debtor and the refinancing creditor to extend the purchase-money priority status of the debt through the refinancing, they botched the priority status afforded by Utah Code Annotated 70A-9a-103(6)(c) by filing a UCC-1 purchase money interest rather than obtaining an assignment from the original purchase-money creditor New Holland. However this overly legalistic and technical interpretation of the "refinance" provisions is neither supported by the statute nor consistent with the commonly understood policy that the UCC provisions should be interpreted liberally to achieve fairness and efficiency. Instead of distinguishing between an assignment of the purchase money priority status from the original creditor and an acceptance of the continuation of the priority status by the debtor, the statute simply provides as follows:

(6) In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:

(a) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;

(b) collateral that is not purchase-money collateral also secures the purchase-money obligation; or

(c*) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.* (Emphasis added).

The plain meaning of the language contained within Utah Code Annotated 70A-9a-103(6)(a) and (c) applies by the statute's terms to the facts of our case. First, the subject collateral involved non-consumer goods: two combines used in the Pali Brother's farming business. Second, prior to refinancing New Holland had acquired a purchase money security interest in the subject collateral. Third, prior to refinancing the combines, Plaintiff had acquired a security interest in all of the Pali Brother's crops and equipment that was subordinate to the New Holland purchase money security interest. Fourth, Defendant's credit transaction by every business practice understanding of the term constituted a refinance of the outstanding balance of the purchase-money debt. Fifth, the Defendant conditioned their willingness to refinance the purchase-money collateral upon their obtaining purchase money priority. Sixth, the debtor and refinancing creditor intended to extend the purchase money status to the Defendant Greenline. The debtor even agreed to pay for the UCC filing of Defendant's purchase-money security interest. Finally, the refinancing creditor did in fact file the purchase-money notice within the twenty day time period following the refinance transaction between the debtor and the Defendant Greenline. Accordingly, the statute by its terms expressly applies and controls the priority issue in this case. The statute does not suggest in any way that the purchase-money status is "transformed" into non-purchase-money debt simply on the basis of the substitution of the identity of the creditors in the refinancing transaction.

II. The Legislative intent underlying the Utah Code Annotated 70A-9a-103(6)(c) justifies extension of the original purchase money priority to the facts in this case.

A. The Uniform Commercial Code Amendment UCC 9-103(f)(3) was intended to extend purchase money status to purchase money debt that is refinanced.

When redrafting the UCC purchase money provisions in 2000, the drafters were specifically concerned over the split of authority in refinance cases between "transformation" and "dual-status" jurisdictions. Under the transformation cases, refinance "transforms" purchase money debt into non-preferred debt. Under the "dual-status" rule, the priority status survives refinancing to the extent that the outstanding balance in the original debt can be "traced" to the refinanced debt. In choosing the "dual status" alternative, the UCC drafters made it clear that purchase money priority is not transformed upon refinancing. In accordance with that choice, UCC 9-103(f)(3) was specifically amended to provide as follows:

> (f) [*No loss of status of purchase-money security interest in on-consumer-goods transaction.*] In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such even if:
>
> (1) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;

(2) collateral that is not purchase-money collateral also secures the purchase-money obligation; or

(3) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

In the OFFICIAL COMMENT to the amended Uniform Commercial Code 9-103(f) provisions, the drafters made it clear that the amendment was intended to adopt the "dual-status rule" that had been previously recognized by many courts by common law analysis, and to reject the alternative "transformation theory":

For transactions other than consumer goods transactions, this Article approves what some cases have called the "dual status" rule, under which a security interest may be a purchase-money security interest to some extent and a non-purchase money security interest to some extent. ... Some courts have found this rule to be explicit or implicit in the words "to the extent," found in former Section 9-107 and continued in subsections (b)(1) and (b)(2). The rule is made explicit in subsection (f). For non-consumer-goods transactions, this Article rejects the "transformation" rule adopted by some cases, under which any cross-collateralization, refinancing, or the like destroys the purchase-money status entirely.

In the OFFICIAL COMMENT to UCC 9-103(f) the drafters further explained:

Subsection (f) buttresses the dual-status rule by making it clear that (in a transaction other than a consumer-goods transaction) cross-collateralization and renewals, refinancings, and restructurings do not lose its status as such. The statutory terms "renewed," "refinanced," and "restructured," are not defined. Whether the terms encompass a particular transaction depends upon whether, under the particular facts, the purchase-money character of the security interest fairly can be said to survive. Each term contemplates that *an identifiable portion of the purchase money obligation could be traced to the new obligation resulting from a renewal, refinancing, or restructuring*. (Emphasis added).

The OFFICIAL COMMENT, therefore, makes it clear that purchase money priority turns on the factual issue of whether "an identifiable portion of the purchase money obligation could be traced to the new obligation." Under the facts of the case, the outstanding amount of the original purchase-money debt of $67,544.79 can be clearly traced to the $67,519.85 refinanced debt. Indeed, the whole purpose of the dual status rule is to protect such instances of refinancing where the outstanding debt is essentially renewed in the refinancing, rather than significantly changed by substantial add-ons that make it difficult to even "trace" the original outstanding debt to the refinanced debt.

B. Utah's verbatim adoption of UCC 9-103(f) in Utah Code Annotated 70A-9a-103(6)(c) makes it clear that purchase money priority extends through the refinance of purchase money obligations.

