

UCC Creation, Perfection, and Priority of Security Interests

by Practical Law Finance

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A discussion on the issues relating to the creation of a UCC security interest in personal property, the different methods of perfection of that security interest and the priorities of security interests under the UCC.

Taking a Security Interest under the UCC

In a financing, a borrower borrows money from a lender and promises to repay it with interest and to perform certain obligations. In a secured financing, these payment and performance obligations are secured by a [security interest](#) over the borrower's assets in favor of the lender. A security interest represents an interest in certain assets which secures payment or performance of an obligation.

Secured financing transactions require lenders, borrowers and their counsel to review and negotiate numerous documents. The lender and borrower focus mainly on the business terms of the loan agreement. An important role of lender's counsel is to ensure the lender remains in a strong legal position if the borrower does not perform its obligations under the loan agreement and/or goes into bankruptcy. Obtaining a [perfected](#) security interest in the borrower's assets helps to protect the lender.

A perfected security interest means:

- The lender has rights and remedies against the borrower's assets if the borrower breaches its obligations to the lender or an event of default exists.
- If the borrower goes into bankruptcy, the lender has additional recovery rights against the borrower's assets compared to other creditors of the borrower.

The [Uniform Commercial Code](#) (UCC) provides the framework for lenders, borrowers and their counsel in completing secured financing. This Note focuses on the UCC Article 9 rules and requirements for the lender taking a security interest in the borrower's [personal property](#) assets and the issues commonly encountered by counsel. This Note is based on the New York UCC.

The UCC has recently been amended in some states, including New York, mainly for clarification purposes (see [Practice Notes, Proposed 2010 Amendments to UCC Article 9](#) and [Proposed 2010 Amendments to UCC Article 9: State-by-state Adoption](#)).

UCC Article 9 may also apply to certain types of transactions that are not discussed in this Note, including:

- Consignments and sales of [accounts](#), [chattel paper](#), payment intangibles and promissory notes ([NY UCC § 9-109](#)).
- Certain leases if specific requirements are satisfied, such as the original term of the lease is equal to or greater than the remaining economic life of the goods ([NY UCC § 1-201\(37\)](#)).

It should be noted that certain transactions are excluded from the application of the UCC ([NY UCC § 9-109](#)). For example, landlord's liens and set-offs (with limited exceptions) are not covered by the UCC.

Although the UCC covers most security interests in personal property, security interests in certain special property have requirements outside or in addition to the UCC and may be subject to other state, federal or foreign laws. Examples of these types of assets are real property, certain intellectual property, vessels, aircraft and motor vehicles. For a discussion on these special kinds of assets, see [Practice Notes, Security: Overview: Requirements Outside or in Addition to the UCC](#) and [Security Interests: Aircraft, Vessels and Rolling Stock](#).

Assets subject to a security interest are commonly called [collateral](#). In a secured financing, if the borrower has a parent company and/or subsidiaries, the lender may require each to guaranty the borrower's obligations and enter into a security agreement granting a security interest over all of their assets (see [Practice Note, Security: Overview](#)). Each party granting a security interest is called a grantor.

In a large secured financing there is usually more than one lender advancing money to the borrower. In that situation, the lenders appoint a separate entity as the collateral agent to take the security interest and hold the collateral on their behalf. This Note assumes that only one entity, the lender, has the role of making the loan and taking the security interest from each grantor, and that the payment and performance obligations are created under a loan agreement (as opposed to other types of debt documents including notes, note purchase agreements and indentures).

Finally, this Note assumes the transaction is a corporate financing and not a consumer transaction involving an individual that is incurring an obligation for personal, family or household purposes. Consumer transactions have extra protection under the UCC and are outside the scope of this Note.

In a secured loan transaction, it is critical to ensure the lender fulfils the UCC requirements for obtaining a perfected security interest in the collateral. This is important for the lender because of the protection it gives in case of bankruptcy of the borrower or breach of the borrower's obligations to the lender. It is important to the borrower because the lender is required to have a perfected security interest in the collateral before the lender completes the financing. Usually the lender relies on the opinion of borrower's counsel that it has a perfected security interest in the collateral to ensure that all steps have been taken to satisfy this condition (see [Practice Note, Legal Opinions: Lending](#)).

