

SECURED TRANSACTIONS

Cases and Materials



Duquesne University School of Law
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Preface

This textbook is designed for a one-credit-hour course on Secured Transactions intended to prepare students for the bar exam. It is a shortened version of the textbook that is used in a three-credit-hour course intended to prepare students for the practice of law in this field. The textbook and materials for this course will familiarize students with the terminology and the broad outline of the law of Secured Transactions, but “a little knowledge is a dangerous thing,” and young lawyers should acquire training and experience beyond this course before attempting to practice law in this complex and difficult area of law. Consider this course to be an introduction to an area of law that is one segment, but an important segment, of any commercial transaction involving collateral.

This textbook is integrated with the resources and materials that are posted to the website for Secured Transactions on Blackboard, Duquesne’s course management system. References to recorded lectures posted to the website are highlighted in yellow; formative assessment quizzes in pink; discussion topics in blue; essay questions in green; and additional materials in gray.

Over the last 20 years the law of Secured Transactions has greatly changed. Article 9 of the Uniform Commercial Code was completely revised and renumbered in 2001 and amended again in 2011. This textbook and the attached codebook concentrate entirely on the law as it is today. Be aware, however, that if you encounter a case that originates more than 10 years ago it may be governed by previous versions of Article 9 and the law may be different than current law.

In this electronic version the textbook and the codebook are combined into a single document. The textbook contains cases, questions, and explanations of the law and the codebook contains the text of Article 9 and other laws pertinent to the use of collateral. The purpose of combining the textbook and the codebook is to facilitate hyperlinks from statutory references in the textbook to the statutes that are contained in the codebook. Students are welcome to separate the textbook and the codebook into two separate documents. That will, however, break the hyperlinks between the textbook and the codebook.

The footnotes in this textbook, including the footnotes in the cases, are consecutively numbered.

The textbook and codebook are provided to students in Word format. Students have permission to highlight, add comments, convert the books into PDF format, or make any other changes they deem useful or necessary. Students may also print these books or any portion of them at their own expense and for their own use. No commercial use, of course, is permitted.

This electronic textbook and the accompanying codebook are provided free of charge to students at Duquesne University School of Law who are enrolled in the Secured Transactions course.

I wish to acknowledge the invaluable contributions of Krista Koontz, Research Assistant. Ms. Koontz helped to gather and summarize cases for inclusion in the textbook, made many valuable suggestions regarding the format of the book, and assisted in proofreading the final product. I am grateful for her persistence and her dedication.

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Chapter 1. The Scope of Article 9

This chapter covers the “scope” of Article 9; that is, it explains what transactions are governed by Article 9 of the Uniform Commercial Code.

A. Learning Objectives

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Recognize how the history of the law of Secured Transactions reflects changes in how people do business and in the kinds of property that are available as collateral.
2. Relate the purposes of the law of Secured Transactions to the principal outline of this field of law.
3. State what a “security interest” is.
4. Identify the differences between collateral that is real property (that is **not** subject to Article 9) from collateral that is personal property or fixtures (that **are** subject to Article 9).
5. Identify other transactions (sale of accounts, agricultural liens, certain types of consignments, disguised sales, and security interests that are created in other Articles of the U.C.C.) that are governed by Article 9.
6. Identify transactions that are not governed by Article 9.

B. Lecture 1. The History of the Law of Secured Transactions

Your first recorded lecture in this course begins with harsh historical judgments against the use of collateral. The Bible repeatedly condemns the taking of collateral. For centuries in the United States slaves were posted as collateral. In our own time the use of collateral has included incidents of sexual exploitation of borrowers. The lecture then describes the many legitimate uses of collateral. As we move through this course keep in mind this tension between the value of collateral as a catalyst for economic growth and the necessity to regulate the use of collateral to prevent exploitation.

The Uniform Commercial Code was first released in 1962. Article 9 was the longest portion of the U.C.C., it was the most innovative, and it was the single most important reason for the swift adoption of the Code by all 50 state legislatures. (Louisiana did not adopt Article 2 as such but it

has enacted most of the provisions of Article 2 as separate state laws.) The reason for its success as a model statute is that Article 9 replaced the patchwork of state laws and recording systems for collateral that previously existed in the states. Article 9 has also undergone the most revision since the initial adoption of the U.C.C. Article 9 was completely revised in 1972 and then again in 2001. A number of revisions were also made in 2010. Much of the ongoing reform has been necessary because new forms of property are emerging as collateral and the law must decide whether and how Article 9 should apply to these transactions. Should businesses be able to use the following kinds of property as collateral?

a. Airline loyalty programs. The airlines need loans to stay in business. Do they have any more assets that could be used as collateral? Gillian Tan, Jennifer Surane, and Mary Schlangenstein, *U.S. Sees Airline Loyalty Assets as Possible Collateral*, (Bloomberg.com April 16, 2020), at <https://www.bloomberg.com/news/articles/2020-04-16/u-s-treasury-sees-airline-loyalty-assets-as-possible-collateral>

b. Bitcoin. Is bitcoin a potential source of collateral? Bradley Keoun, *BitGo Reveals Bitcoin Lending Push: \$150M Booked So Far* (Yahoo.com, March 5, 2020), at <https://finance.yahoo.com/news/bitgo-reveals-bitcoin-lending-push-070000414.html>

c. Electronic chattel paper. Article 9 of the U.C.C. has allowed electronic chattel paper to serve as collateral for 20 years, but Canada is just now changing its law to accept ECP as collateral. Miller Thomson LLP, *Putting the "E" in ECP: Saskatchewan's PPSA Introduces Electronic Chattel Paper* (Lexology.com, May 3 2019), at <https://www.lexology.com/library/detail.aspx?g=9d4c6f3b-04c1-4e31-9acf-3a050baa5029>

C. Lecture 2. Outline of the Law of Secured Transactions

The law of Secured Transactions is enormously complex; it is one of the most difficult areas of law to master. And yet the outline of this field of law is quite simple. There are five fundamental issues in the law of Secured Transactions. Here are those five foundational topics and some of the principal sections of the Code (as enacted in Pennsylvania) that govern each topic:

1. Scope: [Section 9-109](#) (scope)

2. Attachment: [Section 9-203](#) (attachment) and [Section 9-108](#) (sufficiency of description of collateral in security agreement)

3. Perfection: Sections [9-104 to 9-107](#), [9-314](#) (perfection by control); [9-309](#) (automatic perfection); [9-311](#) (perfection on certificates of title); [9-312](#), [9-501 to 9-518](#) (perfection by filing); [9-313](#) (perfection by possession); [9-315](#) (perfection as to proceeds)

4. Priority: [Sections 9-317 to 9-342](#)

5. Enforcement: [Sections 9-207 to 9-210; Sections 9-601 to 9-628](#)

Every rule that you study in this course belongs to one of these five categories. After watching Lecture 2 and taking the quiz be sure that you understand what is generally entailed within each of these topics of the law of Secured Transactions.

D. [Lecture 3. Description of a Secured Transaction](#)

This lecture will introduce you to what a secured transaction is as well as a number of terms you will use throughout the course including “security interest,” “secured party,” “debtor,” and “obligor.”

There are several documents that are typically used in secured transactions. There is the **authorization for filing a financing statement**; a **security agreement or conditional sales contract**; and a **financing statement**. We will study security agreements in Chapter 3 on Attachment and the authorization and the financing statements in Chapter 4 on Perfection by Filing. But it would make sense to familiarize yourself with those documents at this time. These documents are posted to the folder for Lesson 1 in the Weekly Assignments folder on Blackboard.

E. A Cautionary Tale

The law of secured transactions is so detailed and complex that mistakes inevitably occur. Here is a simple mistake that cost clients over a billion dollars.

[In re Motors Litigation – The GM Debacle](#)

To appreciate this story you must know something about the legal doctrine of **perfection of a security interest** and the notice filing system established by the law of Secured Transactions. A **perfected security interest** is superior to many other types of claims to collateral. A creditor with a perfected security interest in collateral takes priority over creditors with an unperfected security interest, lien creditors, bankruptcy trustees, and even many persons who have purchased the collateral from the debtor. Sometimes perfection of a security interest is automatic under Article 9, but in most situations to gain perfection the secured party must file a notice with the office of the Secretary of State of the state where the debtor is located. This notice, called a **financing statement**, informs the public that the secured party has a security interest in the property of the debtor. A financing statement is effective for a period of five

years. A financing statement can be renewed by filing a **continuation statement** or it can be discontinued by filing a **termination statement**. If a creditor fails to file a financing statement, fails to timely file a continuation statement, or files a termination statement then the creditor's security interest is unperfected and its claim to the collateral will be lower in priority than the claims of perfected secured parties, lien creditors, bankruptcy trustees, and most buyers of the collateral.

Can you imagine accidentally filing a termination statement on \$1.5 billion worth of collateral? That's what happened in 2008. A General Motors loan was paid off and there were two financing statements that had to be terminated in the State of Delaware. A paralegal working for the law firm of Mayer, Brown also added a third financing statement, Number 6416808 4, as having to be terminated too. The third financing statement covered all of the equipment and fixtures at 42 GM facilities. When this financing statement was terminated the security interest in that collateral became unperfected. When GM went through Chapter 11 bankruptcy in 2009 the loss to GM's secured creditors was \$1.5 billion.

The associate at the law firm overseeing the paralegal didn't catch the mistake. Neither did the partner overseeing the associate. Neither did anyone at the client, JP Morgan, or at its law firm, Simpson Thatcher, all of whom reviewed the file before the escrow agreement was drafted and reviewed it again afterwards. The Simpson Thatcher attorney even wrote that Mayer, Brown had done a "nice job" and that "it was fine."

JP Morgan tried to argue that Mayer, Brown was liable because the law firm did not have the authority to terminate the 6416808 4 financing statement. But that's incorrect. As a matter of basic agency law, if the principal gives an agent authority to complete a task, the principal has authorized the agent to engage in conduct that the agent reasonably believes to be in furtherance of the interests of the principal in the performance of that task. Mayer, Brown made a mistake but they did not exceed their authority. Ultimately JP Morgan was liable for the error. In 2019 JP Morgan settled with all of GM's secured creditors by paying them \$231 million. For a detailed description of the background of what happened see Bruce A. Markell, *Oops: Official Committee of Unsecured Creditors of Motors Liquidation Co. v. JP Morgan Chase Bank, N.A.*, 35 No. 2 Bankruptcy Law Letter 1 (2015). For the end of the story see Tom Hals, *Long Fight Over Error in JPMorgan Loan to GM Settles for \$231 Million* (USNews.com, May 13 2019), at <https://money.usnews.com/investing/news/articles/2019-05-13/long-fight-over-error-in-jpmorgan-loan-to-gm-settles-for-231-million>

Practice pointer. In this field every filing must be double-checked for accuracy and completeness against a checklist. In addition you must establish a calendar to track all existing and future filings.

F. Lecture 4: The Scope of Article 9

The scope of Article 9 is essentially established by two provisions of the Uniform Commercial Code: [Section 1-201\(b\)\(35\)](#), which defines the term "security interest," and [Section 9-109\(a\)](#), defining the "general scope" of Article 9. These two sections of the Code are intertwined. Note particularly all of the different interests in property that are characterized as "security interests" in Section 1-201, and all of the different transactions that are characterized as "secured transactions" in Section 9-109. Not only does Article 9 apply to contracts that use personal property or fixtures as collateral; Article 9 also applies to the sale of accounts, chattel paper, payment intangibles, and promissory notes; agricultural liens; certain types of consignments; and to certain specific security interests that arise under Article 2, Article 4, and Article 5 of the U.C.C. Here are Sections 1-201(b)(35) and 9-109(a) as enacted in Pennsylvania:

§ 1201(b)(35). "Security interest"

"Security interest." An interest in personal property or fixtures which secures payment or performance of an obligation.

- (i) The term includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Division 9 (relating to secured transactions).
- (ii) The term does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under section 2401 (relating to passing of title; reservation for security; limited application of section), but a buyer may also acquire a "security interest" by complying with Division 9 (relating to secured transactions).
- (iii) Except as otherwise provided in section 2505 (relating to shipment by seller under reservation), the right of a seller or lessor of goods under Division 2 (relating to sales) or Division 2A (relating to leases) to retain or acquire possession of the goods is not a "security interest"; but a seller or lessor may also acquire a "security interest" by complying with Division 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under section 2401 is limited in effect to a reservation of a "security interest."
- (iv) Whether a transaction in the form of a lease creates a "security interest" is determined pursuant to section 1203 (relating to lease distinguished from security interest).

§ 9109. Scope.

(a) General scope of division. Except as otherwise provided in subsections (c) and (d), this division applies to:

- (1) a transaction, regardless of its form, which creates a security interest in personal property or fixtures by contract;
- (2) an agricultural lien;
- (3) a sale of accounts, chattel paper, payment intangibles or promissory notes;
- (4) a consignment;
- (5) a security interest arising under section 2401 (relating to passing of title; reservation for security; limited application of section), 2505 (relating to shipment by seller under reservation), 2711(c) (relating to security interest of buyer in rejected goods) or 2A508(e) (relating to security interest in goods in lessee's possession), as provided in section 9110 (relating to security interests arising under Division 2 or 2A); and
- (6) a security interest arising under section 4210 (relating to security interest of collecting bank in items, accompanying documents and proceeds) or 5118 (relating to security interest of issuer or nominated person).

The next six subsections of this chapter (G through L) describe the various types of transactions that are governed by Article 9. Subsection M briefly describes several exclusions from Article 9.

G. Article 9 Applies to Security Interests in Collateral Consisting of Personal Property and Fixtures; Not Real Property

1. Distinguishing Personal Property from Real Property

Article 9 applies to security interests in **personal property**. A contract that creates a security interest in personal property is called a **security agreement**. In contrast, when **real property** is used as collateral the document that is created is called a **mortgage** and the law of real property controls, not Article 9. The following case illustrates this basic point.

Branch Banking and Trust Company v. Hill, 582 S.W.3d 221 (Tennessee Court of Appeals 2019)

In this case the bank had foreclosed on the borrower's land and cabins, and the borrower sued on the ground that the foreclosure had not been conducted in a commercially reasonable manner under Article 9 of the Uniform Commercial Code. ([Section 9-610\(b\)](#)) of the Code requires "every aspect" of a creditor's disposition of collateral to be "commercially

reasonable.”) When a bank forecloses on land and cabins is the foreclosure covered by Article 9 or the law of real property? In this case the court ruled that the law of real property applies. Land with cabins on it is real property. Buildings are real property. A mortgage on land or buildings is not governed by Article 9.

By extension we might expect that an apartment would also be real property, and so it is, most of the time. But what about a cooperative apartment? Is the right to live in a co-op apartment real property or personal property? If a person uses their co-op as collateral for a loan is the transaction governed by Article 9 or the law of real property?

