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COMMERCIAL LAW—SECURED TRANSACTIONS—
THE PRIORITY OF THE FIRST-TO-FILE
RULE AND ITS EFFECT ON A
SUBSEQUENT LENDER

Index Store Fixture Company v. Farmers' Trust Company1

Index Store Fixture Company sold restaurant equipment to Kenemore on August 21, 1968. Kenemore paid $2,000 down and gave a note for the balance of $5,162.54 secured by the restaurant equipment. Index Store Fixture filed a financing statement as evidence of its security interest in the equipment.2 On March 17, 1969, Farmers' Trust Company executed a loan to Kenemore in which the same restaurant equipment served as collateral. Farmers' Trust filed its financing statement.

Index Store Fixture sold additional restaurant equipment to Kenemore on January 9, 1970. Index terminated the original note and executed a new instrument for $9,063, which included the new debt and the refinanced balance on the original debt, and filed a new financing statement. In April 1971, Kenemore defaulted on his obligations and filed a bankruptcy petition. On June 3, 1971, Farmers' Trust took possession of part of the first group of restaurant equipment. Index Store Fixture demanded delivery of the equipment. Farmers' Trust refused, maintaining that its security interest in the 1968 collateral had priority over the security interest of Index Store Fixture. Index sued for the value of the disputed collateral, arguing its 1968 financing statement had established its priority.3 Index was awarded summary judgment in the lower court, and Farmers' Trust appealed. The Missouri Court of Appeals affirmed, finding that section 400.9-312(5)(a), RSMo 19694 gave Index Store Fixture's security interest in

1. 536 S.W.2d 902 (Mo. App., D.K.C. 1976).
2. All financing statements were filed with the secretary of state and with the county recorder of deeds, pursuant to § 400.9-401(1)(c), RSMo 1969.
3. Kenemore's second note to Index Store Fixture was secured by both the 1968 and 1970 groups of restaurant equipment. Farmers' Trust claimed no interest in the 1970 equipment. Indeed, Farmers' Trust had no interest in this second group because it had not perfected any security interest with this equipment as the collateral. Index Store Fixture had priority to the proceeds from the sale of the second group of equipment under § 400.9-312(4), RSMo 1969, as a purchase-money security interest (a security interest "taken or retained by the seller of the collateral to secure all or part of its price"). § 400.9-107, RSMo 1969. The 1970 equipment was not sufficient to secure the entire 1970 debt; the 1968 equipment also was needed as security. Index's priority in this initial restaurant equipment had to be derived from the 1968 transaction, because Index's purchase-money priority of 1970 was not applicable to that part of its second loan to Kenemore which was secured by the initial restaurant equipment.
4. Section 400.9-312(5)(a), RSMo 1969 reads:

(5) In all cases not governed by other rules stated in this section . . . priority between conflicting security interests in the same collateral shall be determined as follows:
the older restaurant equipment priority over that of the defendant because Index's original financing statement was filed before that of Farmers' Trust.\(^5\)

The court's decision in *Index Store Fixture* presents a problem for a lender who wishes to finance a debtor whose collateral already is encumbered by a filed financing statement. This note will attempt to explain the reason for the *Index* decision, the problem the decision creates for the junior lender, and possible alternatives through which the junior lender may be able to deal with this problem.

The decision in *Index Store Fixture* was based on an interpretation of Article 9 of the Uniform Commercial Code and the priority provisions therein. The primary purpose of Article 9 is to simplify security interests in personal property.\(^6\) Part of this simplification concerns priorities between conflicting security interests. Article 9 resolves priority problems through a set of comprehensive rules which eliminate most of the confusing pre-Code distinctions among chattel mortgages, pledges, conditional sales and other security devices.\(^7\) Priorities under Article 9 generally are based upon a notice filing system. In order to establish priority for his security interest in collateral, a lender files a financing statement.\(^8\) Section 9-312(5)(a), the general priorities provision of the UCC, is a pure race provision. It establishes a first-to-file priority in security interests. The purpose of the notice filing provisions is to provide a "red flag" to all prospective lenders. Just as land deeds must be checked in a real estate transaction to insure the buyer that there are no gaps in, or clouds upon, the chain of title, prospective lenders must check financing statement files to make sure that the prospective debtor's collateral is not subject to a filed security interest. In most instances a previous filing will give the filing party first priority. The

\[(a) \text{ in the order of filing if both are perfected by filing . . . .}\]