Overview of UCC Rules For Taking a Security Interest

Article 9 of the UCC contains the rules and requirements for taking a security interest in personal property and fixtures. The person in whose favor the security interest has been created, identified here as the lender, is called the secured party under the UCC. The grantor, in its role of granting a security interest in collateral, is called the debtor under the UCC.

To make use of the UCC rights and remedies available to lenders, the lender should ensure satisfaction of both of the following UCC requirements:

- The security interest has "[attached](#)" to the collateral (see [Creation and Attachment of a Security Interest](#)).
- The attached security interest in the collateral has been "perfected" (see [Methods of Perfection of a Security Interest](#)).

Once the lender has an attached and perfected security interest, it can look to the UCC to determine where its security interest ranks compared to other creditors of the grantor (its "[priority](#)") (see [Priority of Security Interests](#)).

Creation and Attachment

A security interest must be created and attach to the collateral. Attachment of a security interest generally requires three elements to be satisfied under the UCC:

- Value must be given by the lender to the grantor (see [Why Are They Providing a Security Interest?](#)).
- The grantor must have rights in the collateral (see [What Assets Do They Own?](#)).
- The grantor must sign the security agreement (see [How Are They Providing the Security Interest?](#) and [Have They Agreed to Provide the Security Interest?](#)).

When these elements are satisfied, a security interest in the collateral has been created and has "attached" and it can now be enforced by the lender against the grantor.

Perfection

In order for the lender to enforce its rights against the grantor and the collateral in relation to third parties, the lender must also "perfect" the security interest. The rules governing perfection depend on the type of collateral and jurisdiction. This Note covers perfection of the security interest in different types of personal property as this is the most common type of collateral taken (see [Methods of Perfection of a Security Interest](#)). Other types of collateral have requirements outside or in addition to the UCC which govern their perfection (see [Practice Note, Security: Overview: Requirements Outside or in Addition to the UCC](#)).

Priority

The priority of a lender's claim determines where it ranks in relation to other lenders' claims against the borrower's assets. The higher the priority of the claim, the more likely the lender will be repaid. The lender will rank ahead of all other secured lenders of the grantor if it holds a perfected security interest with first priority. The UCC sets out the rules relating to priority, which depend on a number of factors, including whether or not the security interest is perfected, the timing of the perfection and the method of perfection (see [Priority of Security Interests](#)).

Creation and Attachment of a Security Interest

The first step towards "attachment" involves the "creation" of the security interest in the collateral. The elements of attachment of a security interest in a secured financing require counsel to carefully review the details of their transactions.

Who Are the Parties?

In every legal transaction, counsel must correctly identify the parties involved. As part of the due diligence on a financing transaction, the borrower should provide the lender with information on the different entities in the borrower's group, how they are owned and a list of the assets for the group and their owners (see [Practice Note, Due Diligence: Lending](#)). The lender uses this information to clearly identify the correct legal name of the grantors and the assets held by each grantor. The lender also ensures it receives a security interest from each grantor. This becomes especially important if a certain asset should be specifically identified in a security agreement, such as pledged shares.

Also, the lender must be correctly identified in the loan and security documents. However, in a [syndicated loan](#) the security agreement should not list the lenders by name. As noted above, when there is a collateral agent acting on behalf of a number of lenders, the collateral agent is the secured party in the security agreement acting "as agent for the lenders". Using a collateral agent is beneficial to simplify the borrower's relationship with the lenders and to avoid the need to amend the security agreement if and when the identity of the lenders in the lending syndicate changes.

Why Are They Providing a Security Interest?

The first requirement for attachment of the security interest under the UCC is that value has been given ([NY UCC § 9-203\(b\)\(1\)](#)). Broadly defined in the UCC, value includes a loan of money and a binding commitment to lend ([NY UCC § 1-204](#)). The borrower is the entity directly receiving the value. Its subsidiaries arguably indirectly receive value from the benefit they should receive through the financing transaction. The parent also arguably indirectly receives value from its equity interest in the borrower.