Rapillo v. Citimortgage, Inc., 95 U.C.C. Rep. Serv.2d 267 (E.D.N.Y. 2019)

The court described the transaction in this case:

On April 1, 2008, plaintiff borrowed \$35,000 from defendant CMI and executed a Co-op Fixed Rate Note (the “Note”) evidencing the debt. On the same date, plaintiff and his now-deceased mother, Teresa Rapillo (“Ms. Rapillo”), executed a security agreement pursuant to which they pledged as collateral for the debt their 290 shares of cooperative stock (the “Shares”) in the Linwood Village, and a proprietary lease (the “Lease”) on the property commonly known as 89-35 115th Avenue, Unit 1F, Howard Beach, New York, 11414 (the “Unit”). Defendant CMI recorded its interest in the Shares and Lease by filing a UCC-1 financing statement and cooperative addendum (the “UCC-1”) with the Office of the City Register of the City of New York on February 19, 2008.

Rapillo defaulted on the loan, and CMI evicted Rapillo and sold the apartment to someone else. The court observed that under the law of New York State the shares and lease for a cooperative apartment are **personal property**. The court ruled that the transaction between CMI and Rapillo was governed by **Article 9** and upheld CMI’s right to seize the apartment as a secured creditor under Article 9.

Practice Pointer.

Laws regarding what constitutes “real property” or “personal property” vary from state to state. In New York condominium agreements are personal property. In serving your clients be sure to research the law of the state that applies to the transaction.

2. Fixtures

Fixtures are a hybrid of real property and personal property. Fixtures start off as goods; they are then affixed firmly to real property; but they are capable of returning to their status as goods if they can be severed from the real property without causing material harm to the land or buildings. Because fixtures can be severed and sold separately from real property the law of

secured transactions governs fixtures as personal property. In a commercial setting fixtures are usually classified as “equipment;” in the home fixtures are usually “consumer goods.” The following problem illustrates the special character of fixtures as a hybrid of real and personal property.

Problem 1: The Accessorized Cabin

The Quigleys owned a nicely-appointed seashore cabin. Are the following items goods, fixtures, or part of the real property?

1. The cabin’s cement foundation;
2. A television antenna bolted to the roof;
3. A 400-pound couch in the living room;
4. The water pipes under the cabin, inside the walls, and in the bathroom and kitchen;
5. The sink in the kitchen, resting in the countertop and connected to the drainpipe;
6. An under-the-counter dishwasher connected to the countertop by two small screws and connected to the sink by a hose.

Keep in mind the importance of these distinctions. Under Article 9 a creditor can take a security interest in goods and fixtures. However Article 9 does not apply to real property.

Because of their quasi-personal property and quasi-real property status there are a number of special rules regarding perfection and priority that apply when fixtures are used as collateral. For example there is a special kind of financing statement for fixtures that is filed locally and is called a “fixture filing.” We shall study the special filing rules pertaining to fixtures in Chapter 4 ([Chapter 4 Part C.9](#)) and the special priority rules for fixtures in Chapter 6 ([Chapter 6, Part E](#)).

H. Article 9 Applies to the Sale of Accounts, Chattel Paper, Payment Intangibles, and Promissory Notes

That heading bears repeating. Article 9 applies not only to the use of accounts and other rights to payment as collateral to secure a loan. Article 9 also applies to the **sale** of accounts, chattel paper, payment intangibles, and promissory notes.

What is the difference between a **sale** of accounts, chattel paper, payment intangibles, and promissory notes and a **loan with a security interest** in these forms of property? It depends upon which party, the seller or the buyer, assumes the **risk** that the account debtors will not pay what is owed. If the owner of an account assigns the account to another party (the assignee) and yet the owner is obligated to make up any shortfall to the assignee if the account

debtor does not pay in full then that is not a sale of the account but merely a loan accompanied by the granting of a security interest. If, on the other hand, once the account or chattel paper or payment intangible or promissory note is assigned the assignee assumes all the risk that the account debtor will not pay the amount owed then the transaction was a sale and the assignee has become the owner of the account, chattel paper, payment intangible, or promissory note.

Problem 2: The Department Store's Accounts

On July 1 2019 Branberry Department Store entered into an agreement with Downstream Finance Company assigning all of its accounts receivable to Downstream. The face amount of the accounts was \$120,000 and Downstream paid Branberry \$110,000 for the assignment of the accounts. Downstream began collecting the amounts due from Branberry's customers, the "account debtors." However, under the agreement between Branberry and Downstream if the account debtors did not pay the accounts in full then on December 31, 2020 Branberry would have to pay Downstream the difference between how much their customers had paid on the accounts and the face amount of \$120,000. By December 1, 2020 the account debtors had paid \$90,000 to Downstream Finance; Branberry then paid Downstream the remaining \$30,000. Did Downstream **buy** the accounts from Branberry or did Downstream merely obtain a **security interest** in the accounts?

Why does Article 9 apply to both **sales** and **security interests** of accounts? The answer is straightforward. Article 9 applies so that the buyers of accounts will have to give public notice of their interest in the property by filing a financing statement.

Accounts, chattel paper, payment intangibles, and promissory notes belonging to a debtor all represent a right to payment to the debtor. It is money that is owed to the debtor. The person who owes the money to the debtor is referred to as an "account debtor."

We shall study the differences between these different categories of collateral in Chapter 2 and how to perfect a security interest in each type of collateral in Chapters 4 and 5. In general, here are the differences between them:

1. An "account" is money that is owed for goods or services.
2. "Chattel paper" is a document or documents that contain both an obligation to pay money and a security agreement in certain collateral.
3. A "promissory note" is a signed written promise to pay a sum certain of money that does not contain any other promises or obligations. A contract is not a promissory note because it creates rights and duties other than a promise to pay a sum certain.

4. A “payment intangible” is money that is owed to pay off a loan or any other debt that is not an account or represented by chattel paper or an instrument.

I. Article 9 Applies to Agricultural Liens

Agricultural liens are tricky. These are automatic liens that arise under state statutes in favor of agricultural workers or persons who repair farm machinery or persons who lease farmland to farmers but who have not been paid. Many states such as Pennsylvania do not have agricultural lien statutes as such, while other states not only expressly recognize agricultural liens, they have created a separate filing system for those liens.

Agricultural liens **are** governed by Article 9, so it is necessary to file both a financing statement and a notice with the state’s separate filing system for agricultural liens, if there is one. Be aware that different states have different filing systems for agricultural liens. In Chapter 5 ([Chapter 5 Part G](#)) we shall study some of the rules governing perfection and priority of agricultural liens.

J. Article 9 Applies to Certain Kinds of Consignments But Not Others

A “consignment” is usually understood to mean a delivery of goods to another party (the consignee) for sale. The consignee has no duty to purchase the goods; the consignee’s only duty is to hold the goods for sale to others. The “consignor” reserves title to the goods and has the right to retrieve the goods from the consignee if the goods are not sold.

As Lecture 4 indicates, a problem arises when the consignee goes bankrupt or a creditor of the consignee attempts to seize consigned goods to pay a debt that the consignee owes to the creditor. In that situation who takes priority? Whose claim to the goods is superior; the claim of the consignor or the claim of a creditor of the consignee?

If it is generally known that a debtor is in the business of selling goods on consignment then a creditor should not expect to have a valid claim to those goods, and the consignor should not have to file a financing statement to inform those creditors of their ownership of the goods. Only consignments to businesses that are **not** generally known to be in business of selling the goods of others should be governed by Article 9. If a consignment of goods is **subject** to Article 9 then a consignor **must file a financing statement** in order to take priority over other creditors or a bankruptcy trustee. If a consignment of goods is **not subject** to Article 9 then under the common law of property **the consignor prevails** over the creditors of the consignee because the consignor has “title” to the goods, which is the determinative factor under the common law.

The U.C.C. distinguishes “true consignments” that are not subject to Article 9 from consignments that are subject to Article 9 in [Section 9-102](#). A consignment is subject to Article 9 and the consignor must file a financing statement if:

- The goods are delivered to a merchant for purposes of sale;
- The merchant is not generally known to be substantially engaged in selling the goods of others;
- The aggregate value of each delivery is \$1,000 or more; and
- The goods were not consumer goods in the hands of the consignor.

K. Article 9 Applies to Disguised Sales; Not to True Leases

Consignors contend that they are the “true owners” of goods that are being sold on consignment and that therefore they have title to those goods free of the claims of the creditors of the consignees. We saw in the previous section how Article 9 makes certain consignments subject to Article 9 – consignments where the consignee is not generally known to be substantially engaged in selling the goods of others – and as a result the consignor must file a financing statement covering the goods in order to take priority over the claims of the other creditors of the consignee. Some consignments are governed by Article 9 and others are not.

There is a very similar rule with respect to leases. Some leases are governed by Article 9 and others are not. Just as it was important to distinguish situations where a consignor retains title to goods free of the claims of the creditors of the consignee, so it is important to distinguish situations where the lessor of personal property retains title to goods free of the claims of the creditors of the lessee.

If a transaction is a “true lease” then the transaction is not subject to Article 9. If the lessee owes money to creditors those creditors may not seize property that belongs to the lessor. But what if the “lease” transaction was actually a “sale?” What if the “lessee” is actually a buyer who acquired title to the goods? In that case the consequence is the same for the “lessor” as it is for a “consignor” whose consignment is governed by Article 9. The “lessor” would actually be a credit seller and the lessee would have actually purchased the goods, not leased them. Under [Section 2-401](#) the retention of title by the lessor/seller would be no more than the retention of a security interest. To protect itself from the claims of the creditors of the buyer the seller would have to comply with Article 9 by filing a financing statement with the office of the Secretary of State. If the seller fails to file a financing statement then the creditors of the lessee or a bankruptcy trustee can seize the goods and take priority over the supposed “lessor.”

There are two standards for determining whether a transaction is a true lease or a disguised sale: the **bright line test** and the **facts and circumstances test**. Both tests originate in [Section 1-203](#) of the Code. If the transaction meets one of the “bright line” rules in [Section 1-203\(b\)](#) then it is a sale with retention of a security interest and not a lease. If, however, the transaction does not cross one of these “bright lines” then courts must weigh all of the facts and circumstances to determine whether the transaction is a true lease or a disguised sale.

Both the bright line test and the facts and circumstances test originate in [Section 1-203](#). The bright line test consists of the provisions of [Section 1-203\(b\)](#). If a transaction satisfies any one of the subparagraphs of [Section 1-203\(b\)](#) then the transaction is a sale and not a lease. The facts and circumstances test is a balancing test that considers many different factors. The courts disagree about what factors to consider and how important each factor is in determining whether a transaction was a lease or a sale. As a result this is one of the most-litigated and least-consistent doctrines in the law of Secured Transactions.

The basic distinction between a “true lease” and a “disguised sale” is **whether the lessor retains a significant reversionary interest in the goods**; that is, whether the lessor is likely or entitled to obtain something of value when the lease ends. If not – if when the agreement is entered into it is not likely that the lessor will have a significant interest in the goods when the lease ends – then the transaction is a “disguised sale” because the lessee will have used up or retained all of the significant value of the goods.

Here are the “bright line” tests for a disguised sale as set forth in [Section 1-203\(b\)](#):

- (1) the original term of the lease is equal to or greater than the remaining economic life of the goods;
- (2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;
- (3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or
- (4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

Note that these tests are separated by the word “or.” If any one of these factors is present then the transaction is a disguised sale and not a true lease.

There are also a few “bright line” tests for a true lease. If the lessee can cancel the lease before the end of the lease term then the transaction is a true lease. If the significant economic life of the goods is longer than the lease term and the agreement does **not** give the lessee to purchase the goods then it is a true lease. If the significant economic life of the goods is longer than the lease term and the agreement gives the lessee the option to purchase the goods at their expected fair market value then it is a true lease.

If the agreement is a true lease then the transaction is not governed by Article 9. Under the common law the lessor has “title” and the lessor does not have to file a financing statement to protect its reversionary interest in the goods. However, if the agreement is a disguised sale

then the transaction is governed by Article 9 and the lessor must file a financing statement to protect its interest in the goods against the creditors of the lessee.

Practice pointer.

Practice pointer. There are many different risks that can arise if your client is dealing with a company that is financially unstable besides the risk that the other company may be unable to pay its bills. For example, if your client leases or consigns goods to another company, the other company's creditors may claim that those goods actually belong to the other company and the creditors may attempt to seize those goods. You can protect your client by filing a financing statement covering the leased or consigned.

Here are two cases and a problem regarding whether the transaction was a true lease or a disguised sale.

Excel Auto and Truck Leasing, L.L.P. v. Alief Independent School District, 249 S.W.3d 46 (Texas Ct. App. 2007)

Excel leased automobiles to customers and retained title to the vehicles. However Excel did not pay taxes on the vehicles, claiming that the "leases" were actually "sales" and that the taxes should be paid by their customers. The contracts between Excel and its customers contain the following provision:

23. LEASE TERMINATION: This Lease will end ("terminate") when one of the following events occurs, whichever happens first: *(a) You choose to end this Lease early and return the Vehicle to us; ...*

Is this transaction a "true lease" or a "disguised sale?"

In re Purdy, 763 F.3d 513 (6th Cir. 2014)

Lee H. Purdy was a dairy farmer in Kentucky. Citizens First Bank had a perfected security interest in Purdy's existing and after-acquired equipment, farm products, and livestock. In 2009 Purdy leased a herd of 485 dairy cows from Sunshine Heifers, LLC, for a period of 50 months. The lessee had no right to terminate the lease before the expiration of the 50-month term. Under the lease Purdy had the obligation to replace thirty percent of the cows every year and replace them with younger, more productive cows. Purdy did this until going out of business in 2012. Is the transaction between Purdy and Sunshine a **lease** or a **sale**? [Ed. – Hint – Is the subject of the transaction a number of individual cows or a single herd of cows?]

See In re Purdy, 763 F.3d 513 (6th Cir. 2014) (the herd was the subject of the lease), *reversing* 490 B.R. 530 (Bankr. Ct. W.D. Ky. 2013) (the individual cows were the subject of the lease).

Problem 3. A Contract for Two Trucks

Victor Rodriguez leased two trucks from Capacity Solutions, LLC, for a period of 30 months. At the end of the lease term Rodriguez would have had the option to purchase the trucks for \$6,600. At the time that the contract was entered into the projected fair market value of the trucks was \$12,000 to \$13,000. The last sentence of the lease document states, “Please contact us if you have any questions regarding these docs, since the deal cannot be funded if any of the above is missing.” One of the “docs” was a “copy of title.” The notation on the check that Rodriguez wrote at the commencement of the lease states, “Down payment on trucks.” Is the transaction between Capacity and Rodriguez a **lease** or a **sale**? *See In re Rodriguez*, 2013 WL 1385665 (Bankr. Ct. S.D. Texas 2013).