Subsection (5) is a residual provision and is determinative only if a priority conflict is not resolved by any other part of Article 9. 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY [hereinafter cited as GILMORE] § 34.4, at 907 (1965); R. HENSON, SECURED TRANSACTIONS [hereinafter cited as HENSON] § 5-1, at 71 (1973).

Gilmore was the Reporter for Article 9 of the UCC from 1946-52 and since that time has been a member of the Review Committee of Article 9 as appointed by the Permanent Editorial Board of the Uniform Commercial Code. Henson also is a member of the Review Committee for Article 9.

5. Farmers' Trust also claimed Index Store Fixture's 1970 transaction was usurious, and its 1970 security interest therefore void. The basis for Farmers' Trust's argument was that Index's 1970 transaction terminated the 1968 obligation. The court rejected this argument:

The sale of additional equipment by plaintiff to Kenemore in January, 1970, did not in any realistic way change the character of the balance due from the 1968 transaction . . . . That refinancing did not extinguish the original 1968 transaction.

536 S.W.2d at 907.


7. 2 GILMORE § 25.1, at 655.

8. § 400.9-302, RSMO 1969.
question is: How far does the protection of the first-to-file priority extend?

In Index Store Fixture, when Index entered the initial security agreement with Kenemore and filed its first financing statement in 1968, there was no indication the parties contemplated additional transactions at a later date. There was no contractual provision for future advances in the original security agreement. The case involves the issue of whether a creditor's security interest enjoys priority over an intervening security interest from the time of the first filing if this original security agreement does not mention a series of advances, but rather contemplates a one-time transaction.

In Coin-O-Matic Service Company v. Rhode Island Trust Company, a case with facts similar to those in Index Store Fixture, the court said that the original security agreement must contain a provision for future advances in order for the initial financing statement to give priority to later advances over an intervening security interest. Without this provision, the first lender would be protected only as to his original loan. The Rhode Island court expressed concern that allowing a prior filing to establish permanent priority over collateral would unduly restrict the borrowing power of the debtor. The court reasoned that this would give the creditor an economic "throttle hold" over the debtor because it would be perilous for any second creditor to advance money to a debtor when there was already a financing statement on file. In the absence of a future advance provision, the priority of each subsequent advance should be determined by the filing date of the subsequent financing statement. Applying the Coin-O-Matic rationale to the Index case, Farmers' Trust's intervening interest would have had priority over the 1970 advance because Index's 1968 security agreement contained no future advance clause. Farmers' Trust would have had priority as to the initial restaurant equipment after the satisfaction of Kenemore's 1968 obligation to Index.

The Coin-O-Matic decision has been called an "aberration" and a "minority of one." It has been rejected by a majority of the courts that

9. Section 400.9-204(5), RSMo 1969 provides:
Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to the commitment.
11. Id. at 1120. The court said:
[A] single financing statement in connection with a security agreement when no provision is made for future advances is not an umbrella for future advances based upon new security agreements, notwithstanding the fact that involved is the same collateral.
12. 3 UCC REP. SERV. at 1117.
have decided the question, most of the legal commentators, and the Permanent Editorial Board of the UCC. In Index, the Missouri court joined this rejection of Coin-O-Matic and adopted the majority view: the priority of the first-to-file rule extends to protect later advances against the same collateral, even in the absence of a future advance clause. As a result, when two creditors have secured their loans with the same collateral, the first to file has priority over the second to file as to all of the common collateral. In case of the borrower’s default, the first creditor’s initial loan and subsequent advances must be satisfied through disposition of the collateral. Only after this satisfaction will the second creditor be entitled to the excess value of the collateral—if, indeed, there is any excess. Thus in


The 1972 revision of Article 9 contains new subsection 312(7) which clarifies the future advance problem. It explicitly states that future advances have the same priority as the first advance if the future advances are made while the security interest is perfected by filing or possession, or if the commitment is made before or during the period of perfection. REvised Article 9 of the Uniform Commercial Code 102 (1972). This 1972 revision has not been adopted by Missouri.