What Assets Do They Own?

The second of the three requirements for attachment of the security interest under the UCC is that the grantor has rights in the collateral or the power to transfer rights in the collateral to the lender ([NY UCC § 9-203\(b\)\(2\)](#)). A grantor may hold rights in the collateral even if it does not own the collateral. As a general matter, the grantor can only grant a security interest in whatever rights it holds in the asset. Once the lender completes due diligence of the grantors and their assets, identifying each grantor's rights to the collateral is generally not difficult.

How Are They Providing the Security Interest?

The final requirement for attachment consists of two parts: the "security agreement" and the evidentiary requirement, satisfied by the signing of the security agreement ([NY UCC § 9-203\(b\)\(3\)](#)).

Security Agreement

The security agreement serves as the primary document that records the granting of the security interest by the grantor in favor of the lender. While most financing transactions use a "security agreement", a "pledge agreement" or a "guaranty and collateral agreement", the UCC does not require a precise form or label for the document creating the security interest (for example, see [Legal Update, In re Bucala: SDNY Bankruptcy Court Finds Creditor to be Secured Even Without a Formal Security Agreement](#)). The contents of the security agreement generally reflect the deal between the lender and the grantor concerning the collateral. Security agreement terms are discussed in more detail in [Practice Note, Security Agreement: Overview](#).

The UCC also has certain requirements for the security agreement in order to satisfy the criteria for attachment:

- **Granting Clause.** The security agreement must "create or provide" for a security interest ([NY UCC § 9-102\(a\)\(74\)](#)). The creation of the security interest should be obvious in the financing documentation, and the issue of whether or not the parties intended to create a security interest should never arise in a secured financing. The express language creating the security interest in the collateral should be stated in the "granting clause" of the security agreement. The security agreement must also have clear language describing the obligations to be secured by the security interest in the collateral. The courts have indicated that a [UCC-1](#) financing statement (UCC-1), taken alone, cannot be considered a security agreement under the UCC.

This is an example of the creation language in a granting clause of a security agreement:

"As collateral security for the payment and performance in full of all the Secured Obligations, each Grantor hereby pledges and grants to the [Collateral Agent for the ratable benefit of the Secured Parties/Lender], a Lien on and security interest in and to all of the right, title and interest of such Grantor in, to and under the following property, wherever located, and whether now existing or hereafter arising or acquired from time to time..."

- **Description of Collateral.** The security agreement must contain a description of the collateral that reasonably identifies what is described ([NY UCC § 9-108\(a\)](#) and [§ 9-203\(b\)\(3\)\(A\)](#)). For most collateral, examples of reasonable identification are a description that identifies the collateral by specific listing, category, collateral type, quantity, formula or any other method if the identity of the collateral is objectively determinable ([NY UCC § 9-108\(b\)](#)). To satisfy this requirement, the security agreement should list all of the borrower's assets to be included in the collateral by using their respective collateral type definitions under the UCC. The UCC definitions for different types of personal property are discussed below (see [Methods of Perfection of a Security Interest](#)). This method of description "by type" is not sufficient if the lender wants to take a security interest over a [commercial tort claim](#) or a [cooperative interest](#), as their descriptions require more specific details. Counsel should ensure that the description of collateral matches what the parties intended to be included. A grantor may want a narrow description of collateral to differentiate the asset from its other assets.

It should be noted that describing the collateral as "all assets" or "all the grantor's personal property" in the security agreement does not satisfy the UCC requirement of reasonable identification ([NY UCC § 9-108\(c\)](#)).

Have They Agreed to Provide the Security Interest?

The third requirement for attachment of the security interest also involves satisfaction of an evidentiary requirement. The evidentiary requirement depends on the type of collateral, but can be satisfied for all types of personal property if the grantor signs the security agreement. The UCC refers to this as "authentication". In a financing, parties generally still physically sign documents, but the UCC allows for authentication by electronic signature ([NY UCC § 9-102\(a\)\(7\)](#)).