The Utah legislature, effective July 1, 2001, codified the "refinancing" provision of UCC 9-103(f)(3) in Utah Code Annotated 70A-9a-103(6)(c), thereby explicitly adopting the"dual status" rule before the Defendant ever refinanced the loan. By the express terms of the statute, refinancing of purchase-money debt does not destroy the priority status of the purchase-money debt, to the extent the obligations of the purchase-money debt can be "traced" to the refinanced debt. While "add-on" debt or additional obligations included in the refinance are not entitled to purchase-money priority under the refinance provisions, the amount and terms of the original debt are extended security priority.

The Utah courts have not had an occasion to discuss whether this priority is somehow "transformed" if the refinancing creditor is not identical to the original security holder. However, the Uniform Commercial Code Section 9-103(f)(3) was explicitly adopted to resolve a split amongst the courts regarding the extent to which purchase-money priority is transformed into non-purchase-money priority upon refinancing. The plain meaning of the statute, together with the policy justifications of fairness and efficiency underlying the "dual status" rule apply with equal force and effect regardless of the identity of the refinancing creditor. A review of the common law meaning and policy justifications of dual-status rule provides insight into the applicability of Utah Code Annotated 70A-103(6)(c) to the facts of this case.

III. The rationale of fairness and efficiency underlying the applicable "dual-status" rule, as incorporated into the amended Utah Code Annotated 70A-9a-103(6)(c), apply to the facts of the instant case and justify extending purchase money priority to the outstanding balance of the original debt that can be traced to the refinanced debt.

Prior to the UCC amendment on refinancing (UCC 9-106(f)(3)), the courts split between whether purchase-money priority was transformed upon refinancing (the "transformation rule") or was preserved to the extent of the outstanding balance on the purchase money debt (the "dual status rule"). The transformation courts justified their rule by an overly legalistic reading of the "antecedent debt" proscription for purchase money debt and by the difficulty of tracing the outstanding purchase money debt through complex refinancing transactions. The dual status courts (1) refuted both the "antecedent debt" argument by referring to the "to the extent" language contained in the UCC provisions defining purchase money debt; (2) refuted the practical problem of "tracing" by limiting the amount of the priority afforded post-refinanced debt to the dollar amount that could be traced to the outstanding balance at the time of the refinance; and (3) recommended the "dual status" alternative by emphasizing the fairness and efficiency served by extending priority status to refinanced debt.

A. Transformation Theory: the transformation theory was adopted by those courts concerned with the "antecedent debt" language of the UCC in defining purchase money security and the difficulty in "tracing" the outstanding balance of the purchase money debt through complex refinancing transactions.

According to courts that adopted the "transformation rule," if a debtor refinances collateral that is subject to a purchase-money security interest, and any additional debt is "added-on" then the purchase-money priority is "transformed" into nonpurchase money status. The courts reasoned (much like Judge Low in this case) that because the purpose of a refinancing loan is to pay off an "antecedent debt," contrary to the explicit language defining a purchase money interest under the UCC 9-107, any refinancing necessarily transforms purchase money debt into antecedent debt, which by definition would not qualify for purchase money treatment. *Matthews v. Transamerica Financial Services*, 724 F.2d 798 (9th Cir. 1984)(per curiam), citing with approval *In re Jones*, 5 B.R. 655 (Bankr.M.D.N.C. 1980); *In re Gillie*, 96 B.R. 689 (Bankr.N.D.Tex. 1989).

The courts justified the transformation rule on two grounds. Some courts early on suggested (much like Justice Low in this case) that refinancing does not satisfy the UCC definition of purchase money because refinancing is not made to enable the creditor to acquire rights in the collateral (which he already possesses as a consequence of the original purchase money obligation), but instead is used to pay "antecedent debt." *In re Jones*, 5 B.R. 655 (Bankr. M.D.N.C. 1980)). However, this *Jones* "antecedent debt"argument both ignores the "to the extent" language of UCC 107 and ignores the economic reality underlying the refinancing transaction. Although in technical form the original debt is cancelled, as a matter of economic reality the outstanding balance is absorbed, transferred, renewed, or refinanced into the refinanced loan obligation.

Recognizing this economic reality, many of the transformation courts shifted their justification for the transformation rule away from the legalistic "antecedent debt" argument, to the argument that refinancing creates a practical difficulty of apportioning the pre- and post-refinance obligations. If the refinance involves financial "add-ons," in the sense of adding to the balance due, the interest charged, and/or the collateral relied upon in the refinance, the entire debt is transformed into nonpurchase money debt unless a statutory or contractual mechanism exists for determining the extent to which the outstanding balance of the original purchase money security interest can be differentiated from the "add-ons." *Southtrust Bank of Alabama, Nat. Ass'n v. Borg-Warner Acceptance Corp.*, 760 F.2d 1240, 1243, rehearing denied, 774 F.2d 1179)(11th Cir. 1985)("[w]ithout some guideline, legislative or contractual, the court should not be required to distill from a mass of transactions the extent to which a security interest is purchase money"... "[u]nless the lender contractually provides some method for determining the extent to which each item of collateral secures its purchase money, it effectively gives up its purchase money status"); *In re Snipes*, 86 B.R. 1006 (Bankr. W.D.Mo. C.D.1988)(discussing the transformation and dual-status rules, and adopting the transformation approach because the refinancing agreement did not provide for any method of allocating payments between the original debt and the consolidated debt).

In these transformation jurisdictions, the critical importance of the "method of allocating" argument (rather than the "antecedent debt" argument) is revealed when those very courts adopt the opposite outcome if the method of allocating payments can be established by statute or the contract. *In re Cersey*, 321 B.R. 352, 354 (Bankr. M.D.Ga. 2004)(in a transformation jurisdiction, the court distinguished the transformation rule as adopted for the Eleventh Circuit in *Southtrust* to the extent that the contract provided a coherent basis for allocating payments between the original purchase money debt and the "add-ons").