17. This is true even if the original debt is refinanced along with the subsequent advance in a new security agreement. A new financing statement need not be filed every time the debt is refinanced, and the priority still dates from the filing of the original statement. In re Rivet, 299 F. Supp. 374 (E.D. Mich. 1969); Household Finance Corp. v. Bank Comm’r, 248 Md. 233, 235 A.2d 732 (1967); HENSON § 5-19, at 113.

18. There is some question whether, in a bankruptcy situation, the junior secured interest will retain his second priority, or instead be relegated to the level of a general unsecured creditor. There is support for the proposition that a trustee in bankruptcy can use the senior secured interest to avoid the junior interest by saying in effect that a secured creditor who doesn’t have top priority has no priority at all. Moore v. Bay, 284 U.S. 4 (1931); Abramson v. Voedeker, 379 F.2d 741 (5th Cir.), cert. denied, 389 U.S. 1006 (1967); Bankruptcy Act § 70(e), 11 U.S.C. § 110(e) (1970). See Kennedy, The Trustee in Bankruptcy as a Secured Creditor Under the Uniform Commercial Code, 65 MICH. L. REV. 1419 (1967), in which the author rejects the notion that the holder of a junior secured interest can be reduced to the level of a general creditor through section 70(e) of the Bankruptcy Act. See also Countryman, The Use of State Law in Bankruptcy Cases (Part II), 47 N.Y.U. L. REV. 631, 656-61 (1972), in which the author says the trustee in bankruptcy should be able to use the senior secured interest to avoid the junior interest when the holder of the junior secured interest loses his rights to a subsequent levying creditor or a subsequent security interest solely because of his own neglect—e.g., failure to file or perfect properly or promptly. The author adds, however, that section 70(e) should
Since the 1968 restaurant equipment secured Index Store Fixture's original debt and the advance in 1970, the Index decision creates a problem for junior lenders. A junior lender may find it difficult to safely make a loan to a debtor as long as a prior financing statement is on file. The first lender may decide to make further advances to the debtor, in which case the financing statement would give the first lender priority and leave the junior lender's loan undersecured.

The justification for this broad priority given by the first-to-file rule is the certainty it provides. "Since filing is a public act the timing of which can be proved with accuracy from public records, it is the most certain and satisfactory of the measuring points for priority." The necessity of protecting the filing system has been the driving force behind the rejection of the Coin-O-Matic doctrine. A secured party who has filed first should be allowed to make subsequent advances without having to check each time for filings later than his as a condition of protection.

Another reason for the almost uniform rejection of Coin-O-Matic is that the Rhode Island court's fear of an economic monopoly by the creditor over the debtor has not impressed other courts. The mechanisms within Article 9 which may be used to avoid the monopoly have been recognized. Since Missouri has adopted the majority interpretation of the UCC's first-to-file rule of priority, Missouri lawyers should be familiar with the provisions of Article 9 which may be available to circumvent the results feared in Coin-O-Matic.

The intelligent debtor often willingly ties himself to one major financer so that the financer will find it difficult as a matter of business morality to desert the debtor when he is in trouble. . . . Since the typical users of credit secured by personal property are the smaller companies, often those still in the learning state, the financer's greatest contribution may be advice.


23. Priority problems often will arise in the context of bankruptcy proceedings. For the applicability of state law in the federal bankruptcy courts, see Countryman, The Use of State Law in Bankruptcy Cases (Part I), 47 N.Y.U.L. Rev. 407 (1972).
If a preliminary check of the records indicates a filed financing statement listing the collateral against which the lender intends to make the loan, the lender must proceed cautiously before offering additional financing to the same debtor. There are at least five alternatives which a subsequent lender may find helpful as he attempts to arrange financing against collateral which is already subject to a filed financing statement:

a) The second lender or the debtor may pay off the first loan;

b) The second lender may insist that the record be cleared by the filing of a termination statement;

c) The second lender may be able to enter into a subordination agreement with the first lender;

d) The second lender may have the first lender file a partial release of collateral statement;

e) The second lender may be able to establish his own priority under other provisions of Article 9.