The other methods to satisfy the evidentiary requirement include:

- [Control](#) of the collateral by the lender, in the case of investment property, a [deposit account](#), [electronic chattel paper](#), or a [letter-of-credit right](#).
- Possession of certain collateral by, or delivery of certain collateral to, the lender.

In each case if the control, possession or delivery is pursuant to the grantor's security agreement (which may be oral) ([NY UCC § 9-203\(b\)\(3\)](#)), because of the potential evidentiary and opinion issues involved, these methods are generally not relied upon in secured financings. Oral security agreements also have the disadvantage of potential uncertainty in the terms of the security agreement (for example, in determining the collateral and the secured obligations).

Third Party Consents to a Security Interest

An agreement between a third party and a grantor relating to an asset may provide that:

- The grantor cannot grant a security interest in, or assign its rights in, that asset without the consent of a third party.
- Any grant of a security interest or other assignment of rights in that asset is a breach of that agreement.

Under the UCC, these anti-assignment clauses for many types of assets, including general intangibles and promissory notes, may be rendered ineffective if they attempt to restrict or prevent security interests in those assets ([NY UCC §§ 9-406\(d\)](#), [9-407\(a\)](#), [9-408\(a\)](#) and [9-409](#)).

Therefore, the UCC permits the lender to take a security interest in the asset despite the terms of the agreement between the grantor and the third party relating to that asset.

While this right to take a security interest may allow the lender to receive the proceeds of the asset, it may not allow the lender to enforce the security interest and "step into the shoes" of the grantor without the consent of the third party. Accordingly, when a lender is taking a security interest in a partnership interest, for example, the lender usually tries to obtain the consent of the general partner of the partnership to the security interest to assure its cooperation if the lender wants to exercise its remedies and be admitted to the partnership or sell the partnership interest to a purchaser of its choice.

For more on consents and anti-assignment clauses, see [Practice Note, UCC Issues: Excluded Property and Anti-assignment Provisions](#).

Methods of Perfection of a Security Interest

Once a security interest is "attached", and can be enforced by the lender against the grantor, the lender then "perfects" the security interest to ensure that its security interest is effective against third parties. Only an attached security interest can be perfected ([NY UCC § 9-308\(a\)](#)). In a secured financing, attachment of the security interest is generally straightforward as parties expect to sign a security agreement setting out the types of collateral covered. Perfection of the security interest may not be as straightforward.

It is important to know what types of property constitute the collateral. The UCC categorizes collateral into different types, and the type determines the requirements for attachment, perfection, priority and choice of law under the UCC. In the UCC, the different categories of personal property are found within the definition of [general intangible](#), the catch-all for personal property not otherwise classified.

A general intangible is defined in the UCC as:

"any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, [documents](#), [goods](#), [instruments](#), investment property, letter-of-credit rights, [letters of credit](#), [money](#), and oil, gas, or other minerals before extraction. The term includes payment intangibles and software".

Once counsel determine the type of collateral involved, the UCC rules specifically describe the method used to perfect the security interest in that collateral (see [Perfection Steps Checklist](#)).

The four main methods to perfect an attached security interest are:

- **Filing a UCC-1** (see [Perfection by Filing](#)).
- **Possession of the collateral** (see [Perfection by Possession](#)).
- **Control of the collateral** (see [Perfection by Control](#)).
- **Automatic Perfection** (see [Automatic Perfection](#)).

Depending on the type of collateral, there may be only one method or more than one method of perfection available. When there is more than one method of perfection, one particular method may give better priority to the lender's security interest (see [Priority of Security Interests](#)).

Certain collateral types also have rules of temporary perfection which may apply for only a limited time unless other action is taken to perfect the security interest ([NY UCC § 9-312](#)). A security interest in proceeds is automatically perfected for 20 days if the lender had a perfected security interest in the collateral that was sold that gave rise to the proceeds ([NY UCC § 9-315](#)). However, a lender in a secured financing should not rely on temporary perfection and should instead rely on the other methods of perfection.