B. Dual-Status Theory: the dual status rule was adopted by courts as more consistent with the "to the extent" language of the UCC that qualifies the antecedent debt argument and the fairness and efficiency of extending purchase money priority to refinanced debt.

Many courts rejected both the overly legalistic "antecedent debt" and the "no method of allocating" justification for the transformation rule in favor of a dual status rule. The analysis and explanation given for rejecting the "transformation rule" in favor of the "dual-status" alternative by the United States Court of Appeals for the Tenth Circuit in *In re Billings v. Avco Colorado Industrial Bank*, 838 F.2d 405 (10th Cir. 1988) is illustrative. In *Billings* the debtor had purchased furniture on credit from the "Factory Outlet Store." The debtor had given the Factory a purchase money security interest in the furniture, and the Factory had assigned the obligation to another creditor who financed the transaction. Thereafter, at the request of the debtor, who was having trouble making the payments (much like the facts of the instant case), the creditor refinanced the obligation to reduce the monthly installment payments. To effect this transaction, the parties cancelled the old note (again much like the facts of the instant case), and substituted a new note and a new security interest (much like Greenline did with the Pali Brothers). This refinancing note changed the terms of the original security debt by extending the time for repayment (benefitting the debtor much like the facts in the instant case) and increasing the interest rate (benefitting the creditor but unlike the facts in the instant case where the interest rate change benefitted the debtor as well). The creditor continued to claim a purchase money interest, but took no additional collateral as security (similar to the facts in the instant case). The outstanding balance financed by the refinancing note remained essentially the same, except the debtor "added-on"additional fees for credit life, accident and health insurance, a filing fee, and a cash advance to the debtors (add-on fees that far exceed the minimal add-on fees added by Greenline in the instant case).

When the debtor in *Billings* defaulted and filed for bankruptcy, the debtor sought to avoid the creditor's lien on the furniture under the bankruptcy code, by arguing that the refinance had "transformed" the purchase money status of the credit transaction into a nonpurchase money debt. Rejecting this "transformation" argument, the bankruptcy court held that the purchase-money priority was preserved throughout the refinancing despite the add-ons and the changes in the debt obligation. The district court affirmed. The single issue on appeal was whether under the "antecedent debt" argument, the purchase money security priority had been transformed by refinancing?

The United States Court of Appeals for the Tenth Circuit rejected the transformation argument and affirmed by adopting the dual status rule. The court observed that state law related to the Uniform Commercial Code (UCC) controls the issue of whether refinancing transforms the purchase money security interest into a non-purchase money security interest. The court noted that under the then-existing UCC provisions in Colorado, the UCC omitted any explanation of whether a purchase-money security interest loses its status upon refinancing (the omission UCC 9-103(f)(3) rectifies by stating it does not). In examining the common law response to this omission, the court observed that some courts, adopting a transformation theory, refused to extend the purchase money status through refinancing if the refinancing seeks to extend the purchase money protection *beyond the amount of the outstanding balance on the purchase price*. 838 F.2d at 407. The court identified two reasons underlying this "transformation rule": (1) that purchase money security cannot exist when collateral secures additional debt or "add ons" and (2) the refinancing transaction creates a new loan to pay off an "antecedent debt," The court rejected both justifications for denying continued priority status:

> The problem with the first rationale ... is that it ignores the precise wording of the Uniform Commercial Code. Section 9-107 of the U.C.C. provides that a security interest is a purchase money security interest "`to the extent' that the loan enables the debtor to purchase new property." This language would be meaningless if an obligation could never be considered only partly a purchase money debt.
>
> The problem with the second rationale of the transformation rule is ... it ignores the possibility that the refinancing merely renewed the debt, rather than creating new debt. 838 F2d 405, 408.

Citing substantial authority, the court rejected the "transformation" theory and held that "refinancing does not automatically transform a purchase money security interest." Id. At 409. In place of the "transformation rule" the court justified adopting the alternate "dual status rule" because it better comports with the "to the extent" language of the UCC and serves the important policy considerations of fairness and efficiency that are ignored by the "transformation rule." The court explained: "The basic problem with the automatic `transformation' rule is that it discourages creditors who have purchase money security interests from helping their debtors work out of financial problems without bankruptcy and without surrendering the collateral securing the debt." Id. at 409. Applied to the facts of that case (and also relevant to the instant case), the Court observed: "The instant case is an excellent example. These debtors apparently needed lower monthly payments on their debt. In a `transformation' jurisdiction the creditor could not cooperate without giving up its right to protect its security if debtors filed bankruptcy." Id. At 409.

The Court further noted that a change in interest rate in a refinancing transaction "does not require a finding the original obligation is extinguished." Id. at 409 n. 4. The Court added that the "transformation" rule "jumbles priorities among creditors." Id. At 410, quoting *Gibson* 16 B.R. at 265. The Court in refusing to hold that the purchase-money status had been extinguished as a consequence of the refinancing, commented: "When a debt secured by a purchase money security interest is refinanced, and the identical collateral remains as security for the refinanced debt, then neither the debt nor the security has changed its essential character." The court also noted in dicta (relevant to the instant case) that a holder of a PMSI may assign or transfer its security interest to a third party unrelated to the purchase without losing its preferred status. 838 F.2d at 406.