The first alternative, taking priority by extinguishing the prior obligation, is, in commercial practice, the most common method of overcoming the first-to-file priority rule. The debtor or the prospective lender will accelerate the payment of the first loan, extinguishing the obligation early. After this is accomplished, the first lender has no need for the collateral, and it may be unencumbered through the filing of a termination statement (see below). The drawback to this alternative is, of course, the possibility that neither the second financer nor the debtor may be in a financial position to pay off the first debt.

The second alternative, the termination statement, extinguishes the

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24. A financing statement may be filed before a security agreement is reached. § 400.9-402(1), RSMO 1969. The date of the filing, not the date of the security agreement, determines priority. In fact, the best practice is for a financing statement to be filed at the beginning of the loan negotiations so the records may be checked and priority established before the loan is finalized. For this reason it is not sufficient that a lender knows a debtor has no current outstanding obligations. The lender also must discover whether such an obligation is contemplated, as evidenced by a filed financing statement. Steinheimer, Practice Commentary, 23 Mich. Comp. L. Ann. 467 (1967). It would be wise for the prospective lender to obtain a statement of account in order to ascertain the extent of the obligation between the first creditor and the debtor. § 400.9-208, RSMO 1969. Also note that a financing statement gives the first-to-file priority only as to the collateral mentioned therein. A financer may establish priority as to any other collateral of the debtor by filing his own financing statement.


27. Section 400.9-404(1), RSMO 1969, provides:
Whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value, the secured party must on written demand by the debtor send the debtor a statement that he no longer claims a security interest under the financing statement.
priority of a previously filed financing statement. A debtor may demand a termination statement, and the secured party must comply with this demand, when there is no outstanding obligation between the parties—i.e., when the proposed loan has fallen through or when the debt has been paid off. This provision prevents the debtor from becoming tied to the lender for an indefinite period. It is an improvement over the pre-Code notice filing laws, which provided no mechanism for removing a financing statement after its initial filing.

There are two difficulties with the termination statement. First, the debtor may demand a statement only when there is no outstanding obligation. This presents no difficulty when the termination statement is needed to clear the records where a proposed loan has fallen through. But if there is an outstanding debt, the record may be cleared only by paying off the first lender. As pointed out above, there will be instances where this will not be financially feasible, and the debtor's collateral will remain committed to the first lender. The second problem may arise when the security agreement between the first lender and the debtor contains a provision for future advances. The UCC permits a debtor to demand a termination statement "whenever there is no outstanding secured obligation and no commitment to make advances . . . ." Thus, if the prior financer and the debtor are committed to further loans against this collateral, then the termination statement may not be obtained, even if the original obligation has been extinguished.

The subordination agreement, the third alternative, is a device which has become popular because of the priority provisions of the Uniform Commercial Code. Section 9-316 of the UCC states that a secured party, who has a priority under a provision of the Code, such as the first-to-file rule, can agree to a contractual subordination of that right. The subordi-


29. 2 GILMORE § 34.4, at 908.

30. § 400.9-404(1), RSMO (1969). It is unclear what constitutes a "commitment to make advances." May a termination statement be obtained unless there is some definite obligation for further loans? The Code is unclear on this point.

31. Subordination agreements often are discussed in connection with unsecured debts, i.e., the subordination of a debt, rather than the subordination of a priority. See, Calligar, Subordination Agreements, 70 YALE L.J. 376 (1961); Coogan, Kripke and Weiss, The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements, 79 HARV. L. REV. 229 (1965).

32. 2 GILMORE § 37.1 at 985. The author particularly refers to the protection afforded after-acquired property and future advance clauses.

33. Section 400.9-316, RSMO 1969 provides: "Nothing in this article prevents subordination by agreement by any person entitled to priority."