L. Security Interests Created by Other Articles of the Uniform Commercial Code

Section 9-109(a) notes that provisions in other Articles of the Uniform Commercial Code create security interests in certain situations. The following problems illustrate two of those situations.

Problem 4. An Article 2 Security Interest: The Beach Umbrellas

The Oceanside Hotel purchased 100 beach umbrellas and stands to hold the umbrellas upright from Shadyside Industries. The hotel paid \$200 for each umbrella and stand, a total of \$20,000. One month after delivery the umbrellas began to become moldy; the material used to make the umbrellas was unsuitable for use in the salty air near the ocean but would be perfectly fine at a more inland location. The hotel demanded its money back; Shadyside responded, “We will be happy to refund the purchase price within 90 days after we receive the umbrellas back.” Is the hotel entitled to retain the umbrellas as security for return of the purchase price? See Section 2-711(3) [[PA 2711\(c\)](#)] of the U.C.C.

Practice Pointer. If your client orders goods but rightfully rejects the goods your client has the right to hold on to the goods until the seller agrees to refund any portion of the purchase price that has been paid and to reimburse the buyer for any incidental expenses that the buyer incurred, such as expenses for storing or reshipping the goods. However, this automatic security interest does **not** extend to consequential or expectancy damages that the buyer may have suffered. The buyer does **not** have the right to retain the goods as leverage to recover

damages based upon the difference between the contract price and the cost of cover or for damages based upon personal injury, damage to property, or lost profits.

Problem 5. An Article 4 Security Interest: The Royalty Check

Blair, an author of mysteries, received a royalty check from Alpine Publishing in the amount of \$16,000. Blair deposited the check to Blair's account at Intercity Bank. A day later Intercity allowed Blair to draw upon the check; Blair withdrew all of the funds in Blair's account. The next day Alpine Publishing stopped payment on the check and the check was returned unpaid to Intercity Bank. Intercity Bank desires to recover the \$16,000 that Blair withdrew from the bank, but Blair is penniless. Can Intercity Bank enforce the check against Alpine Publishing? See Section 4-210(a)(1) of the U.C.C., which provides:

§ 4-210. Security Interest of Collecting Bank in Items, Accompanying Documents, and Proceeds.

(a) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either:

(1) in case of a item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied

....

M. Exclusions from Article 9

Section 9-109(d) provides that Article 9 "does not apply to the extent that ... a statute, regulation, or treaty of the United States preempts" Article 9. There are several federal laws governing the recording of title or security interests in different kinds of collateral. Ship mortgages are recorded with the Coast Guard, and airplane liens are recorded with the Federal Aviation Administration. Security interests in registered copyrights can only be perfected by recording the lien with the federal Copyright Office. Unregistered copyrights and trademarks can only be perfected by filing a financing statement in accordance with Article 9. The law governing perfection of security interests in patents is unsettled, and the wisest course of action is to file with both the federal Patent Office **and** with the office of the state Secretary of State.

Section 9-109(d) makes Article 9 inapplicable to several types of transactions. The numbering of the subparagraphs below are the same as in Section 9-109(d), and where the language below is in quotation marks it is the wording of the Code. The exclusions from Article 9 include the following:

1. A landlord's lien.

Landlord liens in the property of a tenant are currently disfavored under the common law and statutory law of many states. Article 9 makes no provision for recognizing or validating landlord's liens. The validity and effect of a landlord lien is dependent upon other state laws.

2. A lien given by law for services or materials.

If a person makes repairs or improvements to real property in Pennsylvania and is not paid for their work they are entitled to file a mechanic's lien on the property. If a person makes repairs or improvements to personal property (for example, by working on a car) they are entitled to retain possession of the property until they are paid. The **creation and effectiveness** of mechanic's liens and artisan's liens are not governed by Article 9. However, **priority disputes** between secured parties and parties with an artisan's lien in fixtures are governed by Article 9. This type of priority dispute is covered in Chapter 7.

3. A wage assignment.

Like landlord's liens, wage assignments have fallen into disfavor and are strictly limited by other laws. They are not governed by Article 9.

4. "A sale of accounts, chattel paper, payment intangibles or promissory notes as part of a sale of the business out of which they arose."

Problem 6. Sale of Accounts as Part of Sale of the Business

Jones sold their hardware store to Smith, including all of the accounts receivable. Is this transaction governed by Article 9? Does Smith have to file a financing statement covering the sale of the accounts?

5. "An assignment of accounts, chattel paper, payment intangibles or promissory notes which is for the purpose of collection only."

Problem 7. Assignment of Accounts for Collection Only

Example: Braintree Lending was owed \$4 million by JetSki Incorporated on a past-due loan. Braintree hired Commercial Collection Company to collect the debt; to make it easier for CCC to collect the debt Braintree assigned the account to CCC. Is this transaction governed by Article 9? Does CCC have to file a financing statement covering the assignment of the account?

6. "An assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract."

Problem 8. Assignment of Right to Payment Under Contract Coupled with Assignment of Duty to Perform Under Contract

Braveheart Construction entered into a contract with Roscoe Developers to construct a strip mall in suburban Atlanta. Under the contract Roscoe is obligated to pay Braveheart \$35 million. With Roscoe's assent Braveheart has assigned the contract to Star Builders, another construction company. Star is now obligated to build the mall and when the job is finished Star will also be entitled to payment from Roscoe. Is this transaction governed by Article 9? Does Star have to file a financing statement covering the assignment of the right to payment under the contract?

7. "An assignment of a single account, payment intangible or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness."

Problem 9. Assignment of a Single Account in Partial Satisfaction of a Pre-Existing Indebtedness

Salem Country Kitchens owed Locke Bank \$20,000. In partial payment of the debt the restaurant chain assigned to the bank the right to collect \$13,000 that it was owed under a contract with Jo Ernst for catering Jo's wedding. Is this transaction governed by Article 9? Does Locke Bank have to file a financing statement?

8. "A transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment."

Problem 10. Assignments of Insurance Claims

a. Dr. Deerhart's aged cousin Pitt passed away. Pitt had named Dr. Deerhart as the beneficiary of Pitt's life insurance policy with Mount Rainier Life Insurance Co. in the amount of \$10,000. Dr. Deerhart assigned their right to collect under the life insurance policy to Hunter, another needy relative of cousin Pitt. Does Article 9 apply to this transaction? Does Hunter have to file a financing statement?

b. On the other hand, the Mount Rainier Health Insurance Company owed Dr. Deerhart \$78,000 for surgery that Dr. Deerhart performed on a particular patient. Dr. Deerhart assigned their right to collect under this health insurance

policy to St. Louis Finance Company in return for \$70,000. Does Article 9 apply to this transaction? Does the finance company have to file a financing statement?

9. "An assignment of a right represented by a judgment, other than a judgment taken on a right to payment which was collateral."

In a case that does not involve collateral, if a litigant wins a judgment and then assigns their right of recovery to another person, Article 9 does not apply. The assignee of a right to payment under a judgment does not have to file a financing statement.

However, if the parties settle the claim then the right to payment is transformed from a right to enforce a judgment into a payment intangible. The assignment of a payment intangible may be subject to Article 9, and if so then the assignee would have to file a financing statement.

- ...
12. "An assignment of a claim arising in tort, other than a commercial tort claim. Sections 9315 and 9322 apply with respect to proceeds and priorities in proceeds."

Problem 11. Security Interests in Tort Claims

Lane Worthington, the owner of an accounting firm, suffered two torts in one week. Lane was injured in an auto accident due to the fault of Parker, and a rival firm, Young and Associates, managed to steal Lane's client list and called several important clients and told lies about Lane's character for honesty. Lane wishes to borrow money and use these two separate claims against Parker and Young and Associates as collateral. Does Article 9 apply to the assignment of either of these claims?

13. "An assignment of a deposit account in a consumer transaction. Sections 9315 and 9322 apply with respect to proceeds and priorities in proceeds."

This exclusion is similar to the exclusions for "landlord liens" and "wage assignments." If a consumer purchases consumer goods on credit then for policy reasons Article 9 does not allow the seller or lender to take a security interest in the consumer's personal bank account. The common law or other statutes might allow this, but in a consumer transaction a creditor hoping to enforce a security interest in the consumer's deposit account would be on shaky legal ground. If a person borrows money to start a business, however, and wishes to use their personal bank account as collateral, this would be a commercial transaction. Article 9 would apply and their personal bank account **could** be used as collateral.

....

End of Chapter 1

Chapter 2. Categorization of Collateral and Description of Collateral

This chapter addresses two critical aspects of the law of Secured Transactions: the categorization of the different types of collateral and how collateral must be described in a security agreement and a financing statement.

In addition several of the recorded lectures and online quizzes that are assigned for Lessons 2 and 3 describe the history and interpretation of the Uniform Commercial Code.

A. Learning Objectives

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Identify the history, purposes, structure, and principal methods of interpreting the Uniform Commercial Code.
2. Categorize and define the different types of personal property that can serve as collateral under Article 9.
3. Identify a security agreement and a financing statement and state the difference between them.
4. Recognize whether a description of collateral in a security agreement or a financing statement is valid under Article 9.

B. Lecture 5, Lecture 6, Lecture 7, Lecture 9, Lecture 10, and Lecture 11. The Uniform Commercial Code

The Uniform Commercial Code is a magnificent achievement of the legal profession of the United States of America. It is a model legal code that has, as [Section 1-103](#) proposes, “simplified, clarified, and modernized” the law of commercial transactions. Because of its adoption in all 50 states it has “made uniform the law” throughout our country. The CISG, the treaty that governs the international sale of goods, is in large part modeled after the Uniform Commercial Code. These six lectures and quizzes explain the history of the Code, its purposes, its relation to the common law, the most common interpretive techniques, how to brief cases arising under the Code, and the significance of Article 1 of the Code.

Article 9 is arguably the most successful component of the Uniform Commercial Code. The rules of Article 9 replaced a myriad of competing and confusing doctrines and filing systems. Before Article 9 there were chattel mortgages, trust receipts, factors' liens, and other security systems, all of which had different filing systems. The definitions, requirements and rules for all of these systems were different from each other and those rules differed from state to state. Article 9 has made great strides to "simplify, clarify, modernize, and make uniform" the law of Secured Transactions.

There is another purpose of the Uniform Commercial Code, however, that is in tension with the desire to "simplify, clarify, and make uniform" the law. [Section 1-103](#) states that another purpose of the Code is "to permit the continued expansion of the commercial practices through custom, usage, and agreement of the parties." We have already seen how Article 9 is constantly under revision to adapt the Code to allow the use of new types of property. This has led to the creation of more than two dozen categories of collateral, each of which is treated differently under the Code. Let us now turn to an analysis of the different categories of collateral.

C. [Lecture 8. The Categorization of Collateral](#)

Article 9 governs security interests in personal property and fixtures. The most common understanding of "personal property" are things that we all own – material objects such as books, tables and chairs, a television or a computer. Tangible things like these are categorized as "goods" under the Uniform Commercial Code. There are four categories of "goods:" inventory, equipment, consumer goods, and farm products. Fixtures are goods, too, and would normally be either equipment or consumer goods.

But goods are only the visible tip of the iceberg that is personal property. Bank accounts are personal property. Financial investments are personal property. Legal rights under a contract are personal property. Documents representing rights to payment (like promissory notes) or documents representing a right to goods (like documents of title) are personal property. Under Article 9 there is even a catch-all category ("equipment") for tangible objects that do not fall into any of the specific categories of goods and a similar catch-all category ("general intangibles") for intangible personal property that does not belong to any of the other specific categories of intangible property.

In analyzing any problem under the law of Secured Transactions it is vital to determine the category of the collateral. To create a security interest it is necessary to "reasonably identify" the collateral in the security agreement. A common and reliable way of doing this is to identify the category of the personal property that is serving as collateral. In contrast when a security interest is perfected it is not necessary to "reasonably identify" the collateral; instead it is sufficient to "indicate" what the collateral is. However as a practical matter a common and reliable way of "indicating" the collateral in a financing statement is by stating the category of the collateral that is subject to the security agreement.

The category of collateral is often determinative as to how the security interest may be perfected. Security interests in some types of collateral are automatically perfected as soon as the security interest attaches. A security interest in certain other types of collateral can only be perfected by filing a financing statement. With yet other types of collateral a security interest can only be perfected by taking possession or control of the collateral. The priority rules also vary with respect to different types of collateral.

It is not always obvious what category a particular item of collateral belongs to. There are some blurred lines and gray areas in this area of the law. Let us consider a few cases where it was difficult to tell which category of collateral a particular piece of personal property belonged to. In each case be sure to identify **why** the category of collateral matters – how the different categories of collateral would be treated differently in the context of each case.

In the first set of cases below we shall study how the category of collateral had a determinative effect on the parties' legal rights irrespective of how they were described in the security agreement or financing statement. In the second set of cases we shall study whether the description of the collateral in the security agreement "reasonably identifies" the collateral. In the third set of cases we shall study whether the financing statement sufficiently "indicated" the collateral.

1. Legal Consequences of the Categorization of Collateral Outside of a Security Agreement or Financing Statement

Is the property that was purchased in the next case an "account" or a "payment intangible?" Why does this make a difference in this case?

Matter of Cornerstone Tower Service, Inc., 97 U.C.C. Rep. Serv.2d 813 (Bankr. Ct. D. Neb. 2019)

The debtor, Cornerstone Tower Service, Inc., was in the business of erecting and maintaining cell phone towers. On March 18, 2016, Cornerstone sold EBF the right to 15% of the future payments that Cornerstone would receive from its customers. Under the agreement EBF paid Cornerstone \$75,000 for those rights, and EBF was entitled to receive monthly payments up to a maximum of \$105,000. Cornerstone declared bankruptcy on May 19. During that period all of which was within the 90-day period before Cornerstone's bankruptcy Cornerstone paid EBF \$27,125 that it had collected from its customers. EBF did not file a financing statement until May 19, 2016, six days after Cornerstone filed for bankruptcy. The court explains why the distinction between an "account" and a "payment intangible" is important:

The distinction is important because a security interest in accounts needs to be perfected by filing, while a security interest in payment intangibles is automatically perfected upon attachment.

Were the payments that EBF was entitled to collect from Cornerstone “accounts” in Cornerstone’s hands or were they “payment intangibles?” See the definitions contained in Section 9-102 of an “[account](#),” a “[general intangible](#),” and a “[payment intangible](#).”

Practice pointer.

If you were not sure whether the property your client purchased was an account (which requires filing a financing statement) or a payment intangible (which is automatically perfected without a financing statement), what practical step you would take to protect your client’s interests?