Many other courts came to the same conclusion for the same reasons. For example, *In re Schwartz,* 52 B.R. 314, 316 (Bankr. E.D.Pa. 1985) the court held that even a novation of a purchase money security interest does not destroy its purchase money status when it is refinanced. In *Schwartz* the debtors purchased certain goods and granted the seller a purchase money security interest in the goods. Later the note and the security interest was assigned to a new creditor. The new creditor later refinanced the loan "whereby new loan documents were generated, a new security agreement was signed and `fresh cash' given to the debtors. By this act of refinancing the parties intended a novation of the earlier loan contract by the new one." 52 B.R. at 314. Nonetheless, the court held that under the dual-status rule the purchase-money priority had been preserved to the extent of the outstanding balance at the time of the refinance. The court explained: "Even granting that a novation has been implemented to cancel the original loan document creating the purchase-money security agreement, such a novation does not nullify the purchase money aspect of the original transaction." 52 B.R. at 316-17.

Similarly, in *In re Krueger,* 172 B.R. 572 (N.D.Ohio 1994), the issue was whether a refinancing of a purchase-money debt, which included the debtor receiving an additional $1000, extinguished the purchase-money status of the original outstanding balance. In rejecting this transformation result, the court held that "[t]he fact that the Refinancing included finance charges incurred by the Debtors on the Loan, provided for longer term of repayment than the Loan, and provided for increased monthly payments does not represent strong support for the Debtor's position that the Refinancing extinguished [creditor's] purchase money security interest." (172 B.R. 574). In recognizing the purchase-money priority for the amount of the original debt, the court found the intent of the debtor and creditor critical (the same intent reflected in the refinancing documents in this case): "in view of the fact that the Refinancing specifically contemplated [the creditor's] retention of a security interest in the Furniture, the Court cannot conclude that the parties intended to extinguish [the creditor's] purchase money security interest in the Furniture." 172 B.R. at 575. Accordingly, the court held: "Therefore, [the creditor's] security interest retains its purchase money character to the extent of ... the payoff balance of the Loan at the time of the Refinancing less subsequent payments made by the Debtors." 172 B.R. at 574.

The court in *In re Short*, 170 B.R. 128 (S.D.Ill.1994) similarly relied upon the intent of the debtor and the refinancing creditor in adopting the "dual-status rule" for a refinanced purchase-money security interest. There the court held that *the degree of financial change* in the underlying obligation determines whether the PMSI status continues following refinance. 170 B.R. at 134. In response to the argument (also posed in this case by Judge Low) that refinanced debt fits within the language of "antecedent debt" proscribed for purchase-money debt under the UCC, the court found the "to the extent" language of UCC 9-107 determinative:

> A security interest is a "purchase money security interest" *to the extent* that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in ... collateral ... (170 B.R. at 132).

According to the court in *Short*, the "to the extent" language of 9-107 is more compatible with the "dual-status rule" than the "transformation rule" "to the extent" that purchase money priority is extended only to the amount of the outstanding balance of the original purchase money debt:

> the "dual-status rule" "is premised on the language of section 9-107, which provides that a lien is a purchase money security interest "to the extent" that it is taken to secure the purchase price of collateral. Accordingly, the purchase money security interest taken under the original note is preserved to the extent of the balance remaining unpaid on the original purchase money loan. See *Russell v.*

Associates Financial Services Co. (In re Russell), 29 B.R. 270, 273-74 (Bankr.W.D. Okl.1983). (170 B.R. at 133).

The court identified the "tracing" problem as the key challenge for implementing the dual status rule:

> The difficulty with the dual status rule lies in determining the extent of the purchase money interest remaining after refinancing.... When a purchase money loan has been consolidated with nonpurchase money debt and payments have ensued, some method of applying payments between the purchase money and nonpurchase money portions of the refinanced loan is necessary so that the purchase money collateral secures only its own price and does not remain as collateral for the entire obligation.

After weighing the strengths of the dual status rule against the single "tracing" problem associated with the transformation rule, the court adopted the dual status alternative:

> the dual status rule more closely adheres to the statutory language of Section 9-107 while effecting the policy behind [the priority rules]. The "to the extent" language of 9-107 clearly contemplates that a loan may be partially purchase money and partially nonpurchase money, depending on the circumstances of its creation. 170 B.R. at 134.

The court in *Geist v. Converse County Bank*, 79 B.R. 939 (D.Wyo. 1987) also adopted the dual status rule and applied it to a creditor's refinancing of collateral. The court criticized the transformation rule as overly legalistic and contrary to the language of the UCC:

> Courts accepting the transformation rule reason that refinancing transforms a purchase money security interest into an ordinary one because the refinancing does not enable the debtor to acquire rights in the collateral. This reasoning, however, not only exalts form over substance, but moreover ignores the preamble to U.C.C. Section 9-107 ... which states that a security interest is a purchase money security interest "*to the* extent" that it si taken by one making a loan that enables a debtor to acquire rights in the collateral. 79 B.R. at 942.

In adopting the dual status rule, the court explained: "[a]lthough the refinancing of a purchase money loan does not enable a debtor to acquire rights in the collateral, the purchase money security interest after refinancing is nevertheless preserved to the extent that the balance remaining on the original loan is transferred to the renewal note." Id.

Again in *In re Hill*, 226 B.R. 284 (Bankr.Ct. 1998), the bankruptcy court followed the "dual status" rule. In *Hill* the debtor purchased certain items of household goods and furnishings. The debtor financed the purchase by giving to the seller a promissory note and a security interest. That note and security interest were then assigned to Norwest (relevant to the economic reality, if not formal assignment, in the instant case). Later Norwest (a nonpurchase money creditor) refinanced the loan. In the refinance Norwest advanced $500 in additional funds and the debtor gave additional collateral consisting of additional items of household goods. When the bankruptcy was filed the debtor sought to avoid the security interest by Norwest by arguing that the add-ons had transformed the purchase money debt into nonpurchase money debt. In rejecting this argument, the court ruled that the issue had been decided in the Tenth Circuit by *In re Billings v. Avco Colorado Industrial Bank*, 838 F.2d 405 (10th Cir. 1988).

