

# Business Law

## Text & Exercises *6th Ed.*

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## Chapter 32: Secured Transactions

# Learning Outcomes

- LO1** • Explain how an enforceable security interest can be created and perfected.
- LO2** • Define the scope of a security interest.
- LO3** • Set out the priorities among perfected security interests.

# Learning Outcomes

**LO4**

- **List the rights and duties of the debtor and creditor in a secured transaction.**

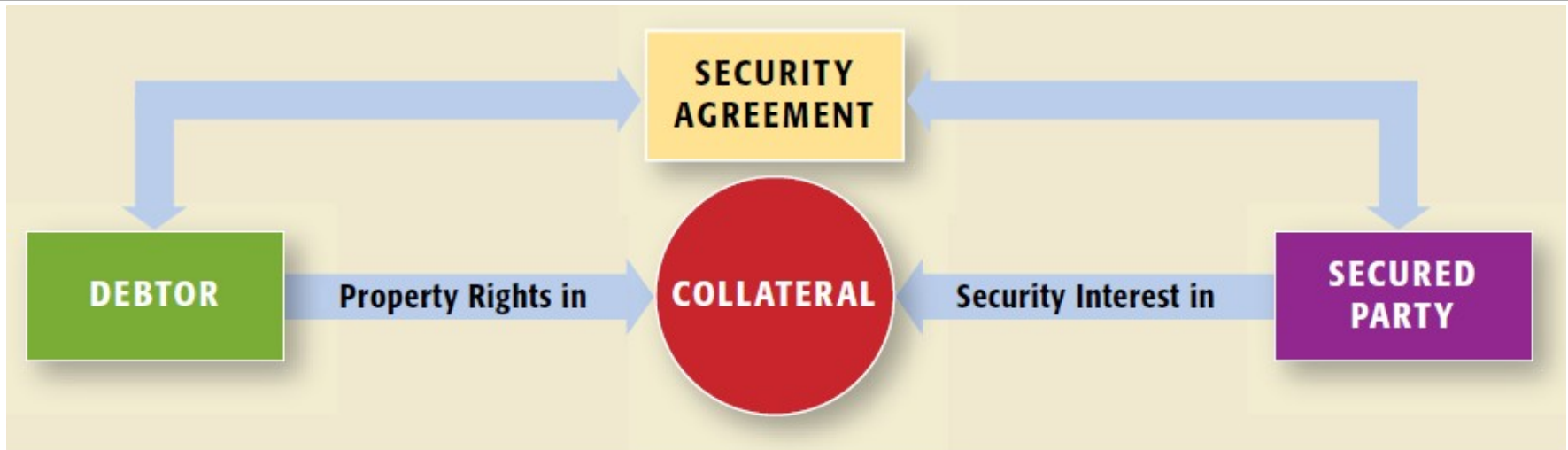
**LO5**

- **State the secured party's options on a debtor's default.**

# Terminology

1. **Security Interest**: interest in the collateral that secures the performance.
2. **Secured Party**: creditor who has a security interest in debtor's collateral.
3. **Debtor**: person who owes payment of a secured obligation.
4. **Security Agreement**: agreement that creates or provides for a security interest.
5. **Collateral**: subject of the security interest.

# Creating a Security Interest



## Creating a Security Interest.

- Collateral in Possession of Creditor, or there must be a written agreement describing the collateral signed by Debtor.
- Creditor must give something of value to Debtor.
- Debtor must have “rights” in collateral.



# Creating a Security Interest

- **A written security agreement is generally used to create a security interest. Agreement must:**
  - (1) Be signed by the debtor,
  - (2) Contain a description of the collateral, and
  - (3) Must reasonably identify the collateral.



# Creating a Security Interest

- **Once a security agreement executed, the creditor's rights ATTACH to the collateral.**
  - Creditor has an enforceable security interest against the debtor.
  - Attachment ensures that the security interest between the debtor and the secured party is effective.

# Perfecting a Security Interest

- **Perfection is the legal process by which the secured party protects herself from third party claims against the same collateral.**
- **In most situations, perfection is accomplished by filing the financing statement with the appropriate government agency.**



# Perfection: Financing Statement

- **Gives 3<sup>rd</sup> parties notice. Effective for 5 years. Continuation statement if longer.**
- **Financing statement must contain:**  
(1) legal name and signature of debtor, (2) addresses of debtor and creditor, and (3) description of collateral by type or item.
  - Improper filing reduces secured party's claim in bankruptcy to an unsecured creditor.

# The Scope of a Security Interest

- **Other than the collateral itself, a security agreement can cover various types of property already in debtor's possession:**
  - Proceeds of Sale of Collateral: whatever received when collateral sold or disposed of.
  - After-Acquired Property: provide for a security interest in property acquired after execution of security agreement.



# The Scope of a Security Interest

- **Other types of property (cont'd):**
  - Future Advances: continuing line of credit; subject to security interest.
  - Floating Liens: security interest in proceeds in after-acquired property, or collateral subject to future advances.

# Priorities Among Security Interests

- 1. Conflicting unperfected security interests:** first to attach has priority.
- 2. Perfected security interests versus unperfected interests:** a perfected security interest has priority over any unperfected interests.
- 3. Conflicting perfected security interests:** first to perfect generally has priority.

# Priorities Among Security Interests

- 4. Conflicting perfected security interests in commingled or processed goods:** goods to which two or more perfected security interests attach may be so manufactured or commingled that they lose their separate identities and become a single product or mass.

# Rights and Duties

- **Reasonable Care of Collateral.**
  - Debtor must pay creditor for reasonable charges in preserving collateral.
- **Termination Statement.**
  - When Debtor has fully paid the debt, secured party must release security interest and file a termination statement.

- **Not expressly defined by Article 9 but rather in the security agreement. Any breach can constitute default.**
- **Basic Remedies are *cumulative*:**
  - Taking Possession of the Collateral (Self-Help).
  - Retaining or Disposing of the Collateral. →

# Retaining or Disposing of the Collateral

- **Once default has occurred and secured party has collateral, she may retain or dispose of the collateral.**
  - Retention of Collateral by Secured Party: Notice Required. If objection, then Secured Party must sell property.
  - Disposition of the Collateral by Secured Party: must dispose in a commercially reasonable manner. →



# Disposition of the Collateral

- **Procedures:**
  - Public or private sale with notice (unless perishable).
  - Secured party may purchase collateral at a public (but not private) sale.
  - “Satisfactory” price is only one factor:

# Disposition of the Collateral

- **Proceeds from Distribution:**
  - 1. Reasonable expenses from preparation.
  - 2. Remaining balance of debt owed to the secured party.
  - 3. Subordinate security interests of creditors whose written demands are received prior to the completion of distribution of the proceeds.
  - 4. Any surplus to the debtor.

# Disposition of the Collateral

- **Redemption Rights:** debtor (or any other secured party) has the right of redemption before the collateral is disposed or sold.
  - Debtor must tender performance of all obligations secured by the collateral, pay all reasonable expenses by secured party, and by retaking the collateral, and maintaining its care and custody.