Estate of Grimmett v. Encompass Indemnity Co. 94 U.C.C. Rep Serv 2d 258 (E.D. Michigan, November 21, 2017)

This case is of significance to physicians, hospitals, and other health care providers. A Michigan statute states that health care providers do not have the right to bring a direct cause of action against insurers. But may health care providers sue an insurer if the policyholder assigns their right to payment to the provider? Article 9 provides the answer.

Toma Grimmett was injured in an auto accident and incurred extensive medical expenses. As is customary she assigned her right any insurance proceeds for health care expenses to her medical providers. One of the insurers was Encompass Indemnity Co., who issued Grimmett an automobile insurance policy with a “Person Injury Protection” clause, which provided:

We will pay personal injury protection benefits to or for a covered person who sustains bodily injury. ... [P]ersonal injury protection benefits consist of the following: 1. Medical expenses. Reasonable and necessary medical expenses incurred for a covered person’s:
a. Care; b. Recovery; or c. Rehabilitation.

When the health care providers were not paid they sued Encompass. However, the Encompass policy also explicitly prohibited the policyholder from assigning the benefits that it was entitled to under the policy.

Normally an assignment of a claim under an insurance policy is excluded from Article 9. See [Section 9-109\(d\)\(8\)](#). However, the assignment of a “health-care-insurance receivable” **is** subject to Article 9. *Id.* Section 9-102 of the Code defines the term “[health-care-insurance receivable](#).” Another provision of the Code prohibits “anti-assignment” clauses in promissory notes and agreements that are subject to Article 9. [Section 9-408\(a\)](#).

Accordingly the court held that the health care providers who served Grimmett were entitled to assert their claims to payment against Encompass under the assignment of rights from their patient.

Practice pointer.

If you represent a health care provider who treats a patient who was injured in an auto accident make sure to have the patient assign not only their right to health insurance payments but also any other types of insurance (such as auto insurance) that pays for medical expenses. Any “anti-assignment” clause in those policies is invalid.

D. The Description of Collateral in the Security Agreement and the Financing Statement

A security agreement is a contract between the secured party and the debtor. It can be in any form. A sample security agreement is included in the Weekly Assignment folder for Lesson 2. As mentioned above, the collateral must be described in both the security agreement and in the financing statement. The security agreement must be more specific in its description of the collateral; a financing statement may be more general. Under [Section 9-108](#) a security agreement must “reasonably identify” the collateral because a security agreement is a contract that creates the security interest. **A mistake in identifying the collateral in a security agreement means that the security interest was never created.**

A financing statement, in contrast, is a standard government form (the UCC1) that is filed to serve as a public notice that the secured party has a security interest in the property of the debtor. This form is also included in the Weekly Assignment folder for Lesson 2. Under [Section 9-502](#) a financing statement does not have to “identify” but merely “indicate” the property that is the subject to the security interest. **A mistake in the description of the collateral in a financing statement means that the security interest was never perfected.**

Both mistakes are usually fatal to the interest of the secured party in the collateral.

1. Descriptions of Collateral in Security Agreements

Just how specific does the “description of the collateral” in a security agreement have to be? It is not necessary to specifically identify each item of collateral, for example by listing the serial number of each piece of collateral. [Section 9-108](#) expressly provides that a description of the collateral by “category” is sufficient. If the collateral is described as “all equipment” of the debtor that would be adequate to create a security interest in the collateral. As a practical matter, however, it is good practice to describe the collateral both generally and specifically at least with respect to particularly valuable items of collateral: “All equipment belonging to the debtor, including but not limited to the Model XY97 printing press located at 1982 Industrial Parkway, Ridgeway, Pennsylvania.”

In contrast, [Section 9-108\(c\)](#) expressly provides that a supergeneric description of the collateral (“all of the debtor’s personal property”) in a security agreement is not sufficient to create a security interest in collateral. But what if both the secured party and the debtor were perfectly aware of the specific property that the parties intended for the security interest to apply to? Would the rule against “supergeneric” descriptions in a security agreement apply in that situation? The following case illustrates that dilemma.

Cheniere Energy, Inc. v. Parallax Enterprises LLC, 585 S.W.3d 70 (Tex. Ct. App. 2019)

Cheniere Energy, Inc., advanced \$46 million in funding for a joint project with Parallax Enterprises. Parallax owned Live Oak, a liquid natural gas processing facility, and Live Oak was the principal asset owned by Parallax. The parties executed a security agreement and promissory note with the following description of the collateral:

All of Loan Party’s [Parallax’s] right, title and interest in and to the following, whether now owned or hereafter acquired by such Loan Party and whether now existing or in the future coming into existence:

1. All deposit, securities and other accounts and investment property
2. All instruments, documents and chattel paper
3. All inventory, equipment, fixtures and goods
4. All contracts and permits
5. All letter-of-credit rights
6. All intellectual property
7. All real property
8. All other tangible and intangible property and assets of such Loan Party

The security agreement and the note did not specifically mention Parallax’s interest in Live Oak nor did they use the term “general intangibles,” which is the catch-all category for intangible property used in Article 9. The court reasoned:

The Cheniere Parties contend that “all other ... intangible property” includes equity because the Uniform Commercial Code defines “general intangibles” to mean “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.” *Id.* [§ 9.102\(a\)\(42\)](#). We agree that Parallax’s equity in Live Oak is a “general intangible” as defined in the UCC, so if the Note had listed “general intangibles” among the collateral, this would have been sufficient for a security interest to attach because the UCC states that a “description of collateral reasonably identifies the collateral if it identifies the collateral by ... a type of collateral *defined in this title.*” *Id.* [§ 9.108\(b\)\(3\)](#) (emphasis added); *see also In re Barr*, 180 B.R. 156, 159 (Bankr. N.D. Tex. 1995) (agreement giving

party a secured interest in collateral described as “general intangibles” was sufficient to give the party a secured interest in capital credits).

But the Note instead refers to “intangible property,” which is not a term defined in the UCC.

The majority of the court ruled that the use of the term “all ... intangible property and assets” was not specific enough to “reasonably identify” Parallax’s equity interest in Live Oak. As a result the majority of the court ruled that the loan documents did not create a security interest in Live Oak in favor of Cheniere.

Practice pointers.

1. In drafting the description of the collateral in a security agreement don’t use inexact language such as “all intangible property.” Instead echo the categories of collateral used in Article 9 such as “general intangibles.”
2. If there is a particularly valuable piece of property that is part of the collateral such as the ownership interest of Parallax in the Live Oak facility in this case, mention it specifically in the security agreement in a clause stating, “including but not limited to”

The last case dealt with the adequacy of a “supergeneric” description of collateral in a security agreement. The next case deals with problems that arise when the parties describe the collateral by category.

Section 9-102 defines the categories of “[inventory](#)” and “[equipment](#).” As a practical matter, however, it is often difficult to determine whether certain items of property are inventory or equipment. See how the court in the next case approached this issue in ruling on competing motions for summary judgment.

In re Aluminum Extrusions, Inc., 100 U.C.C. Rep Serv 2d 504 (Bankr. Court, N.D. Mississippi, 2019)

In this case the secured party took a security interest in the debtor’s “inventory.” The collateral consisted of steel dies and aluminum racks that were eventually consumed in the manufacturing process. The standard for determining whether goods like these are inventory or equipment depends upon how long they last:

In general, goods used in business are equipment if they are fixed assets or have, as identifiable units, a relatively long period of use, but are inventory, even though not held for sale or lease, if they are used up or consumed in a

short period of time in producing a product or providing a service. [U.C.C. 9-102, Comment 4(a)]

In support of their competing motions for summary judgment the parties offered conflicting testimony about how long the steel dies and aluminum racks lasted in the manufacturing process. The witness for the secured party testified that the dies and racks were consumed within a year, while the witness for the debtor testified that in general the dies and racks lasted for several years.

Because there was genuine dispute as to a material question of fact the court denied both motions for summary judgment.

One of the cases that the court cited in *Aluminum Extrusions* is *Morgan County Feeders v. McCormick*, a 1992 case from Colorado. Neil Allen owned 50 cattle and Morgan County Feeders had a perfected security interest in the cattle. Allen sold the cattle to McCormick and the issue in the case was whether McCormick had purchased the cattle free of Morgan County Feeders' security interest or subject to the security interest. When someone purchases from a debtor property that is subject to a security interest, if that person is a "**buyer in the ordinary course of business**" (BIOC or BOCB) then that person takes the property **free of** the prior security interest but a person who is **not a BIOC** usually buys collateral **subject to** a security interest in the property. For McCormick to be a buyer in the ordinary course the cattle would have had to have been "inventory" in Allen's hands; if Allen had held the cattle as "equipment" then the sale of the cattle would not be in the ordinary course. (Merchants ordinarily sell their inventory; they do not sell their equipment in the ordinary course of business.)

Allen operated a "dude ranch" and used the cattle to entertain guests on pretend cattle drives. The cattle lived for several years in this operation. Like the dies and racks in *Aluminum Extrusions* the cattle in Allen's possession were definitely goods. In your opinion were the cattle consumer goods, farm products, inventory or equipment?

Practice Pointer. The specific lesson to be learned from *Aluminum Extrusions* and *Morgan County Feeders* is how to distinguish **inventory** from **equipment**. The more general lesson is that in describing the collateral in the security agreement be aware of which category of collateral the collateral belongs to.

Here is another case where the secured party might want to find a time machine to go back and fix the security agreement.

Mantle v. North Star Energy & Construction LLC, 98 U.C.C. Rep Serv 2d 1153 (Supreme Court of Wyoming, 2019)

North Star Energy and Construction LLC was a company owned by the Garland brothers, Gary, Ray, and Matt. First Northern Bank (FNB) loaned North Star \$3 million. North Star signed a promissory note that gave FNB a security interest in the “general intangibles” and “payment intangibles” owned by North Star. However, the security clause of the note specifically excluded “commercial tort claims” as collateral. Alex and Marjorie Mantle then purchased the note from FNB and sued North Star on the note.

The Garlands and North Star had sued their accountant, Mr. Killmer, for accountant malpractice. In a settlement with Killmer’s malpractice insurer North Star received \$121,271 and the Garlands split the remainder of the settlement. The Mantles sued the Garlands claiming that the entire Killmer Settlement Fund should have been paid to North Star and that it was a “general intangible” that was collateral for the note and therefore owing to the Mantles.

Once a commercial tort claim is settled the obligation becomes a payment intangible. However, [Section 9-108\(e\)\(1\)](#) provides that a “description by type of collateral” is not sufficient when a commercial tort claim is used as collateral. Instead the parties must specifically identify a commercial tort claim. Once a commercial tort claim is settled is a security agreement that refers to it as a “general intangible” or a “payment intangible” sufficient?

The court held:

Under the UCC, a creditor may obtain a security interest in a commercial tort claim, but only if the agreement specifically identifies the tort claim that is purportedly covered.
[Citing [Section 9-108\(e\)\(1\)](#)]

...

... A “general intangibles” clause is insufficient to create a security interest in the proceeds of a commercial tort claim, absent specific identification of the claim.

Practice Pointer. If a principal asset of the debtor is a commercial tort claim then to create a security interest in the claim it must be **specifically identified in the security agreement**, even if the claim is later settled and it becomes a payment intangible.

The next and last case regarding the sufficiency of descriptions of collateral in security agreements involves a wrong serial number. In studying this case keep in mind the difference between a security agreement and a financing statement. A security agreement is a **contract** between the debtor and the secured party. A financing statement is a **public notice** to third parties.

1st Source Bank v. Minnie Moore Resources, Inc., 98 U.C.C. Rep Serv 2d 1104 (United States District Court, N.D. Indiana, 2019)

1st Source Bank loaned money to Minnie Moore Resources, Inc., to purchase three pieces of equipment from Interval Equipment Solutions. The security agreement identified the equipment by name, serial number and purchase price. The debtor later claimed that the security agreement was ineffective for two reasons: (1) the equipment was defective, and (2) some of the serial numbers in the security agreement did not match the serial numbers on the equipment.

As to the first defense, the court ruled that any dispute over the quality of the equipment was between the debtor Minnie Moore and the seller Interval Equipment. As to the second, the court found that there was no doubt regarding which pieces of equipment were the subject of the security agreement; the debtor did not own any other equipment of this description and the debtor had not purchased any other equipment from Interval Equipment.

Practice pointer. The security agreement does not have to describe the collateral perfectly. It need only "reasonably identify" the collateral.

2. Descriptions of the Collateral in Financing Statements

It is much easier to satisfy the requirement for "describing the collateral" in a financing statement than in a security agreement. As the preceding cases illustrate the **security agreement** is the **contract** between the debtor and the secured party. It is vitally important for them to **reasonably identify** the collateral. If the parties fail to reasonably identify the property that is subject to the security agreement then the contract would be invalid because it would be too indefinite for the courts to be able to enforce the contract.

Financing statements, on the other hand, are not contracts but **notices**, and a financing statement need not "reasonably identify" the collateral but must only **indicate** the collateral. The purpose of a financing statement is to put third parties on inquiry notice that some or all of the property of a debtor is already subject to a security interest held by another secured party. [Section 9-504](#) of the Code even permits "supergeneric" descriptions of collateral in financing statements ("all assets" or "all personal property.")

A financing statement can be "supergeneric" but it must still be accurate. The next case illustrates this point.

[Ed. – The secured party in the following case is CERx and the debtor is PM.]

In re ProvideRx of Grapevine, LLC, 507 B.R. 132 (Bankr. Ct. N.D. Texas, 2014)

In this case CERx is the secured party and PM is the debtor. The security agreement granted CERx a security interest in “all IP assets” of PM. However, the financing statement described the collateral as the debtor’s “patent applications.” The collateral included patent applications, copyrights, trademarks, software, and source code. The court held that the description of the collateral in the security agreement (“all IP assets”) was sufficient to reasonably identify the collateral, but that the description of the collateral in the financing statement (“patent applications”) sufficiently indicated only the patent applications and was not sufficient to perfect the security interest in the debtor’s other intellectual property – the copyrights, trademarks, software, and source code. The financing statement would have been sufficient to cover all of this property if it had described the collateral as “all the debtor’s assets” or “all general intangibles,” but the term “patent applications” was insufficient to give third parties inquiry notice that the secured party claimed a security interest in the other types of intellectual property owned by the debtor.

Practice pointer. The secured party could have used a supergeneric description of the collateral in the financing statement (“all of the debtor’s assets”). Or the secured party could have described the collateral as “all IP assets,” as it did in the security agreement. Or the financing statement could have referred to “all general intangibles,” the category of collateral defined in Article 9 to which intellectual property belongs. Unfortunately the secured party in this case used the term “patent applications” in the financing statement, which was simply an inaccurate description of the collateral.