Many bankruptcy courts, district courts, and the United States Courts of Appeal for the Third, Eighth, and Tenth circuits adopted a "dual status rule" for the refinance of purchase-money security interests as more consistent with both the language of the UCC, and the principles of fairness and efficiency underlying the UCC. *Pristas v. Landus of Plymouth, Inc.*, 742 F.2d 797, 800-01 (3rd Cir. 1984)(in a refinancing case the court observed that consolidating several loans did not destroy the purchase-money character of a security interest and explained that "the `transformation rule' is misguided because it fails to consider the import of the critical language defining purchase money in section 9-107 – `to the extent.' By overlooking that phrase, the `transformation' courts adopt an unduly narrow view of the purchase-money device. Their reasoning is inconsistent with the Commercial Code, which gives favored treatment to those financing arrangements on the theory that they are beneficial both to buyers and sellers"); *In re Hemingson*, 84 B.R. 604 (Bankr. D.Minn. 1988)(holding that under Minnesota law the refinancing of a purchase money loan of farm equipment did not destroy the "purchase money" character of the original debt: "This court accepts the `dual status' rule because it gives credence to the Uniform Commercial Code. Section 9-107 states that a security interest is a purchase money security interest *to the extent* that it is taken by one making a loan that enables a debtor to acquire rights in the collateral. The courts that follow the transformation rule merely exalt form over substance"); *Bond's Jewelers, Inc. V. Linklater (In re Linklater)*, 48 B.R. 916 (Bankr. D.Nev. 1985)(holding that a purchase money security in jewelry was not lost when the perfected purchase money security interest was consolidated with a subsequent retail installment contract and explaining: "If the allocation can be made, the purchase money security interest will remain intact to the extent that the collateral continues to secure its own price. Purchase money security interests that secure other goods will be deemed nonpurchase money only to the extent that they secure the other goods."); *In re Gibson*, 16 B.R. 257, 266-69 (Bankr.D.Kan. 1981)(rejecting the transformation rule, in part, because its effect is to "jumble priorities among creditors, and to defeat the very reason for having a priority system"); *In re Russell*, 29 B.R. 270, 274 (Bankr.W.D.Okl.1983)(in denying that a refinanced and consolidated loan that had been marked "PAID" was thereby transformed into nonpurchase money debt, the court reasoned "[t]he only way `to the extent' [of UCC 9-107] can be given meaning is to find that a secured debt may be split into two parts, a purchase money part constituting so much of the debt as represents the price of the collateral and a nonpurchase money part constituting `add on' debt"); *In re Parsley*, 104 B.R. 72, 74 (Bankr.S.D.Ind.1988)(in following the dual status rule the court explained that it would not grant "avoidance of a security interest to the extent that the debtor has never paid the purchase price"); *In re Ionosphere Clubs, Inc.*, 123 B.R. 166, 171 (1991)(identifying the dual status rule as the modern trend and explaining that "[u]nder [the dual-status] approach, the relevant question is whether the financing party takes an interest in the collateral as security for the purchase price obligation, not whether the purchased property also serves or will serve as collateral for other debts of the purchaser").

C. The Trial Court Misinterpreted the Tracing Issue in Determining Whether a Refinanced Purchase-Money Security Interest is Entitled to Preserve the Original Purchase-money Status.

The trial court in his Memorandum decision held that Defendant's priority claim could not succeed under the statute because the amount refinanced by the Defendant could not be "traced" to the outstanding balance of the original purchase-money security interest as required by Utah Code Annotated 70A-9a-103(6)(c). However, the court's decision clearly misinterprets the tracing requirement under the statute.

In the OFFICIAL COMMENT to the amended refinancing provision, the UCC drafters discussed the "tracing" issue as it related to comparing the outstanding balance of the original purchase money debt with the amount of the debt refinanced, rather comparing a continuity of the original UCC filing document and any successive assignments. Contrary to the trial court's formalistic suggestion that the original UCC-1 filing must be traced to the re-financed UCC filing through a formal assignment document, the "tracing" the UCC drafters clearly had in mind involves correlating the amount of the outstanding purchase-money debt to the refinanced debt. The OFFICIAL COMMENT that the court misinterprets by its focus on tracing the UCC filing status is the following:

> Whether the terms [of the refinancing] encompass a particular transaction depends upon whether, under the particular facts, the purchase-money character of the security interest fairly can be said to survive. Each term contemplates that *an identifiable portion of the purchase money obligation could be traced to the new obligation resulting from a renewal, refinancing, or restructuring.* (Emphasis added).

In his Memorandum Decision when the court found that the refinanced debt cannot be "traced" to the original purchase money debt, the court ignored the obvious economic reality that "an identifiable portion of the purchase money obligation could be traced to the new obligation resulting from a renewal, refinancing, or restructuring." Instead of focusing on the amount of the debt, the key tracing issue in all the refinancing cases, the court relied exclusively upon formally tracing UCC filing documents: asking only whether the Defendant had received from the prior creditor New Holland a formal UCC assignment of the original purchase money security interest? This misinterpretation of "tracing" requirement makes no sense if one examines the issues discussed in the context of the respective "transformation" and the "dual-status" cases. In all of these cases the courts in discussing the issue of "tracing" ask whether the outstanding dollar balance of the original purchase money obligation can be traced to the dollar amount contained in the more complex refinancing or consolidation transaction. Thus if significant additional debt is added, the collateral is substantially changed, the terms of the financing significantly are altered to the disadvantage of the debtor, it may be difficult to identify the original purchase-money debt in the final terms of the refinance. Conversely, if the collateral remains the same and the terms of the refinancing are either identical with or more favorable to the debtor, then consistent with the OFFICIAL COMMENT to the amended provision, it is easy to "trace" an "identifiable portion of the purchase money obligation ... to the new obligation resulting from ... refinancing."