In In re Thornor Manufacturing Co., 4 UCC REP. SERV. 595 (E.D. Pa. 1967),...
nation agreement is useful in situations where the prior financer, although reluctant to release his collateral completely, is willing to grant priority to the second lender. The agreement is appealing to the first lender because he will retain his priority position as to all financers except the one with whom he has agreed to subordinate.

A lender seeking to use a subordination agreement may encounter difficulties. The first is one of persuasion—the prospective lender must persuade the first creditor to subordinate his priority in the collateral to that of the prospective financer. The first lender will have to be induced to subordinate voluntarily because no situation in the Code requires it. Consideration for the promise to subordinate is another problem. If the first creditor agrees to subordinate his priority to the prospective lender, a problem may arise with respect to whether consideration has passed to make the promise enforceable. A subordination agreement may be obtained when the creditor with the priority will benefit from his debtor procuring another loan from another lender. The first creditor thus may be induced to subordinate his priority to the second lender. The consideration for his deferral will be the increased financial stability of the common debtor.\textsuperscript{34}

The fourth alternative, the release of collateral,\textsuperscript{35} will be feasible if the first lender's financing statement has established priority to more collateral than necessary to secure his loan. A release filed by the first lender will not terminate his priority, but will limit his security interest to the collateral necessary to secure his loan. In this way the first lender's loan will remain secured and his priority will remain established, while, at the same time, the released collateral will be available to the second lender and debtor for further financing.

The difficulty with this mechanism is that, like the subordination agreement, it is a voluntary procedure and the first lender is under no obligation to give the release. The problem is compounded by the lender's

the referee in bankruptcy said that even unilateral subordination agreements which are intended to benefit subsequent creditors of the debtor will be enforced. The subsequent creditor, who was not a party to the subordination agreement, nevertheless was allowed to enforce the agreement on a third-party beneficiary theory.

Note also that the Code does not require the subordination agreement to be in any certain form, nor in writing. Williams v. First Nat'l Bank and Trust Co. of Vinita, 482 P.2d 595 (Okla. 1971); Hillman's Equipment, Inc. v. Central Realty, Inc., 144 Ind. App. 18, 242 N.E.2d 522 (1968), modified, 253 Ind. 48, 246 N.E.2d 383 (1969). The same rule applies to partial or total releases of collateral discussed infra. Credit Plan, Inc. v. Hall, 9 UCC REP. SERV. 514 (Okla. App. 1971).

\textsuperscript{34} 2 W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE \S 2.3103 at 679 (1964). The agreement also may be enforceable through theories of waiver or estoppel. 2 GILMORE \S 37.1, at 987; Hillman's Equipment, Inc. v. Central Realty, Inc., 144 Ind. App. 18, 242 N.E.2d 522 (1968), modified, 253 Ind. 48, 246 N.E.2d 383 (1969).

\textsuperscript{35} \S 400.9-406, RSMO 1969. The release is recorded by a notation upon the financing statement.

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ability, under Article 9, to take all of the debtor's assets as security. Often too much collateral is as bad as too little. It may behoove the first lender to release collateral when he is oversecured so that a second lender may give additional financing to the common debtor. The theory is that a debtor, in the usual case a businessman, will be able to use the increased financing to improve his productivity and financial standing, thus becoming a more sound investment for the first lender. It has been suggested that commercial pressures within the financing community may be used to control lenders who require more collateral than necessary to secure their loans.

Because of the nature of the transaction or the unwillingness of the first lender to cooperate, the second lender may be unable to avoid the first-to-file priority of the first lender under UCC 9-312(5)(a). The second lender still may be able to finance the debtor safely through the fifth alternative: the creation of a first priority for himself through other priority provisions in Article 9. In some cases a financer may be able to frame the transaction so as to come within the first-to-perfect rule or one of the special priority rules, such as those designed to protect the negotiability of documents, instruments or chattel paper. Thus, the second lender may be able to avoid the first-to-file rule of priority. The extent to which these other methods are available depends upon the nature of the collateral.