Perfection by Filing

Types of Collateral Perfected by Filing

Security interests in most types of personal property can be perfected by filing a properly completed UCC-1 in the appropriate filing office (see [Where to File](#)). The most common exceptions are deposit accounts, money and letter-of-credit rights ([NY UCC § 9-312](#)). Filing of the one-page UCC-1 form

serves as public notice of the security interest. The UCC-1 is not meant to be a summary of the underlying financing transaction or the security agreement.

Assets including fixtures (by fixture filings), as-extracted collateral, timber to be cut and cooperative interests can also be perfected by filing. These real-property-related filings carry additional filing requirements (including contents and locations of filings) in the UCC ([NY UCC § 9-502\(b\)](#)) and are beyond the scope of this Note.

Contents of a UCC-1

The UCC-1 must contain:

- The legal name and mailing address of the debtor (identified here as the grantor). After July 1, 2013, most states no longer require that the UCC-1 include the debtor's entity type or jurisdiction of organization. New York still requires that the UCC-1 include this information.
- The legal name and mailing address of the secured party (identified here as the lender) or a representative of the secured party.
- A description of the collateral covered by the UCC-1.

([NY UCC §§ 9-502](#) and [9-516](#)).

For more information on preparing UCC-1s, see [Practice Note, UCC: Preparing and Filing Financing Statements](#), [UCC Financing Statements Preparation and Filing Checklist](#) and [UCC Financing Statements \(04/20/11 Versions\) Preparation and Filing Checklist](#).

Filing Authorization

A grantor must authorize the filing of a UCC-1 in writing ([NY UCC § 9-509](#)). When the UCC-1 covers the same collateral as the security agreement, signing the security agreement is sufficient authorization for filing the UCC-1. Generally lenders include an express authorization for filing in the security agreement. If lenders want to file UCC-1s in advance of the closing date, they should obtain a specific written authorization from the grantor beforehand and/or a ratification of prior filings from the grantor in the security agreement.

Where to File

The UCC contains choice of law rules to determine the location (also known as jurisdiction) a UCC-1 should be filed (see [Place of Perfection \(Choice of Law\)](#)). Once the jurisdiction is determined, the UCC-1 should be filed in the central filing office of that jurisdiction. The Secretary of State's office usually serves as the central filing office. The general rule for a grantor that is a registered organization (such as a corporation, limited partnership or limited liability company) is to file the UCC-1 at the Secretary of State's office in the grantor's jurisdiction of organization. For example, a Delaware corporation would file a UCC-1 in the Delaware Secretary of State's office.

How to File

The UCC-1 must be sent to the filing office using an authorized method (such as electronically by e-File) with the correct filing fee ([NY UCC § 9-516](#)). The filing office may reject the filing on certain grounds, including lack of sufficient information to enable it to index the filing. Lenders and counsel have minimized rejections by relying on independent search and filing companies to check and submit the filings.

For more information on filing UCC-1s, see [Practice Note, UCC: Preparing and Filing Financing Statements](#), [UCC Financing Statements Preparation and Filing Checklist](#) and [UCC Financing Statements \(04/20/11 Versions\) Preparation and Filing Checklist](#).

Perfection by Control

Types of Collateral Perfected by Control

A security interest in investment property, deposit accounts (only method), electronic chattel paper and letter-of-credit rights (only method if not a supporting obligation) can be perfected by control.

Method of Control

The method of control depends on the type of collateral. For example:

- **Investment Property.** Perfection of a security interest in investment property by control depends on whether the investment property is a certificated security, uncertificated security or securities entitlement. Commodity contracts and accounts are not discussed in this Note. Generally the lender is perfected by possession or by entering into a securities account control agreement (see [Standard Document, Securities Account Control Agreement](#)). For a discussion on this topic, see [Practice Note, Security Interests: Investment Property](#).