Under the facts of the case, the tracing of pre-refinancing and post-refinancing debt is pellucidly clear, notwithstanding the court's confused suggestion to the contrary. The amount of the original purchase-money obligation owing New Holland for the combines was $67, 654.79. The Defendant Greenline refinanced essentially the same amount, "adding on" only a $10 UCC filing fee to preserve the purchase-money status, and a $150 origination fee. The additional amount identified by the court in his Memorandum Decision for the "finance costs" of $10,626,43 were actually less than the financing costs that would have been owing under the New Holland purchase money debt, because the Defendant Greeline reduced the interest rate on the loan and consequently the total "financing" costs. Thus even these finance costs could be traced favorably to the outstanding purchase-money obligation owing to New Holland at the time of the refinance.

The court's confusion over the "tracing" issue contributed to the court's confusion over whether the debtor and the Defendant "intended" to continue the purchase-money status of the "traced" balance through the refinancing. As a consequence, the court erred in holding as irrelevant on the issue of whether the Defendant and the debtor intended to preserve the purchase-money status, the following facts (which were part of the record and which the court had to interpret in favor of the nonmoving party in the hearing for summary judgment):(1) the Defendant conditioned the refinancing of the New Holland debt upon the Pali Brothers accepting the Defendant as a substitute purchase-money creditor; (2) the Defendant memorialized this agreement on the issue of preservation of priority by including $10 cost for the UCC filing as one of only two "add-ons" included in the refinancing documents (the other fee was $150 for an origination fee); (3) the Defendant filed the new purchase-money UCC filing within twenty days of the refinance, as required by the UCC filing requirements; and (4) the Defendant treated the security interest as having purchase-money priority throughout the term of the loan and throughout the default dispute. Because the court held that the only way the prior security interest could be "traced" to the refinancing is through a formal UCC assignment (which the court believed acknowledged would have been outcome determinative to the priority issue), the court misconstrued the "tracing" issue underlying Utah Code Annotated Section 70A-9a-103(6)(c) and disregarded the clear intent of the parties to continue the purchase money status through the refinance.

According to the common law rationale for requiring tracing, the outstanding purchase money debt should receive continued purchase-money status that can be traced to the outstanding balance at the time of the refinance and any "add-ons" should receive nonpurchase money status. Priority should be preserved for the outstanding purchase money debt throughout refinancing "to the extent" the outstanding balance under the purchase money debt can be "traced" to the refinanced amount. Under the tracing rule, if a refinancing creditor "adds-on" additional debt or significantly increases the outstanding obligation of the debtor, then the purchase money status is preserved only "to the extent" that it can be traced to the balance of the original debt.

The UCC adoption of 9-103(f)(3) and the Utah adoption of the verbatim provisions in Utah Code Annotated Section 70A-9a-103(6)(c) must be understood and applied in the context of the dual-status cases that provide the policy justification for the dual status rule: the priority status should be retained in this case because the pre-refinancing debt can be traced to the post-refinancing debt and extension of priority status would serve the policy considerations of fairness and efficiency.

IV. The policy justifications of fairness and efficiency underlying Utah Code Annotated Section 70A-9-103(6)(c) argue in favor of extending purchase money priority to the refinanced debt in this case.

Both the dual status cases and UCC commentators have justified extending purchase money priority in those instances where principles of fairness and efficiency argue in favor of extending the priority. According to the fairness justification, if a general security interest attaches after the original purchase money security interest existed, there is no change to the creditor's security status upon refinancing. Therefore, it would not be unfair to the general creditor to extend purchase money priority to the refinanced debt, but it would be unfair to the refinancing creditor to lose the priority status upon refinancing. Following refinancing the general security interest holder has available the exact same collateral available upon default as they had available when the loan was originally made. (Jackson & Kronman, Secured Financing and Priorities Among Creditors, 88 Yale L.J. 1143, 1167-75 (1979); Jackson & Kronman, A Plea for the Financing Buyer, 85 Yale L.J. 1, 6-7 (1975); Lacy, Conflicting Security Interests in Inventory and Proceeds under the Revised Article 9 of the Uniform Commercial Code, 41 S.C.L.Rev. 247, 276-78 (1990); Nickles, Setting Farmers Free: Right in the Unintended Anomaly of U.C.C. Section 9-312(2), 71 Minn. L.Rev. 1135, 1171-75 (1987).

For example, in *In re Halprin*, 280 F.2d 407 (3rd Cir. 1960), in granting a later acquired purchase money priority over a tax lien, the court observed:

> such a [purchase money] lender as Commercial has enriched the taxpayer's estate by the amount loaned to the taxpayer. For this reason it is not unreasonable to allow it a corresponding security interest in the fruit of the borrowed money, with the government relegated to the borrowing taxpayer's net after the lender is reimbursed. The government has suffered no diminution of the assets which were available to satisfy its tax claim before the loan. 280 F2d at 410.

The result in the instant case should be the same for the same reasons. Greenline enriched the debtor's estate by the amount loaned to refinance the purchase money debt for which the debtor was in default. If the Plaintiff is relegated to receiving the debtor's net after the Defendant Greenline is reimbursed (the dual-status result and the result required by Utah Code Annotated Section 70A-9a-103(6)(c), the Plaintiff will have suffered "no diminution of the assets which were available to satisfy its [general security interest] claim before the loan." The Plaintiff can not argue that it has been treated unfairly in being unable to benefit from a financial contribution it neither created nor relied upon in making its loans. Fairness does not require a windfall to the Plaintiff simply because the Defendant did not obtain a formal assignment of New Holland's prior purchase money status.