Perhaps the most common way that a second lender avoids the priority of a previous filing is making a loan in conjunction with the purchase of goods or inventory by the debtor, thus falling within the "second-in-time, first-in-right" priority given to purchase-money security interests, as set

36. "There will no doubt be a temptation to do this on the principle of the more security the better." 1 GILMORE, § 15.3 at 479.
37. Id. See also Coogan, Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien," 72 HARV. L. REV. 838, 874 (1959).
38. Coogan, supra note 37 at 874.
39. Section 400.9-312(5)(b), RSMo 1969 says that if both competing interests are not perfected by filing, then the order of perfection determines priority, rather than the order of filing as in 9-312(5)(a). To perfect by filing, a party must file a financing statement and give value. To perfect by possession a party must give value and take possession of the collateral. Therefore, if one lender perfects by taking possession before a filing lender has perfected by giving value, then, under 9-312(5)(b), the party with possession has priority—the prior filing notwithstanding. See the example in Lee, Perfection and Priorities under the Uniform Commercial Code, 17 Wyo. L.J. 1, 42 (1962).
40. Special priority provisions are set out in sections 9-304 (goods covered by documents); 9-306 (proceeds and repossessions); 9-307 (buyers of goods); 9-308 (chattel paper or non-negotiable instruments); 9-309 (negotiable instruments, documents or securities); 9-310 (liens arising by operation of law); 9-313 (fixtures); 9-314 (accessions); and 9-315 (commingled goods). For a discussion of these provisions and their operation, see generally, HENSON, GILMORE and WHITE & SUMMERS.
41. Coogan, supra note 37.
42. A security interest is the purchase-money security interest to the extent that it is (a) taken 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
out in UCC 9-312(3) and (4).\textsuperscript{43} These sections are especially valuable in equipment financing and after-acquired property situations.\textsuperscript{44} Through the use of a purchase-money security interest, the second lender may finance a debtor, even when the debtor's initial creditor refuses to release collateral or subordinate his priority, and despite the first lender's established priority over all after-acquired property.\textsuperscript{45} This "super" priority given to the purchase-money security interest also establishes priority for the second lender where the first lender has a future advance provision.\textsuperscript{46}

The \textit{Index Store Fixture} decision poses problems for a junior lender who wishes to conduct financing with a debtor whose collateral is subject to a prior financing statement. This note has explored the procedures a junior lender may be able to use to conduct this financing safely. The mechanisms discussed are not fool-proof. There will be situations where none will be workable—for instance, when the transaction is not conducive to purchase-money financing and the first lender will not, or, because of the low value of the collateral, cannot subordinate his priority or release collateral. Another example is the situation where the debtor is in no position to extinguish the debt for the purpose of a termination statement. However, a financer well-versed in commercial practice and Article 9 of the Uniform Commercial Code often will be able to arrange satisfactory financing with a debtor—even in the face of a prior financing statement filed against the same collateral.

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an obligation gives value to enable the debtor to acquire rights in or the use of the collateral if such value is in fact so used.

\textsuperscript{43} Section 400.9-312(3), RSMo 1969 gives the holder of a purchase-money security interest in inventory priority over a conflicting interest in the same collateral if certain strict guidelines are followed. (\textit{E.g.}, notice must be given to the holders of prior filed financing statements). Subsection (4) is broader, giving the holder of a purchase-money security interest in collateral other than inventory a priority if the interest is perfected when the debtor receives possession of the collateral or within ten days thereafter.

\textsuperscript{44} HENSON § 5-3 at 78; 2 GILMORE § 29.1 at 777.

\textsuperscript{45} After-acquired property clauses are valid pursuant to § 400.9-204(3), RSMo 1969. For cases recognizing the purchase-money security interest priority over a conflicting after-acquired property clause, see Brodie Hotel Supply Co. v. United States, 431 F.2d 316 (9th Cir. 1970), and International Harvester Credit Corp. v. Commercial Credit Equipment Corp., 125 Ga. App. 477, 188 S.E.2d 110 (1972). Note that the purchase-money security interest in collateral other than inventory has priority only if it is perfected within ten days of the debtor's receipt of the collateral. James Talcott Inc. v. Associate Capital Co., 491 F.2d 879 (6th Cir. 1974); International Harvester Corp. v. American Nat'l Bank, 296 So.2d 32 (Fla. 1974).