- **Deposit Accounts.** A lender must take control of the deposit account to perfect its security interest in that account. The lender has control ([NY UCC § 9-104](#)) if, for example the deposit account is in the name of the lender or if the lender, the grantor and the depository bank enter into an agreement providing that the depository bank will comply with instructions from the lender concerning the funds in the deposit account without further consent of the grantor. This agreement is customarily known as a deposit account control agreement (see [Standard Document, Deposit Account Control Agreement](#)). For a discussion on this topic, including other methods of obtaining control, see [Practice Note, Security Interests: Deposit Accounts](#).
- **Electronic Chattel Paper.** A lender has control ([NY UCC § 9-105](#)) over electronic chattel paper if, in simple terms, there is one authoritative or identifiable copy of the electronic record of the chattel paper, the copy identifies the lender and its interest, the copy is communicated to and maintained by the lender or its designated custodian, the copy is readily identifiable as the authoritative copy and any revision of the authoritative copy is readily identifiable as authorized or unauthorized (see [Perfection Steps Checklist](#)).
- **Letter-of-Credit Rights.** A lender has control over a letter-of-credit right if the issuer of the letter of credit has consented to an assignment of proceeds of the letter-of-credit as set out in [NY UCC § 9-107](#).

Perfection by Possession

Types of Collateral Perfected by Possession

A lender may perfect its security interest in tangible chattel paper, instruments, goods and negotiable documents by taking possession of these assets or by filing a UCC-1.

A lender must take possession in order to perfect its security interest in money (if the money is not in a deposit account).

Method of Perfection

Possession is not defined under the UCC. The lender can, but is not required to be, the entity taking possession of the assets. The lender can appoint a third party to act as collateral agent or bailee to take possession of the assets on its behalf. The grantor cannot qualify as an agent of the lender for the purposes of taking possession. In addition, the third party taking possession should not be too closely connected to, or controlled by, the grantor.

In order for possession by a third party to be sufficient for perfection under the UCC (for assets other than certificated securities and goods covered by a document of title), the third party agent must sign a document acknowledging that it holds possession of the collateral for the lender's benefit ([NY UCC § 9-313\(c\)](#)).

For certificated securities, a lender can perfect by filing or by taking delivery of the certificated security. Delivery may be effected by the lender taking possession or by a third party taking delivery on behalf of the lender as set out in [NY UCC § 8-301](#) (see [Practice Note, Security Interests: Investment Property](#)).

Automatic Perfection

For some types of collateral, the security interest becomes perfected as soon as it becomes attached.

Types of Collateral Perfected Automatically

Examples of security interests that become perfected automatically on attachment include security interests in proceeds and in supporting obligations (such as guaranties and letter-of-credit rights):

- **Proceeds:** For collateral over which there is a perfected security interest, perfection of the security interest in the proceeds from the sale or disposition of that collateral continues automatically for 20 days after the sale or disposition ([NY UCC § 9-315](#)). During that 20 day period, the lender may be required to take additional steps to continue its perfected security interest in those proceeds after that period ([NY UCC § 9-315\(d\)](#)).
- **Supporting Obligations:** The security interest in a supporting obligation automatically attaches and is perfected if the security interest in the asset that it is supporting has attached and been perfected ([NY UCC § 9-203\(f\)](#) and [§ 9-308\(d\)](#)). For example, a supporting obligation could be a letter-of-credit right or a guaranty that supports payment or performance of another type of asset such as an account. Perfection of the security interest in the account automatically perfects a security interest in a guaranty which is supporting payment of the account.

For a summary of perfection methods, see [Perfection Steps Checklist: Perfection Summary Table](#).

What Methods of Perfection are Customary in a Secured Financing?

In a standard type of secured financing involving no special assets or circumstances, lender's or borrower's counsel, as applicable, customarily take the following actions to perfect the lender's security interest in the grantor's collateral:

- **Filing a UCC-1.** Lender's counsel typically files a UCC-1 in respect of each grantor.
- **Certificated Securities.** Grantor delivers any certificated security to the lender together with a signed stock power (blank and undated) (see [Standard Document, Stock Power](#)), thereby satisfying the requirements of possession and control (see [Practice Note, Security Interests: Investment Property](#)).
- **Notes:** Grantor delivers any note to the lender together with a signed note power (blank and undated) (see [Standard Document, Note Power](#)), which satisfies the requirements of possession.
- **Deposit Account.** For any deposit account, the grantor enters into a deposit account control agreement (see [Standard Document, Deposit Account Control Agreement](#)) with the lender and the depository bank which satisfies the requirements of control (see [Practice Note, Security Interests: Deposit Accounts](#)).
- **Securities Account.** For any securities account, the grantor enters into a securities account control agreement (see [Standard Document, Securities Account Control Agreement](#)) with the lender and the securities intermediary maintaining the securities account which satisfies the requirements of control (see [Practice Note, Security Interests: Investment Property](#)).