In recent years secured parties have attempted to “stretch the envelope” by simply incorporating the security agreement by reference into the financing statement without stating what is in the security agreement. In what was a surprise to many commentators the United States Court of Appeals for the 7th Circuit approved this approach in the case of *In re 180 Equipment*, 938 F.3d 866 (7th Cir. 2019), reversing 96 U.C.C. Rep. Serv.2d 658 (Bankr. Ct. C.D. Ill., 2019).

Practice pointer. What is the advantage of describing the collateral in a financing statement by simply incorporating a general reference to the security agreement in the financing statement? What is the disadvantage? On balance, would you “indicate” the collateral in this manner?

End of Chapter 2

Chapter 3. Attachment of a Security Interest

Chapter 3 is concerned with “attachment” of a security interest. In this context “attachment” means “creation.”

A. Learning Objectives

After watching the recorded lecture, taking the quiz, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. State the three required elements for attachment of a security interest.
2. Given a fact situation, analyze whether value has been given, whether the debtor has rights in the collateral, and whether the secured party and the debtor have entered into a valid security agreement.
3. Recognize whether the agreement contains an after-acquired property clause, a future advance clause, or a cross-collateralization clause, and state the purpose of each type of clause.

B. Lecture 12. Attachment of a Security Interest: Value, Rights and Agreement

Section 9-203 of the Uniform Commercial Code defines “attachment” of a security interest.

The definition of “attachment” is a bit roundabout. Under Section 9-203(a) a security interest “attaches” to collateral when a security interest becomes “enforceable.” Section 9-203(b) provides that a security interest becomes “enforceable” when three events have occurred:

- (1) Value has been given;
- (2) The debtor has rights in the collateral; and
- (3) The parties have entered into a security agreement.

If one of these elements is missing – if any of these requirements has not been satisfied – then the creditor’s security interest has not attached to the collateral.

It follows that a creditor’s security interest does not attach to collateral until the **last** of these three events has occurred.

Problem 12. Attachment of a Security Interest to a Liquor License

On August 1 Elm Street Bank loaned Temple Restaurant \$80,000 to purchase a liquor license from the Lordship Bar and Grill. The loan agreement signed by both parties on that same date contained four pages of provisions under the heading “Security.” The loan agreement granted the bank a security interest in all of Temple’s “equipment, inventory, accounts, and general intangibles, including but not limited to any liquor licenses.” The bank filed a financing statement describing the collateral in the same terms. Temple Restaurant then purchased the liquor license from Lordship and paid Lordship \$80,000. However, the State Board of Liquor Control has the authority and the duty to approve or disapprove all sales of liquor licenses, and on September 1 Temple declared bankruptcy before the Board could rule on Temple’s application to become a liquor license holder. Did the bank have a security interest in the liquor license by September 1? See *Semark Associates LLC v. RCL LLC* (Penn. Super. Ct., 2019) (non-precedential decision).

Variation: What if the Board of Liquor Control had approved Temple’s purchase of the liquor license on August 15, but the Bank did not advance any funds or commit to making the loan to Temple until September 10. Would the security interest have attached to Temple’s liquor license by September 1? In the following section of the textbook we will consider the requirement that value must be given.

C. The Requirement That Value Be Given

A security agreement is not enforceable until “value has been given.” But “value” is not the same as “consideration.” And who is supposed to give value?

1. The Definition of “Value” as Including “Past Consideration”

The term “value” is not defined in Article 9 but rather in Article 1. [Section 1-204](#) provides:

Except as otherwise provided in Divisions 3 (relating to negotiable instruments), 4 (relating to bank deposits and collections), and 5 (relating to letters of credit), a person gives value for rights if the person acquires them:

- (1) in return for a binding commitment to extend credit or for the extension of immediately available credit, whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection;
- (2) as security for, or in total or partial satisfaction of, a preexisting claim;
- (3) by accepting delivery under a preexisting contract for purchase; or
- (4) in return for any consideration sufficient to support a simple contract.

Note that the scope of the term “value” is broader than “consideration.” Consideration sufficient to support a contract constitutes “value,” but “value” encompasses more than “consideration.”

Under the common law “past consideration” is not valid consideration. The “pre-existing duty rule” is the concept that if a person is already obligated to perform under a contract then a subsequent promise to perform that same duty is not consideration. If a homeowner and a housepainter agreed that the painter would paint the house for \$6,000, and after the house was painted the homeowner persuades the painter to accept \$4,000 instead, the painter is free to change their mind and sue the homeowner for the remaining \$2,000. Under the “preexisting duty rule” the parties’ agreement to reduce the contract price to \$4,000 after the house was painted was not supported by consideration and the housepainter is not bound to that agreement.

But the result is different under the law of Secured Transactions. Assume that the housepainter owes the bank \$10,000 on a loan that was made three years earlier and that is not yet due. Assume further that today the bank asks the painter for collateral to secure payment of the previously-made loan. Assume that the painter agrees and enters into a security agreement giving the bank a security interest in the painter’s equipment. In this case the security agreement is valid. The painter did not receive valid **consideration** for granting the bank the security interest; however, the bank did give **value**. The “value” that the bank conferred upon the debtor was the pre-existing loan that had been extended to the debtor. In the words of [Section 1-204](#), “a person gives value for rights if the person acquires them … as security for … a preexisting claim.”

2. By Whom the Value Is Given and To Whom the Value is Given

The language of [Section 9-203\(b\)\(1\)](#) is curiously opaque. The “value” requirement for attachment of a security interest is expressed in the passive voice. The law requires that “value has been given.” This can lead to confusion. In a recent unreported case the court reasoned that “value had been given” because the debtor had granted the secured party a security interest in the collateral.¹ This is **not** a correct interpretation of the requirement that “value has been given.”

Normally in return for a security interest in the property of the debtor the secured party will have given value to the debtor in the form of an extension of credit; the secured party has loaned money to the debtor or the secured party has sold goods to the debtor on credit. But this is not always the case; it is not always the secured party who gives value, and value is not always given to the debtor. For example, if a secured party extends credit to the husband’s

¹ *In re Assignment for the Benefit of Creditors of William Sczepanski*, 99 UCC Rep. Serv.2d 706, (Ct. App. Minn., 2019) (unpublished).

corporation and the wife puts up collateral as security, “value has been given.”² Or if the father of the secured party was the source of funds that were loaned to the debtor “value has been given.”³ As Hawkland says, “It is sufficient that value be given by someone to someone.”⁴ The following case illustrates this point.

Royce v. Michael R. Needle, 381 F. Supp.3d 968 (2019)

The following case involves the competing claims of various attorneys and law firms to the proceeds of a settlement agreement in a RICO case, the *Amari* litigation. One of the firms who represented the plaintiffs in *Amari* and who obtained the settlement agreement was MRNPC, which was owned by Attorney Michael Needle. Needle then solicited another firm, Mayer, Brown, to represent one of the original plaintiffs, his former client John Cardullo and Sons, in post-judgment litigation over the settlement agreement. Cardullo fell behind in its payments to Mayer, Brown, and to keep Mayer, Brown involved in representing Cardullo Needle granted Mayer, Brown a security interest in MRNPC’s share of the settlement funds. The money from the *Amari* settlement agreement that is owed to MRNPC is the **collateral**, Mayer, Brown is the **secured party**, and MRNPC is the **debtor**.

Another party with a claim to the funds contended that Mayer, Brown’s security interest in the collateral did not attach because Mayer Brown rendered services (“gave value”) to Cardullo, not to the debtor MRNPC.

The court rejected the other party’s contention for two reasons. First, the law does not require the secured party to give value to the **debtor** before a security interest can attach to the debtor’s property; instead the law merely requires that **value is given**. Second, Mayer, Brown did give value to MRNPC because it assumed a legal detriment (to represent Cardullo) at the request of MRNPC.

Practice pointer. The practical lesson to be drawn from *Royce v. Needle* is that you could include in the security agreement a recitation of the value that the secured party gave in return for the security interest. This would reduce the threat of litigation over whether the requirement that “value has been given” had been satisfied.

D. The Requirement That the Debtor Have Rights in the Collateral

² Matter of Van Kylen, 98 B.R. 455 (Bankr. Ct. W.D. Wis. 1989).

³ Hill v. Farmers & Merchants Bank of Waterloo, 641 So.2d 788(Ala. 1994).

⁴ Hawkland’s Uniform Commercial Code Series, § 9-203:11, Requirement That Value Be Given.

Perhaps the most difficult element in determining whether a security interest has attached is the requirement that the debtor must have “rights in the collateral.” At its most basic level this requirement makes sense. If the debtor does not have any rights in the collateral then it would be impossible for a secured party to acquire a security interest in the collateral by entering into an agreement with the debtor.

But it is important to keep in mind that “title” or “ownership” of property is not a singular concept but rather is a “bundle of rights.” There is a spectrum between not having any rights at all in the collateral and having clear title to the collateral. A person may have **no rights** to a piece of property, or **some rights**, or **all possible rights** to it.

A basic rule of property is that a purchaser of property acquires the same rights that the seller had. The first words of [Section 2-403](#) of the U.C.C. entitled “Transfer of Title” are:

A purchaser of goods acquires all title which his transferor had or had power to transfer
....

There are points along the spectrum between having “no rights” in collateral and having full rights of ownership in collateral. The courts have interpreted Section 9-203 as requiring the debtor to have **“sufficient rights”** in collateral so that a secured party can take a security interest in the collateral.

1. The Debtor Does Not Have to Own the Collateral But the Debtor Must Have Sufficient Rights in the Collateral

The following case illustrates the principle that the debtor does not have to own the collateral to be able to grant a security interest to a creditor. Instead a security interest can attach so long as the debtor has “sufficient rights” in the collateral.

Border State Bank of Greenbush v. Bagley Livestock Exchange, Inc., 690 N.W.2d 326 (Minn. Ct. App., 2004)

Anderson had a “cattle sharing agreement” with Bert Johnson. Johnson owned the cattle. Under the agreement Anderson would care for and breed the cattle, Johnson would pay for feed and certain other expenses, and when the cattle were sold Anderson and Johnson were to split the proceeds. Hal Anderson borrowed \$155,528 from Border State Bank and granted the bank a security interest in Anderson’s “rights, title and interest” in all “livestock” that Anderson owned or thereafter acquired. When the cattle were sold at auction, however, Johnson ordered the auctioneer not to pay Anderson his full share of the proceeds. Border State Bank sued Johnson and the auctioneer, Bagley Livestock Exchange, claiming a security interest in the livestock and its proceeds. The trial court directed a verdict against the Border State Bank on the ground that the debtor must **own** the collateral before granting a security interest in it.

The appellate court reversed the decision of the trial court based on its interpretation of Section 9-203, stating:

Simply stated, the UCC “does not require that collateral be owned by the debtor.” *State Bank of Young Am. v. Vidmar Iron Works, Inc.*, 292 N.W.2d 244, 249 (Minn.1980).

Other jurisdictions have cautioned against an interpretation that ownership rights are necessary for the attachment of a security interest. For purposes of the UCC, “sufficient rights” arise with far less than full ownership.

...

On remand, the district court shall consider the cattle-sharing agreement to determine whether Anderson had “rights” in the calves, to which the bank’s security interest attached.

Practice Pointer. The proper standard for determining whether a debtor has “sufficient rights in the collateral” is whether it is feasible to enforce the security interest. Can debtor’s interest in the collateral be identified, repossessed, disposed of and fairly divided among the claimants? If the security agreement can be enforced in a way that is fair to all parties then the debtor has sufficient rights in the collateral to grant a security interest.

The next two cases both follow the rule articulated in *Border State Bank of Greenbush* that a debtor must have “sufficient rights” in collateral to grant a security interest. The next case, *Church Crop Insurance Services*, addresses the issue of **whether a debtor can grant a secured party a security interest in funds that the debtor owes to someone else.**

Church Crop Insurance Services, Inc. v. GemCap Lending, LLC, 98 U.C.C. Rep. Serv. 2d 150 (Court of Appeals of Iowa, 2019)

Gem Cap took a security interest in “all of the property and assets” of Crop USA. Diversified Crop Insurance Services would pay commissions to Crop USA, and Crop USA was to pass on those commissions to Church Crop. The issue in the case was whether Crop USA had a legal right to the commissions it received from Diversified or whether Crop USA was a “mere intermediary” in passing the commissions from Diversified to Church Crop. The trial court found that Crop USA was a “mere intermediary” and therefore that Crop USA did not have “sufficient rights in the collateral” to grant a security interest in the commissions to Gem Cap. The appellate court reversed. The Court of Appeals found that “Crop USA was more than a mere intermediary holding possession without title.” The court based its conclusion on the fact that Crop USA had the right to “receive and retain the [funds], to commingle the [funds] with its general operating funds, to use the [funds] in its operations and to apply the [funds]” Accordingly Crop USA had the power to grant Gem Cap a security interest in the funds, even though Crop USA owed the money to Church Corp.

Practice pointer.

If a debtor collects or receives funds that are owed to another party but the debtor has the right to commingle the funds with its own operating funds, the debtor may have the power to grant a security interest in those funds to one of its own creditors. If you represent a party who is owed funds by the debtor make sure that those funds are not commingled with the debtor's funds or accessible to the debtor. If you represent a party who is considering lending to the debtor carefully investigate whether the debtor has access to the funds being used as collateral.

The next case involving the requirement that the debtor must have rights in the collateral is even more surprising. What if the debtor has already sold the collateral to someone else? In most cases if the debtor no longer has rights in the property that it has sold then it can no longer use that property as collateral. But what if the debtor **sells some accounts** to another party and the purchaser of the accounts **fails to file a financing statement** recording the transaction?

SE Property Holdings, LLC v. Unified Recovery Group, LLC (Rights in the Collateral), 97 U.C.C. Rep. Serv.2d 459 (Dist. Ct. E.D. La. 2018)

On August 29, 2008, SEPH loaned money to URG and took a security interest in URG's accounts. On the same day URG sold a valuable account to a related company, JKS. However, JKS failed to file a financing statement covering the account. Does SEPH have a security interest in the account that was sold to JKS? This matter is governed by [Section 9-318](#). The court held:

According to the UCC, as adopted in Louisiana, a debtor who sells an account "does not retain an ownership interest in the collateral sold." La. Stat. Ann. § 10:9-318(a). Nevertheless, with regard to creditors' rights, where "a debtor has sold an account or chattel paper, while the buyer's interest is unperfected, the debtor is deemed to have rights and title to the account or chattel paper identical to those the debtor sold." La. Stat. Ann. § 10:9-318(b). Thus, "[a]s a consequence of subsection (b), if [JKS's] security interest is unperfected, [URG] can transfer, and [SEPH] can reach, the account or chattel paper as if it had not been sold." UCC § 9-318 cmt. 3. SEPH has put forth evidence reflecting that it accomplished the last step necessary for attachment and perfection on September 2, 2008. There is no evidence in the record suggesting that JKS ever filed a financing statement. Therefore, it appears that SEPH has priority as to the \$227,075.00.