Extending priority status to the refinanced debt is not only fair it is also efficient. Encouraging refinancing by extending priority status to the original outstanding balance is efficient in encouraging refinancing where the debtor finds it expedient for a variety of reasons. Extending purchase money status through refinancing serves efficiency in encouraging subsequent lenders to extend credit and to prevent earlier lenders from frustrating a borrower's attempts to obtain additional funding from another source. Nickles at 1173. Just as allowing later acquired purchase money interests to take priority over floating liens, extending priority status through refinancing prevents a monopoly in the debtor's access to credit. Jackson and Kronman, Secured Financing at 1167. In this sense, extending PMSI status through refinancing promotes competition among creditors and reduces transaction costs to debtors, without unfairly imposing a penalty on existing creditors who are left no worse off than they were prior to refinancing. Nickles at 1173-74.

These policy considerations of fairness and efficiency make sense as applied to the facts of the instant case. At the time of the refinance, the Pali Brothers were already delinquent in their payments to New Holland Credit. New Holland Credit could have immediately repossessed the two combines and the Plaintiff would have had no chance of recovering anything from the productive capacity of the combines. If the refinancing rule were as Plaintiff suggests, creditors such as John Deere Credit and Greenline would not work with the debtor in an attempt to stave off bankruptcy by delaying immediate payment obligations, extending the period in which the payments can be made at a lower monthly payment schedule, or lowering interest rates. Consequently, not only would the debtor be disadvantaged, the general secured creditors would also lose the advantage of a temporary credit reprieve. The initial purchase-money creditor would have to enforce strictly the terms of the purchase-money security interest to avoid loss of the purchase-money priority status. Everyone would be disadvantaged with no apparent gain to anyone. By assisting the debtor to stay in business through refinancing, the debtor has an increased the business opportunity of the debtor to recover financially with no increased exposure to anyone.

V. The purposes and policies underlying the definition of purchase money security interests under Utah Code Annotated 70A-9a-324 also justify extension of the original purchase money priority.

Even without the benefit of either the common law dual status rule or the specific statutory reference to refinance under Utah Code annotated Section 70A-9a-103(6)(c) the refinancing transaction in this case fits within the purposes and policies underlying the statutory definition of a purchase money security interest. Under Utah Code annotated 70A-9a-103(1)(b), "'purchase-money obligation' means an obligation of an obligor incurred as all or part of the price of the collateral or for value given *to enable the debtor to acquire rights in the use of the collateral if the value is in fact so used."* (Emphasis added). Utah Code annotated Section 70A-9a-103(2) further provides: "A security interest in goods is a purchase-money security interest: (a) to the extent that the goods are purchase-money collateral with respect to that security interest ..."

Apart from the dual status "to the extent" argument discussed above, under any interpretation of the refinancing in this case, the Defendant, as part of the refinance transaction, advanced $67,544.79 to New Holland "to enable the debtor to acquire rights in the use of the collateral is the value is in fact so used." By making the refinancing loan, the Defendant "enabled" the debtor Pali Brothers to both avoid an impending default and to acquire rights in the use of the collateral (the combines). Additionally, the money financed was in fact used for that very purpose, extending the debtor's use of the combines another year. Without the refinance the debtor would have defaulted on New Holland's loan and would have lost the use of the combines. Moreover, Defendant's claim of priority through the refinance extends only "to the extent that the goods are purchase-money collateral with respect to that security interest."

Grant Gilmore, one of the principal draftsman of the UCC, suggested that the "enabling" requirement for purchase money status should not be rigidly interpreted. Grant Gilmore, The Purchase Money Priority, 76 Harv. L. Rev. 1333, 1374 (1963). He asserted that if a loan transaction appears to be "closely allied" to the purchase transaction, courts should find that a PMSI has been created. Gilmore at 1374. The UCC commentators White and Summers, following Gilmore, observe that while the UCC does not provide guidance as to how broadly the requirement "to enable the debtor acquire rights in or the use of collateral," should be interpreted, they also recommend that the requirement should be liberally construed:

> "If the loan transaction appears to be closely allied to the purchase transaction, that should suffice. The evidence intent of paragraph (b) is to free the purchase-money concept from artificial limitations; rigid adherence to particular formalities in sequences should not be required." 4 White and Summers,Uniform

Commercial Code [4th ed. 1995], section 33-5 at 326, quoting 2 G.Gilmore, Security Interests in Personal Property 782 (1965).

Accordingly, in interpreting the requirement that "the creditor give value to enable the debtor to acquire rights in the collateral," the courts should liberally consider whether the loan was "to enable" a debtor to acquire use in the subject collateral and whether the value given was in fact used for that purpose. *Ingram v. Ozard Prod. Credit. Ass'n*, 468 F.2d 564, 564-65 (5th Cir. 1972); *In re McHenry*, 71 B.R. 60, 64 (Bankr. N.D. Ohio 1987); *In re Dillon*, 18 B.R. 252, 254 (Bankr.E.D.Cal. 1982).