Priority of Security Interests

General Priority Rules

In many cases, a grantor in financial difficulty owes money to a number of creditors. A creditor can recover amounts owing to it by taking action against the assets of the grantor. The UCC determines the priority of the creditor's claims to those assets. The higher the creditor's priority, the more likely it will be repaid from those assets. In general, a secured lender has priority over an unsecured lender. For all secured lenders, the general UCC priority rules are as follows ([NY UCC § 9-322](#)):

- Perfected secured lender versus unperfected secured lender: perfected secured lender has priority.
- Unperfected secured lender versus unperfected secured lender: the first to attach has priority.
- Perfected secured lender versus perfected secured lender: if both are equally perfected, the first to file or perfect has priority. However, if there is more than one way to perfect in the specific type of collateral and one perfected secured lender has a better form of perfection under the UCC than another, then the secured lender with better perfection has priority, regardless of who was perfected first (see [Which Method of Perfection Gives the Best Priority?](#)).

Under these rules, filing refers to filing an effective UCC-1 in the correct filing office and perfection refers to acquiring a perfected security interest.

Which Method of Perfection Gives the Best Priority?

Certain asset types have more than one method of perfecting the security interest in that asset (for example, investment property). The UCC may provide that a certain method of perfection is better than the others and gives a lender a better priority. Lender's counsel should ensure their client uses the method with highest priority. In a secured financing, lenders often perfect using more than one method to minimize the potential for dispute with other creditors over conflicting priorities.

The most common examples of alternative methods of perfection where one method gives the best priority are:

- **Certificated securities.** A security interest in a certificated security perfected by possession gives better priority than a security interest perfected by filing ([NY UCC § 9-328](#)).
- **Letter-of-Credit Rights.** A security interest in a letter-of-credit right perfected by control gives better priority than a security interest perfected automatically as a supporting obligation ([NY UCC § 9-329\(a\)](#)).
- **Investment property and securities accounts.** A security interest in investment property and securities accounts perfected by control gives better priority than a security interest perfected by filing ([NY UCC § 9-328](#)).

Place of Perfection (Choice of Law)

The UCC contains rules to determine which law governs:

- Whether perfection of the security interest has occurred.
- The effect of perfection and non-perfection.
- The priority of the security interest.

General Rule for Perfection

To determine whether the security interest is perfected, the general rule is to look at the local law where the grantor is located ([NY UCC § 9-301\(a\)](#)). Registered organizations are located in the state of their organization. Individuals are located at their principal residences, and other types of organizations at their place of business, or at their chief executive office, if they have more than one place of business. Foreign grantors are generally deemed to be located in the District of Columbia unless their jurisdiction has a public filing system that is similar to the UCC ([NY UCC § 9-307](#)). For example, for a secured financing with a security agreement governed by New York law and entered into by a Delaware company, the New York UCC provides that the Delaware UCC governs the perfection of the security interest for that Delaware company, and under the Delaware UCC, the UCC-1 should be filed with the Office of the Secretary of State of the State of Delaware.