Practice pointers.

1. Before a client purchases accounts or loans money and takes a security interest in the debtor's accounts check the UCC filing records to make sure that the debtor still owns the accounts.
2. Whenever a client purchases accounts or takes a security interest in accounts file a financing statement covering the accounts. If you do not then the law deems that the debtor still owns the accounts and can sell them to someone else.

The remaining issue in *SE Property Holdings* is whether the IRS should prevail over SEPH under its tax lien or whether SEPH takes priority over the IRS under the security agreement. We shall return to this case in Chapter 9 when we study the relative priority of tax liens and security interests in after-acquired property.

The previous cases establish that a debtor need not have “full ownership” of property to use it as collateral; instead under Article 9 the debtor must have “sufficient rights” in the collateral.

In the following section we consider a different aspect of attachment and the debtor’s rights. What “rights” in the collateral does the secured party acquire from the debtor?

2. The Secured Party Acquires a Security Interest in Whatever Ownership Rights the Debtor Has

The following case illustrates the general principle that when a secured party takes a security interest in the debtor’s collateral the secured party obtains a security interest in whatever ownership rights the debtor has to the collateral. For example, if the debtor owns a one-half interest in aluminum ingots stored in a warehouse, a secured party who takes a security interest in the debtor’s “inventory” will have a security interest in half of the aluminum ingots.

This general principle often arises in cases of accounts financing. When a secured party takes a security interest in the debtor’s accounts, the debtor is the “assignor” and the secured party is the “assignee” of the accounts. The collateral consists of the amount of money that the debtor’s customers (the “account debtors”) owe to the debtor. But what if the debtor breaches its contract with an account debtor in some way? What if, as a result, the account debtor does not owe the account, or owe the full amount of the account, to the debtor? If the secured party was not involved then the account debtor could certainly assert a “claim in recoupment” or other defense to payment against the debtor. Once the debtor (the assignor of the account) has assigned the account to the secured party (the assignee of the account), may the account debtor still assert its defense to payment against the secured party?

Section 9-404(a) of the U.C.C. provides:

(a) Assignee's rights subject to terms, claims and defenses; exceptions. Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections (b) through (e), the rights of an assignee are subject to:

- (1) all terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction which gave rise to the contract; and
- (2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.

A secured party who takes a security interest in the debtor's "accounts" should be aware of the fact that the account debtors may have a claim or defense against the debtor that can be "set off" against the amount owed to the secured party. The following case illustrates the operation of the doctrine of setoff among Mobilization Funding (the secured party), CEC Electrical (the debtor), and Halvorson Construction (the account debtor).

Mobilization Funding, LLC v. Halvorson Construction Group, LLC, 100 U.C.C. Rep. Serv. 2d 188 (U.S. Dist. Ct. W.D. Wash. 2019)

Halvorson Construction was a general contractor and CEC Electrical was a subcontractor working for Halvorson. As CEC Electrical completed its work on a project Halvorson would pay CEC. However, CEC was having financial difficulties so Halvorson would frequently loan CEC money and pay CEC's debts. In addition Halvorson had to hire another contractor to complete a project that CEC had been hired to perform.

Mobilization Funding loaned money to CEC Electrical and took a security interest in CEC's accounts: specifically, the amounts owed to CEC by Halvorson Construction.

Is Halvorson Construction liable to Mobilization Funding for the full amount owed to CEC under the subcontracts, or is Halvorson entitled to a "set-off," that is, may Halvorson deduct from those payments the amounts that CEC owed to Halvorson?

Here is how the court ruled on a motion for summary judgment filed by Mobilization Funding:

Thus, the only question remaining before the Court is whether Mobilization Funding's security interest has priority over any claim Halvorson may make to CEC's receivables. Mobilization Funding argues that its security interest has priority because Mobilization Funding is the only party to have perfected its security interest. But even if a party properly and promptly perfects its security interest, this protection is not absolute.

Under RCW 62A.9A-404(a)(1), an assignee's rights under a contract are subject to all the "terms of the agreement between the account debtor and assignor and any defense or

claim in recoupment arising from the transaction that gave rise to the contact.” Here, Mobilization Funding’s security interest in CEC’s contract receivables is subject to the terms of CEC’s subcontracts with Halvorson.

Practice pointer.

If you represented Mobilization Funding, and Mobilization Funding was in negotiations to loan money to a subcontractor to enable the subcontractor to complete their portion of a construction project, what concession would you seek from the general contractor?

3. Contractual Limitations on Assignment of Accounts, Chattel Paper, Payment Intangibles, and Promissory Notes

It is relatively common for contracts, loan agreements, chattel paper, and promissory notes to prohibit a party from assigning their rights under the document to another party. Under the common law these non-assignment clauses are generally enforceable. However, if these contractual provisions were enforced in the context of secured transactions this would mean that a debtor who possessed accounts, payment intangibles, chattel paper or promissory notes containing a non-assignment clause could not grant a creditor a security interest in that collateral.

Section 9-406(d) changes the common law and, in general, invalidates non-assignment clauses for secured transactions involving accounts, payment intangibles, chattel paper and promissory notes. Other claimants to collateral often contend that a party’s security interest is invalid; they argue that under a non-assignment clause the debtor did not have “sufficient rights in the collateral” to grant a security interest to the secured party. This argument fails in most cases because of Section 406(d). Hawkland states: “in general, even though a clause in a contract prohibits its assignment, rights under the contract may still be assigned.”⁵

Problem 13

Flanders Floors completed its job to install flooring for an office tower in New York. The general contractor Ibsen Builders now owes Flanders Floors \$870,000 for this work. The contract between Flanders and Ibsen expressly prohibits Flanders from assigning any portion of the payment due under the contract to any other party. Flanders sells its right to payment from Ibsen under the contract to Commercial Investors, Inc. Is this a valid transaction under Article 9? See Section 9-406(d).

⁵ Hawkland’s Uniform Commercial Code Series, § 9-406:2, written by Frederick H. Miller and Carl S. Bjerre, updated by William Henning, and edited by Carl. S. Bjerre.

E. The Requirement of a Security Agreement

The third requirement for attachment of a security interest is that the parties must have entered into a contract – a “security agreement” – granting the secured party a security interest in the property of the debtor. Did the parties enter into such an agreement in the following case?

Green Automotive, LP v. ATN Management Co., LLC, 96 U.C.C. Rep. Serv.2d 907 (U.S. Dist. Ct. W.D. Okla., 2018)

ATN Management Co. filed a UCC1 financing statement against Green Automotive, claiming to have a security interest in the business assets of Green Automotive to secure payment under a consulting contract. There was a dispute about the terms of the agreement. ATN claimed that the following provision of a “letter engagement” between the parties created a security interest in Green’s assets:

22. In the event the Customer fails to pay as agreed or delays payments due beyond the agreed upon time frame, the Consultant shall provide written notice and a 10 day Notice will be provided to cure or bring current and such Default (sic). Thereafter, the Consultant will retain the rights to file a UCC claim on the Customer’s assets related to the businesses.

The court invoked [Section 9-108\(c\)](#) to resolve the validity of the security agreement in the following passage:

Plaintiffs contend the agreement fails in that it does not sufficiently describe the collateral, relying on the vague description of “Customers’ assets related to the businesses.” Oklahoma Stat. tit. 12A § 1-9-108 governs the sufficiency of descriptions of collateral for creation of a security interest. Pursuant to § 1-9-108(a), “[e]xcept as otherwise provided in subsection[] (c) ... of this section, a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.” Subsection (c), one of the noted exceptions, indicates that “[a] description of collateral as ‘all the debtor’s assets’ or ‘all the debtor’s personal property’ or using words of similar import does not reasonably identify the collateral.” Okla. Stat. tit. 12A § 1-9-108(c). Defendant’s attempt to rely on the phrase “Customer’s assets related to the businesses” is in violation of the restriction set forth in § 1-1-108(c). /

Practice pointer. Do not file a financing statement against a party without that party’s authorization; to do so violates Article 9. It may also subject you or your client to liability for tortious interference, defamation, fraud, or other torts. And it may be an ethical violation as well. A valid security agreement implicitly authorizes a secured party to file a financing

statement, but if the security agreement is invalid, like the one in this case, both the secured party and their attorney may be liable for any loss suffered by the debtor.

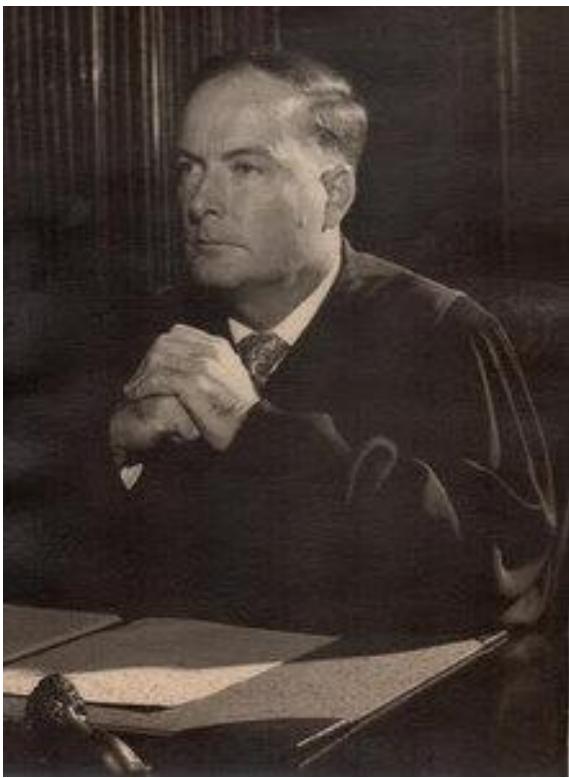
Here are some additional rules regarding the formation, format, and contents of a security agreement.

1. A Security Agreement Is a Contract Between the Secured Party and the Debtor That Is Subject to the Normal Rules of Contract Formation and Contract Interpretation

A security agreement is a contract. As such it is subject to the normal rules of contract formation; the only exception is that instead of consideration “value must be given.” ([See Part C above](#)). The parties must express a definite willingness to be bound to terms that are clear and complete. There must not be grounds for avoiding the contract on account of any affirmative defense such as lack of capacity, mistake, misrepresentation, duress, undue influence, unconscionability, or violation of public policy.

A security agreement is interpreted by means the usual interpretive tools: by taking the entire contract into account; considering the commercial context of transaction; with due regard for the language of the contract as well as the canons of construction; and in light of any course of performance, course of dealing, trade usage, and expert testimony regarding any terms of art. The normal rules apply regarding the admissibility of extrinsic evidence to resolve any ambiguous language in the contract. And the parol evidence rule governs the admissibility of extrinsic evidence to prove the existence of terms not included in the written agreement.

The following case, *Williams v. Walker-Thomas Furniture*, illustrates the application of the doctrine of unconscionability to a secured transaction. Williams was a relatively uneducated single mother who purchased furniture and appliances on credit at a local store, Walker-Thomas Furniture. The store’s standard sales contract contained both a cross-collateralization clause and a clause allocating payments among all of the purchases that a customer had ever made at the store. The consequence of the allocation clause was that **none** of the purchases that a customer had made at the store was ever paid off until **all** of the items had been paid for, and the consequence of the cross-collateralization clause was that all of the furniture and appliances that the customer had ever purchased at the store served as collateral for every separate transaction. In effect, no single item was ever fully paid off, and if the customer defaulted on a single payment the store had the right under the contract to repossess every item the customer had ever purchased at the store.



Judge J. Skelly Wright, pictured here, ruled that the cross-collateralization clause in the store's sales contract was unconscionable. His opinion in this case remains a classic explanation of the doctrine of unconscionability. Notice that Judge Wright considered both the "absence of meaningful choice," "inequality of bargaining power" and "deceptive" practices in the formation of the contract (procedural unconscionability) and the "unreasonable," "unfair," "extreme" and "one-sided" terms of the contract (substantive unconscionability). Modern cases treat both of these elements – procedural and substantive unconscionability -- on a sliding scale in determining whether a contract or one of its terms are unconscionable. The more procedural inequality there is, the less is required of substantive unfairness; the more extreme and one-sided the terms of the contract are the less is required of procedural unconscionability.

Williams v. Walker-Thomas Furniture
350 F.2d 445 (1965)

Judge J. Skelly Wright.

Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances surrounding the transaction. In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power. The manner in which the contract was entered is also relevant to this consideration. Did each party to the contract, considering his obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices? Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain. But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms. In such a case the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.

In determining reasonableness or fairness, the primary concern must be with the terms of the contract considered in light of the circumstances existing when the contract was made. The test is not simple, nor can it be mechanically applied. The terms are to be considered 'in the light of the general commercial background and the commercial needs of the particular trade or case.' Corbin suggests the test as being whether the terms are 'so extreme as to appear unconscionable according to the mores and business practices of the time and place.' We think this formulation correctly states the test to be applied in those cases where no meaningful choice was exercised upon entering the contract.

Practice Pointers.

1. Do you agree with Judge Wright that the payment allocation and cross-collateralization clauses are unconscionable in a contract for the sale of consumer goods?
2. In determining the validity of a security agreement and in interpreting a security agreement do not focus solely on Article 9. The principles of the common law like unconscionability and the other affirmative defenses that make a contract void, voidable, or unenforceable also apply. So do interpretive rules such as the rules governing ambiguity, the parol evidence rule, the canons of construction, and the effect of course of performance, course of dealing, and trade usage. The rules governing modification of contracts apply as well.

2. The Security Agreement Must Usually Be in Writing But May Be Oral in Certain Circumstances

Section 9-203 used to require security agreements to be in a signed writing unless the secured party had possession of the collateral; if the secured party had possession an oral security agreement would suffice. In order to accommodate the widespread use of electronic documents and widespread acceptance of electronic forms of property the law now requires security agreements to be in the form of an "**authenticated record**" unless the secured party has "**possession or control**" of the collateral. See [Section 9-203\(b\)\(3\)](#) (setting forth the requirement that a security agreement be "authenticated") and the provisions of Section 9-102 defining "[authenticate](#)" and "[record](#)."

3. The Security Agreement Must Reasonably Identify the Collateral

In Chapter 2 we studied how under [Section 9-108\(a\)](#) a security agreement must "reasonably identify" the collateral. If the security agreement does not reasonably identify the collateral then under [Section 9-203](#) the security interest does not "attach" to the collateral; if the description of the collateral is insufficient then the security agreement does not create a security interest in the collateral. This principle was illustrated in several of the cases we have studied including *Green Automotive*.