For example, the court in *In re Enterprises Industries, Inc. v. Sutherland Press*, 259 B.R. 163 (Bankr.N.D. Calif. 2001) liberally construed the "enabling" requirement as applied to a third party creditor's advancement of financing. In *Sutherland* the debtor entered into an initial purchase money security interest for the purchase of a press, but the debtor later required additional financing from a separate third party financier to obtain possession of and title to the press. In connection with this later transaction, the debtor executed a purchase order for a press from the seller and first creditor. Although the purchase agreement required the filing of a UCC -1 purchase money security interest, the seller-creditor delayed making the filing. Both parties agreed that this seller-creditor acquired an enforceable purchase money security interest in the unpaid balance of the press under 9-107(a) of the UCC.

However, before the debtor could obtain possession of the press, the debtor obtained financing from a third party fiancier who filed an earlier UCC-1 financing statement on the same collateral. The initial purchase-money seller of the press argued that a debtor can only acquire rights in collateral one time during a purchase transaction, effectively precluding a second lender from acquiring a purchase money security interest in the same collateral. Rejecting this argument, the court held that the respective purchase money creditor acquired "different `rights' in the press at each successive stage." The court held that the second creditor also qualified as a purchase money security interest because the second creditor under UCC 9-107(b) "enable[d] the debtor [to] acquire rights in or the use of collateral." This result liberally construes the "enabling" provisions and suggests a similar result in the instant case.

Much like the payments in *Sutherland* that were "key to [the debtor] obtaining possession of and title to the press," the money advanced by Greenline enabled the debtor to retain possession of and continued right to use the collateral. The transaction extended a second level of purchase money status to the second purchase money security holder, just as the second payment in *Sutherland* extended purchase money status to a second creditor. Once Greenline had completed the purchase from New Holland, it refinanced the combines to the debtor on the outstanding balance, just as the second creditor in *Sutherland* paid the outstanding balance necessary for the creditor to obtain possession. Greenline's refinance enabled the debtor to "acquire rights in or the use of collateral," that they would have otherwise not been entitled to upon their default.

Similarly, the court liberally construed the "to enable" UCC language in *General Electric Capital Commercial Automotive Finance, Inc. V Spartan Motors, Ltd.*, 675 N.Y.S.2d 626, 246 A.D.2d 41 (New York. App. 1998). In *General Electric* a financier held a blanket lien on the debtor's inventory much like the Plaintiff held on all of the Pali Brother's existing and after-acquired property. Later the debtor signed a second security agreement with a new creditor to finance the debtor's inventory. After the second security agreement had been signed, the debtor purchased two Mercedes automobiles, for which the second creditor reimbursed the debtor without a specific agreement requiring the reimbursement. The court observed that "many courts have been reluctant to decide that a purchase money security interest has been created where, as here, title to and possession of the merchandise have passed to the debtor *before* the loan is advanced." Citing Grant Gilmore, the court explained that then existing "UCC 9-107(b) was enacted at least in part to liberalize the rather rigid traditional rules, e.g., regarding the circumstances under which purchase money secured status could be obtained by a creditor who enables a debtor to acquire new inventory (see, Gilmore, The Purchase Money Priority, 76 Harv. L.Rev. 1333, at 1373 [1963])." 675 N.Y.S.2d at 631. Agreeing with Gilmore, the court observed: "the evident intent of paragraph (b) is to free the purchase money concept form artificial limitations; rigid adherence to particular formalities and sequences should not be required." Id. at 631. In answering how a transaction is to be evaluated to determine if it is sufficiently "closely allied" to the purchase transaction to justify extending purchase money status, the court held that the intent of the debtor and creditor is controlling transaction. Id. at 632.

Also, in *Thet Mah & Assoc. V. First Bank of N.D.*, 336 N.W.2d 134, 138 (N.D. 1983), the North Dakota Supreme Court held that a bank created a PMSI when its advance of a binding commitment to issue funds enabled the debtor to enter into an equipment lease with a third party. *Thet Mah*, at 138. Given the fact that the debtor would have been unable to enter into the equipment lease without the binding commitment, the "enabling" requirement was met. Id.

The results in the above "enabling" cases are also consistent with the rule recognized by United States Supreme Court authority in tax lien areas where a later advancement of purchase-money financing provides a priority for the loan even against a pre-existing lien on after-acquired property. In such cases the Court has stated: "a security interest based on the extension of purchase money defeats a previously filed federal tax lien." *Slodov v. United States*, 436 U.S. 238 (1978). According to the

Supreme Court, "the [Internal Revenue] Code and established decisional principles subordinate the tax lien, to certain perfected security interest in ... collateral which is subject to a purchase-money mortgage regardless of whether the agreement was entered into before or after the filing of the tax lien." *Slodov*, 436 U.S. at 257-58. The Court explained that "[t]he purchase-money mortgage priority is based upon recognition that the mortgagee's interest merely reflects his contribution of property to the taxpayer's estate and therefore does not prejudice creditors who are prior in time." *Slodov* 436 U.S. at 258 n.23.

CONCLUSION

Because Defendant's purchase money refinancing of the New Holland original purchase money establishes a security priority in favor of Defendants, as a matter of plain meaning of Utah Code Annotated Section 70A-9a-103(6)(c), the legislative intent underlying the statute, the common law interpretation of the dual status rule and the tracing requirement, the policy justifications of fairness and efficiency, and the language and liberal justification for purchase money debt generally, the court's granting of Plaintiff's Motion for Summary Judgment should be overruled and the case remanded for further proceedings consistent with recognizing Defendant's priority in the refinanced debt that can be effectively traced to the original purchase money debt.

DATED this 1ST day of ~~August~~ Dec, 2005.

CERTIFICATE OF MAILING

I hereby certify that I mailed a copy of the Brief of Appellant via the United State Mail, postage prepaid, on this the 1st day of ~~Septembe~~r December, 2005 to the attorney for the Plaintiff addressed as follows:

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