Special Rules

The most common special rules (overriding the general rule above) for determining the law governing perfection are as follows:

- **Possessory Security Interests.** The local law of the jurisdiction where the collateral is located governs whether or not perfection of a security interest by possession has taken place ([NY UCC § 9-301\(b\)](#)).
- **Investment Property.**
 - Where perfection takes place by filing, the general rule applies regarding the location of the debtor to determine the law governing perfection;
 - Where the asset is a certificated security and perfection is not by filing (or automatically by a securities intermediary), the local law where the certificated security is located determines the law governing perfection;
 - Where the asset is an uncertificated security and perfection is not by filing (or automatically by a securities intermediary), the local law of the issuer's jurisdiction determines the law governing perfection; and
 - Where the asset is a security entitlement or securities account and perfection is not by filing (or automatically by a securities intermediary), the local law of the securities intermediary's jurisdiction determines the law governing perfection. Parties can agree to a specific jurisdiction in a written agreement. The securities account control agreement should expressly state the securities intermediary's jurisdiction for the purposes of the NY UCC. ([NY UCC § 9-305](#).) The parties should also consider the effect of the Hague Securities Convention on choice of law issues (see [Practice Note, Security Interests: Investment Property](#)).
- **Deposit Accounts.** The local law of the jurisdiction of the depository bank governs whether or not perfection of a security interest in a deposit account has taken place ([NY UCC § 9-304\(a\)](#)). Parties can agree to a specific jurisdiction in a written agreement. The deposit account control agreement should expressly state the bank's jurisdiction for the purposes of [NY UCC §9-304](#) ([NY UCC § 9-304\(b\)](#)).
- **Letter-of-Credit Rights.** The local law of the jurisdiction of the letter of credit issuer determines the law governing perfection ([NY UCC § 9-306](#)).

Effect of Perfection, Non-Perfection and Priority

The general rule is that the jurisdiction whose law governs whether or not perfection has taken place also governs the effect of perfection, non-perfection and priority ([NY UCC § 9-301](#)).

Maintaining Perfection Post-Closing

After closing, as the borrower continues to operate its business, events may occur relating to the grantors and the collateral. The lender should ensure that, despite these events, its security interest in the collateral remains perfected.

A lender needs to know about an event relating to a grantor or the collateral before it can react to protect its interests. The security agreement should contain terms requiring the grantor to notify the lender if certain events occur, or are about to occur, relating to itself or the collateral. Since these events usually require amending the UCC-1s or taking some other action, the lender gains time to ensure it maintains perfection of its security interest (see [Changes to UCC Financing Statements](#)).

For example, when a grantor changes its name and causes the existing UCC-1 to become "seriously misleading", the lender must file an amendment to the UCC-1 within four months of the name change to ensure that its security interest in assets acquired after that date remains perfected ([NY UCC § 9-507](#)).

For more information on how a lender can maintain its perfected security interest in collateral after the occurrence of certain common post-closing events, see [Practice Note, UCC: Maintaining Perfection Post-Closing](#) and [UCC Filing Perfection Maintenance Checklist](#).

Changes to UCC Financing Statements

UCC-1s are amended, terminated, assigned and continued by filing UCC-3s. UCC-3s are one page documents with optional boxes that can be checked and spaces for information similar to the UCC-1. When a UCC-1 is filed, it is stamped with a filing number and a copy is returned to the filing party. Lender's counsel send these filed copies to the lender on receipt (see [Practice Note, Closing a Loan Transaction](#)). Lenders should keep these filed copies in their records as lender's and borrower's counsel generally do not keep records of UCC-1 and UCC-3 filings. All UCC-3s, whether they are amending, continuing or terminating a UCC-1, must include the filing number of the UCC-1 they relate to and the name of the party authorizing the filing.

A UCC-1 lapses five years after filing ([NY UCC § 9-515](#)). If a lender wants to extend the duration of a UCC-1 that perfects its security interest in collateral, it must file a UCC-3 continuation statement within six months before the expiration of the UCC-1 ([NY UCC § 9-515\(d\)](#)). Lender's counsel should remind their clients to keep a record of all filings so clients can file their continuation statements on time. Counsel should notify clients in writing that it is the client's obligation to file continuation statements.

For more information on preparing and filing UCC-3s, see [Practice Note, UCC: Preparing and Filing Financing Statements, UCC Financing Statements Preparation and Filing Checklist](#) and [UCC Financing Statements \(04/20/11 Versions\) Preparation and Filing Checklist](#).

For Further Reading

The leading reference on the New York UCC is the New York Commercial Law (Goldbook) which includes the New York UCC with New York annotations and official uniform comments. The Goldbook is published each year.

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