Under [Section 9-108\(b\)](#) in most cases it is sufficient to describe collateral by “type,” that is, by the category of collateral such as “equipment” or “documents” or “general intangibles.” However, there are three situations where collateral may not be described by type but must be more specifically defined:

- (1) where the collateral is a commercial tort claim it must be described with more specificity ([Section 9-108\(e\)](#));
- (2) where the collateral consists of a security entitlement, securities account, or commodity account it may be described as such or as “investment property;” if the collateral is a commodity contract it must also be described with more specificity ([Section 9-108\(d\)](#)); and
- (3) in consumer transactions it is insufficient to describe consumer goods, a security entitlement, a securities account, or a commodity account by type; the description must be more specific. [Section 9-108\(e\)](#).

F. Future Advance Clauses, After-Acquired Property Clauses, and Cross-Collateralization Clauses

Security agreements typically include a number of provisions that establish and clarify the rights of the secured party and the debtor. At the end of this course in Lessons 11 and 12 we shall study a number of contractual provisions governing responsibility for maintaining and insuring the collateral; identifying the acts or events that constitute breach or default; and regarding redemption, repossession, resale, and strict foreclosure.

At this point in the course, however, it is appropriate to introduce three other types of clauses that are often included in security agreements: after-acquired property clauses, future advance clauses, and cross-collateralization clauses.

1. After-Acquired Property Clauses

After-acquired property clauses are used to make property that the debtor obtains in the future to serve as collateral. For example, a security agreement granting the secured party a security interest in the debtor’s equipment might state that the collateral includes “all of the debtor’s equipment, now-owned and hereafter acquired.” After-acquired property clauses are expressly authorized under [Section 9-204\(a\)](#). [Section 9-204\(b\)](#) prohibits after-acquired property clauses from applying to consumer goods acquired by the debtor more than 10 days after the secured party gives value or to commercial tort claims. After-acquired property clauses that apply to inventory or accounts are often referred to as “floating liens.”

2. Future Advance Clauses

A future advance clause in a security agreement provides that the collateral secures not only any funds that the secured party committed or advanced to the debtor at the time that the agreement was entered into; but that the collateral also secures any future advances or commitments of funds by the secured party to the debtor. Future advance clauses are expressly authorized under [Section 9-204\(c\)](#).

3. Cross-Collateralization Clauses

A cross-collateralization clause in a security agreement subjects the collateral to serve as security not only for the debt incurred in the same transaction but also for any other debts owed by the debtor to the secured party under other transactions as well. This is sometimes referred to as a “dragnet clause.” A broad cross-collateralization clause might state that the collateral secures “any and all indebtedness from any source whatsoever owing by the debtor to the secured party at the present time or at any time in the future.” Cross-collateralization clauses are useful in commercial transactions to resolve problems that arise with the allocation of payments when there are multiple purchase-money loans secured by the same collateral. (See Chapter 6.) However, as we saw in *Williams v. Walker-Thomas Furniture*, in consumer cases cross-collateralization clauses may be unconscionable in certain circumstances.

End of Chapter 3

Chapter 4. Perfection of a Security Interest: Filing a Financing Statement

In Lesson 4 we begin our study of “perfection” of a security interest.

A. Learning Objectives

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Identify six different methods of perfecting a security interest.
2. Recognize how security interests in different types of collateral can be perfected.
3. Obtain an authorization to file a financing statement from the debtor.
4. Complete the required fields in a financing statement.
5. Identify how to ascertain the proper name and location of a debtor for the purpose of filing a financing statement, and state the consequences of using the wrong name or location.
6. Identify the proper state in which a financing statement must be filed.
7. Identify whether the financing statement must be filed centrally with the office of the Secretary of State or locally with the land records in the office of the County Recorder.
8. State the additional information needed when filing a fixture filing.
9. State the legal consequences when errors are made by the filing office.
10. Advise a client regarding the proper procedure to remove fraudulent filings from the filing system.

B. Lecture 13. Perfection of a Security Interest

“Perfection” of a security interest is the process of giving public notice that some or all of the debtor’s property is serving as collateral for a debt that is owed to the secured party.

There are six ways of perfecting a security interest.

1. Perfection by Filing a Financing Statement. A “financing statement” is a form that can be filed either centrally with the office of the Secretary of State or locally with the real property records.

2. Automatic Perfection. In certain situations the security interest of a secured party is automatically perfected as soon as the security interest attaches to the collateral.

3. Temporary Automatic Perfection. In certain situations the security interest of a secured party is automatically perfected for 20 days.

4. Perfection by Possession. A secured party can perfect a security interest in certain tangible items of collateral by taking possession of the collateral.

5. Perfection by Control. A secured party can perfect a security interest in certain intangible items of collateral by taking “control” of the collateral.

6. Perfection by Notation on a Certificate of Title. In most states security interests on automobiles, trucks, motorcycles and other vehicles can be perfected only by listing the lien on the certificate of title filed with the state Department of Motor Vehicles.

The most common way of perfecting a security interest in collateral is by filing a financing statement. Perfection by filing is the subject of Chapter 4.

C. [Lecture 14. Filing Financing Statements](#)

[Section 9-509\(a\)](#) requires a secured party to obtain a signed authorization from the debtor before filing a financing statement.

1. Authorization to File a Financing Statement

Under [Section 9-509\(b\)](#), if the debtor signs a security agreement that is automatically deemed to grant the secured party authority to file a financing statement. *See, e.g. Rebel Auction Co., Inc. v. Citizens Bank*, 93 U.C.C. Rep Serv 2d 1176 (Court of Appeals of Georgia, 2017).

[Section 9-502\(d\)](#) as enacted in Pennsylvania authorizes a secured party to file a financing statement before the parties have entered into a security agreement. Section 9-502(d) provides:

A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.

Why would a potential lender wish to file a financing statement as early as possible? There are two reasons.

1. Once a financing statement is filed other potential lenders will be reluctant to extend credit to the debtor because it will appear that the debtor's assets are already encumbered; and
2. The priority rules of Article 9 give priority to the secured party who was **the first to file or perfect**. [Section 9-322](#). This means that if one party has perfected its security interest first but the other has filed a financing statement even earlier, the one who filed the financing statement first will take priority over the party who perfected first.

Practice pointer. As soon as negotiations begin for an extension of credit, the creditor should ask the borrower to sign an authorization to file a financing statement and should then file the financing statement in the appropriate office. If the negotiations fall through or if the borrower changes its mind and demands that the financing statement be terminated then the creditor must file a termination statement ending the effectiveness of the financing statement.

But be careful. If a financing statement is filed without authorization it could form the basis for a claim of tortious interference with the business of the debtor. See *ConcealFab Corporation v. Sabre Industries, Inc.*, 2019 WL 3282966 (U.S. Dist. Ct. D. Colorado, 2019). Moreover, Paragraph (d) of Section 9-502 has not been adopted in every jurisdiction. In states where Paragraph (d) has not been adopted a financing statement that is filed before a security agreement has been entered into would violate the rights of the borrower and would likely be considered void.

A standard "Authorization to File a Financing Statement" is on the Blackboard website for this course.

2. Perfection by Filing Is the Default Method of Perfection

The general rule for perfection of a security interest is set forth in [Section 9-310\(a\)](#). That Section provides:

§ 9310. When filing required to perfect security interest or agricultural lien; security interests and agricultural liens to which filing provisions do not apply.

(a) General rule: perfection by filing. Except as otherwise provided in subsection (b) and section 9312(b) (relating to control or possession of certain collateral), a financing statement must be filed to perfect all security interests and agricultural liens.

Section 9-310(a) is immediately followed by [Section 9-310\(b\)](#), which identifies ten broad exceptions to the general rule requiring the filing of a financing statement. Those exceptions, which include perfection by possession and control, automatic perfection, and temporary automatic perfection, will be studied and discussed in future chapters.

Here is Form UCC1, the financing statement:

UCC FINANCING STATEMENT

FOLLOW INSTRUCTIONS

A. NAME & PHONE OF CONTACT AT FILER (optional)
B. E-MAIL CONTACT AT FILER (optional)
C. SEND ACKNOWLEDGMENT TO: (Name and Address)

Print

Reset

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1. DEBTOR'S NAME: Provide only one Debtor name (1a or 1b) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name); if any part of the Individual Debtor's name will not fit in line 1b, leave all of item 1 blank, check here and provide the Individual Debtor information in item 10 of the Financing Statement Addendum (Form UCC1Ad)

1a. ORGANIZATION'S NAME				
OR	1b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX
1c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY

2. DEBTOR'S NAME: Provide only one Debtor name (2a or 2b) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name); if any part of the Individual Debtor's name will not fit in line 2b, leave all of item 2 blank, check here and provide the Individual Debtor information in item 10 of the Financing Statement Addendum (Form UCC1Ad)

2a. ORGANIZATION'S NAME				
OR	2b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX
2c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY

3. SECURED PARTY'S NAME (or NAME of ASSIGNEE of ASSIGNOR SECURED PARTY): Provide only one Secured Party name (3a or 3b)

3a. ORGANIZATION'S NAME				
OR	3b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX
3c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY

4. COLLATERAL: This financing statement covers the following collateral:

The UCC1 is filed in the office of the Secretary of State in the proper state. But which state is the proper state for filing?

3. Where Should the Financing Statement Be Filed: In Which State, and Centrally or Locally?

In general a financing statement must either be filed in the state where the **debtor is located** or the state where the **collateral is located**. [Section 9-301\(a\)](#) states:

(a) General rule; location of debtor. Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection and the priority of a security interest in collateral.

Section 9-301(a) distinguishes between states whose laws govern “perfection” and states whose laws govern the “effect of perfection” and “priority.” In order to determine the state where a financing statement must be filed we must determine which state’s law governs “perfection” of a security interest. As we have seen, the general rule is that the law of the state where the **debtor is located** governs perfection, so that is the state where a financing statement covering the collateral must be filed.

Section 9-301(c) and 9-301(d) identify three situations where perfection is governed by the law of the state where the **collateral is located**. These are:

- a. When a fixture filing is filed;
- b. When the collateral is timber to be cut; and
- c. When the collateral is as-extracted collateral, that is, oil, gas, other minerals where the security interest attaches upon extraction.

Section 9-501 provides that if the law of Pennsylvania governs perfection of a security interest then a financing statement covering the collateral must be filed in one of two places: either in the office of the Secretary of State or with the real property records in the office of the County Recorder. Section 9-501(a) provides:

§ 9501. Filing office.

(a) Filing offices. Except as otherwise provided in subsection (b), if the local law of this Commonwealth governs perfection of a security interest or agricultural lien, the office in which to file a financing statement to perfect the security interest or agricultural lien is one of the following:

(1) The office designated for the filing or recording of a record of a mortgage on the related real property if:

- (i) the collateral is as-extracted collateral or timber to be cut; or
- (ii) the financing statement is filed as a fixture filing and the collateral is goods which are or are to become fixtures.

(2) The office of the Secretary of the Commonwealth in all other cases, including a case in which the collateral is goods which are or are to become fixtures and the financing statement is not filed as a fixture filing.

In general, therefore, a financing statement must be filed **centrally** with the Department of State. In three situations, however, a financing statement must be filed **locally** in the real property records of the County Recorder's office. The form that is used in these three situations is the UCC1ad, the UCC Financing Statement Addendum. Here is that form:

UCC FINANCING STATEMENT ADDENDUM

FOLLOW INSTRUCTIONS

9. NAME OF FIRST DEBTOR: Same as line 1a or 1b on Financing Statement; if line 1b was left blank because individual Debtor name did not fit, check here

9a. ORGANIZATION'S NAME

OR 9b. INDIVIDUAL'S SURNAME

FIRST PERSONAL NAME

ADDITIONAL NAME(S)/INITIAL(S)

SUFFIX

Print

Reset

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

10. DEBTOR'S NAME: Provide (10a or 10b) only one additional Debtor name or Debtor name that did not fit in line 1b or 2b of the Financing Statement (Form UCC1) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name) and enter the mailing address in line 10c

10a. ORGANIZATION'S NAME

OR 10b. INDIVIDUAL'S SURNAME

INDIVIDUAL'S FIRST PERSONAL NAME

INDIVIDUAL'S ADDITIONAL NAME(S)/INITIAL(S)

SUFFIX

10c. MAILING ADDRESS

CITY

STATE

POSTAL CODE

COUNTRY

11. ADDITIONAL SECURED PARTY'S NAME **or** ASSIGNOR SECURED PARTY'S NAME: Provide only one name (11a or 11b)

11a. ORGANIZATION'S NAME

OR 11b. INDIVIDUAL'S SURNAME

FIRST PERSONAL NAME

ADDITIONAL NAME(S)/INITIAL(S)

SUFFIX

11c. MAILING ADDRESS

CITY

STATE

POSTAL CODE

COUNTRY

12. ADDITIONAL SPACE FOR ITEM 4 (Collateral):

13. This FINANCING STATEMENT is to be filed [for record] (or recorded) in the REAL ESTATE RECORDS (if applicable)

14. This FINANCING STATEMENT:

covers timber to be cut covers as-extracted collateral is filed as a fixture filing

15. Name and address of a RECORD OWNER of real estate described in item 16 (if Debtor does not have a record interest):

16. Description of real estate:

This form has four boxes that do not appear in the UCC1. To make a local filing Box 13 must be checked, one of boxes in Box 14 must be checked, and Box 15 (name and address of the record owner of the real estate) and Box 16 (description of the real estate) must completed accurately.

If the financing statement must be filed locally with the office of the County Recorder then by necessity it must be filed in the state where the **collateral is located**. (In the case of as-extracted collateral the financing statement must be filed in the county where the wellhead or minehead is located.) If the financing statement is filed centrally with the office of the Secretary of State then it must be filed in the state where the **debtor is located**.

4. Where Is the Debtor Located?

Section 9-307 governs the location of a debtor. There are three different rules for three different categories of debtors.

- a. Individual debtors.** "A debtor who is an individual is located at the individual's principal residence."
- b. Debtors that are organizations that are not registered organizations.** "A debtor which is an organization and has only one place of business is located at its place of business. A debtor which is an organization and has more than one place of business is located at its chief executive office."
- c. Registered organizations.** "A registered organization which is organized under the law of a state is located in that state."

Businesses that are sole proprietorships are treated as "individuals." A sole proprietorship is located in the state where the individual who owns the business has their residence.

Businesses that are general partnerships are organizations but are not registered organizations. A general partnership is located at its place of business (if there is only one) or at its chief executive office (if it has more than one place of business).

A corporation, limited liability company, a limited partnership, and a limited liability partnership are registered organizations. These are all located in the state where the articles of incorporation, the certificate of organization, or the certificate of partnership is filed. All of these forms are available from the Pennsylvania Department of State at <https://www.dos.pa.gov/BusinessCharities/Business/RegistrationForms/Pages/default.aspx>.

Keeping all of these rules in mind let us practice determining where a financing statement should be filed in the following problem.

Problem 14. Where Should the Financing Statement Be Filed?

Carroll Springbok is a resident of Pennsylvania who owns several businesses. Carroll has applied for loans for each of the businesses from Buttermilk Bank. The bank has demanded collateral for each loan. Assume that the parties have entered into valid security agreements with respect to each secured transaction. Where should the bank file its financing statement with respect to each item of collateral?

1. Carroll is the sole proprietor of a plumbing supply store located in Jamestown, New York doing business as "Plumbing Extras." Jamestown is the store's sole place of business. As collateral for a loan to the store Carroll grants the bank a security interest in "all of the inventory, now-owned or hereafter acquired" by the store.

State _____ Central or local _____

2. Assume that the plumbing supply store is not a sole proprietorship but instead is a general partnership by the name of "Plumbing Partners" that is not registered with any state. The partnership does not own any other businesses. The other general partner is Jo Springbok, who also lives in Pennsylvania. Again the collateral is the store's inventory, "now owned or hereafter acquired."

State _____ Central or local _____

3. Assume that the plumbing supply store is owned by a limited partnership by the name of "CJ Plumbing LP" that is registered in the state of Massachusetts. Carroll is the general partner and Jo is the limited partner and they both live in Pennsylvania. Again the collateral is the store's inventory, "now owned or hereafter acquired."

State _____ Central or local _____

4. Carroll is the sole stockholder of CS Enterprises, Inc., which is registered in Delaware. CS Enterprises is a headhunting firm that has its sole place of business in New London, Connecticut. As collateral for the loan CS Enterprises grants the bank a security interest in "all of the accounts, now owned or after-acquired" by the corporation.

State _____ Central or local _____

5. As additional collateral for the loan that the bank made to CS Enterprises Carroll grants the bank a security interest in a stand of timber on land that Carroll personally owns in Athens County, Ohio.

State _____ Central or local _____

6. Carroll is the managing member of RipRock LLC, which operates a granite quarry in Vermont. The Certificate of Organization for RipRock LLC is filed in the state of Colorado.

As collateral the LLC grants the bank a security interest in all of the granite that is dug out of the quarry.

State _____ Central or local _____

7. There is a warehouse at the site of the Vermont quarry owned by RipRock LLC. Attached to the warehouse is a valuable crane that is used in the operation of the quarry. The crane may be a “fixture” or it may be “goods.” The bank isn’t sure so it decides to file both a regular financing statement and a fixture filing. Where would each of those financing statements be filed?

Regular financing statement: State _____ Central or local _____

Fixture filing: State _____ Central or local _____

We shall return to the topic of fixture filings later in this Chapter. For now let us turn to another box that must be accurately filled out in a financing statement: the name of the debtor.

5. Who Is the Debtor?

Whether the financing statement is filed centrally or locally the name of the debtor must appear on the financing statement, and it must be accurate because financing statements are filed alphabetically according to the name of the debtor. Let us reconsider Problem 12 but this time we shall determine who the debtor is.

Problem 15. Who Is the Debtor?

Carroll Springbok is a resident of Pennsylvania who owns several businesses. Carroll is has applied for loans for each of the businesses from Buttermilk Bank. The bank has demanded collateral for each loan. Assume that the parties have entered into valid security agreements with respect to each secured transaction. In each case who is the debtor?

1. Carroll is the sole proprietor of a plumbing supply store located in Jamestown, New York doing business as “Plumbing Extras.” Jamestown is the store’s sole place of business. As collateral for a loan to the store Carroll grants the bank a security interest in “all of the inventory, now-owned or hereafter acquired” by the store.

Debtor _____

2. Assume that the plumbing supply store is not a sole proprietorship but instead is a general partnership by the name of “Plumbing Partners” that is not registered with any

state. The other general partner is Jo Springbok, who also lives in Pennsylvania. Again the collateral is the store's inventory, "now owned or hereafter acquired."

Debtor _____

3. Assume that the plumbing supply store is owned by a limited partnership by the name of "CJ Plumbing LP" that is registered in the state of Massachusetts. Carroll is the general partner and Jo is the limited partner and they both live in Pennsylvania. Again the collateral is the store's inventory, "now owned or hereafter acquired."

Debtor _____

4. Carroll is the sole stockholder of CS Enterprises, Inc., which is registered in Delaware. CS Enterprises is a headhunting firm that has its sole place of business in New London, Connecticut. As collateral for the loan CS Enterprises grants the bank a security interest in "all of the accounts, now owned or after-acquired" by the corporation.

Debtor _____

5. As additional collateral for the loan that the bank made to CS Enterprises Carroll grants the bank a security interest in a stand of timber on land that Carroll personally owns in Athens County, Ohio.

Debtor _____

6. Carroll is the managing member of RipRock LLC, which operates a granite quarry in Vermont. The Certificate of Organization for RipRock LLC is filed in the state of Colorado. As collateral the LLC grants the bank a security interest in all of the granite that is dug out of the quarry.

Debtor _____

7. There is a warehouse at the site of the Vermont quarry owned by RipRock LLC. Attached to the warehouse is a valuable crane that is used in the operation of the quarry. The crane may be a "fixture" or it may be "goods." The bank isn't sure so it decides to file both a regular financing statement and a fixture filing.

Debtor _____

Here is a case where the secured party made a critical error regarding who the debtors were.

In re Meena, 97 UCC Rep. Serv.2d 181 (Bankr. Ct. E.D. New York, 2018)

Choudhry and Gulmeena Javaid, individuals, entered into franchise agreements with General Nutrition Corporation (GNC). The Javaids signed security agreements covering any inventory in their stores. GNC filed financing statements listing Choudhry and Gulmeena as the debtors. However, the stores were actually owned and operated by three corporations that were formed by the Javaids: Meena, Inc., Desa of NY, Inc. and SDA, Inc. The corporate entities ordered and paid for the inventory that the stores purchased from GNC.

The Bankruptcy Court found that the financing statements were invalid. Accordingly the security interests of GNC in the inventory of the stores were unperfected and therefore invalid in bankruptcy.

Practice pointer. The practical lesson is obvious. A secured party must be aware of who the debtor is, that is, what individual or commercial entity owns the collateral that secures the indebtedness. That lesson also applies to every kind of contract: leases, sales contracts, service contracts, construction contracts, and employment contracts. Be aware of whom you are dealing with.

6. What Is the Name of the Debtor?

Not only is it necessary to identify who the debtor is; it is also necessary to accurately state the debtor's name. This matter is governed by [Section 9-503](#), [Section 9-506](#) and the "standard search logic" rules that have been adopted by the state.

[Section 9-503\(a\)](#) provides that "a financing statement sufficiently provides the name of the debtor:

- (1) ... if the debtor is a registered organization ... only if the financing statement provides the name that is stated on the public organic record most recently filed with ... the registered organization's jurisdiction of organization
...
(4) ... if the debtor is an individual to whom the Department of Transportation has issued a driver's license which has not expired ... or an identification card ..., only if the financing statement provides the name of the individual which is indicated on ... the driver's license or ... if there is no driver's license, the identification card.

(5) If the debtor is a person to whom Paragraph (4) does not apply, only if the financing statement provides the individual name of the debtor or the surname and first personal name of the debtor.

(6) In other cases, if the debtor has a name, only if the financing statement provides the organizational name of the debtor; and if the debtor does not have a name, only if the financing statement provides the names of the partners, members, associates or other persons comprising the debtor, in a manner that each name provided would be sufficient if the person named were the debtor.

Section 9-506 provides a safe harbor for errors that are not “seriously misleading.” If a search of the filing system using standard search logic would disclose a financing statement then an error in the name of the debtor would not be “seriously misleading.”

The “seriously misleading” standard has invalidated a great many financing statements. Here are a few recent examples.

In re Pierce, 94 U.C.C. Rep Serv 2d 1031 (Bankr. Ct. S.D. Georgia 2018).

The Farm Bureau Bank loaned \$18,000 to Kenneth R. Pierce to purchase a fertilizer spreader, and Pierce granted the bank a security interest in the spreader. On the financing statement the bank listed the debtor’s name as “Kenneth Pierce.” The debtor’s driver’s license displayed his name as “Kenneth Ray Pierce.” The driver’s license was signed as “Kenneth Pierce.”

Like Pennsylvania, Georgia is an “**only if**” state. That is, Section 9-502 of the U.C.C. as enacted in Georgia provides that a financing statement is sufficient only if it “**provides the name of the debtor**” and Section 9-503 provides that a financing statement sufficiently provides the name of an individual debtor “**only if the financing statement provides the name of the individual which is indicated on the driver’s license.**”

The Bankruptcy Court ruled that the financing statement was “seriously misleading” and therefore ineffective. The security interest of the Farm Bureau Bank in the fertilizer spreader was therefore unperfected and unprotected in bankruptcy.

Practice pointer. As a practical matter what procedure should a lender follow when an individual applies for a loan to prevent the kind of problem that arose in *In re Pierce*?

In the following case a similar problem arises but the debtor is a limited liability company, not an individual. What documentation supplies the correct name of a registered organization?

In re Wastetech, LLC, 99 U.C.C. Rep Serv 2d 110 (Bankr. Ct N.D. Georgia, 2019)

The debtor officially changed its name from “NTC Waste Group, LLC” to “Wastetech, LLC” on July 7, 2017. Between June 13 and September 26, 2017, the debtor sold its accounts receivables

to Silverline Services, Inc. On November 14, 2017, Silverline filed a financing statement naming the debtor as “NTC Waste Group, LLC.” The Bankruptcy Trustee filed an affidavit stating that a search of the U.C.C. records under the name “Wastetech, LLC” failed to reveal the financing statement filed by Silverline. As a result the name of the debtor on the financing statement was “seriously misleading” within the meaning of [Section 9-506](#). The Bankruptcy Court concluded:

Accordingly, the perfection of the security interest of the Defendant in Accounts Receivable of the Debtor is ineffective under Georgia law because (i) the Debtor’s name listed on the Financing Statement (NTC Waste Group, LLC) is inconsistent with its name on the public record (Wastetech, LLC) due to a name change prior to the filing of the Financing Statement, and (ii) a search of the Georgia Superior Court Clerks’ Cooperative Authority’s Lien records for the entity “Wastetech” or “Wastetech LLC” would not have disclosed the existence of the Financing Statement.

The Bankruptcy Trustee prevailed over Silverline and the accounts were subject to the claims of the creditors represented by the trustee.

Practice pointer. What documentation should a lender demand when a registered organization applies for a loan? And what should the lender do before releasing any funds to the debtor?

Cases involving wrong debtors’ names are legion. Here are two more examples.

Fishback Nursery, Inc. v. PNC Bank, N.A., 94 U.C.C. Rep. Serv.2d 484 (U.S. District Ct. N.D. Texas, 2017)

The debtor’s name in its Certificate of Organization was “BFN Operations LLC”. However, the secured party listed the debtor’s name on the financing statement as “BFN Operations, LLC abn Zelenka Farms”. The District Court ruled that the inserted comma and the inclusion of the trade name made the financing statement “seriously misleading.” Accordingly the court ruled that the security interest was unperfected.

In re PTM Technologies, 452 B. R. 165 (Bankr. Ct. M.D. N.C., 2011)

The debtor’s name was “PTM Technologies” but the secured parties listed the debtor’s name in the financing statement as “PTM Tecnologias” (omitting the “h”). [Section 9-506\(c\)](#) contains a “safe harbor” provision for situations where the debtor’s name is misstated or misspelled; it provides:

(c) Financing statement not seriously misleading. If a search of the records of the filing office under the debtor’s correct name, using the filing office’s standard search logic, if

any, would disclose a financing statement which fails sufficiently to provide the name of the debtor in accordance with section 9503(a), the name provided does not make the financing statement seriously misleading.

In this case, however, when the actual name of the debtor (PTM Technologies) was used to search the North Carolina UCC filings the “standard search logic” of the filing office did not turn up the financing statement the lenders had filed under the name “PTM Technologies.” As a result their security interest was unperfected.

Once a financing statement has been filed it may have to be amended or refiled. The following recorded lecture and subsection of this chapter covers that important topic.

7. Lecture 15. Changes That Require Amending or Refiling the Financing Statement

Lecture 15 identifies five situations where a financing statement must be amended or refiled:

- a. When collateral is added to a security agreement;
- b. When a debtor's name changes and the new name makes the financing statement “seriously misleading;”
- c. When a debtor becomes bound to a security agreement by operation of law (a “new debtor”) and the name of the new debtor makes the financing statement “seriously misleading;”
- d. When a debtor moves to a different state; and
- e. When the collateral is transferred to another party, the other party acquires the collateral subject to the security interest, and the other party is located in another state.

Problem 15 tests your understanding of what the secured party must do if one of the foregoing events occurs. Please prepare answers for each of the questions; we'll discuss those answers in class.

Problem 16. The Changeable Debtor

Ostend Company is a corporation registered in New York that deals in medical supplies. Granger Bank has a security interest in Ostend's inventory and has filed a financing statement in New York covering “inventory.” As to each event listed below indicate what form (if any) needs to be filed: (1) No filing at all is necessary; a UCC3 Amendment to the original financing statement; or a new UCC1; (2) In which state the form must be filed; and (3) The legal consequence that will occur if the form is not filed.

a. Ostend Company changes its name to “Ostend Co.” Section 9-507(c).

No Filing, file a UCC3, or file a new UCC1

In which state

Legal consequence if the new form is not filed

b. Ostend Company changes its name to “MedSupp Inc.” Section 9-507(c).

No Filing, file a UCC3, or file a new UCC1

In which state

Legal consequence if the new form is not filed

c. Ostend and Granger amend the security agreement to add “accounts” as collateral. Section 9-512(c).

No Filing, file a UCC3, or file a new UCC1

In which state

Legal consequence if the new form is not filed

d. Ostend Company terminates its registration in New York as a corporation and converts to an LLC in New York without changing its name. Section 9-508.

No Filing, file a UCC3, or file a new UCC1

In which state

Legal consequence if the new form is not filed

e. Ostend Company terminates its registration in New York and files its Articles of Incorporation in Delaware without changing its name. Section 9-316.

No Filing, file a UCC3, or file a new UCC1

In which state

Legal consequence if the new form is not filed

f. Ostend sells all of its assets to Ypsilanti Incorporated, a Michigan corporation. Section 9-316.

No Filing, file a UCC3, or file a new UCC1

In which state

Legal consequence if the new form is not filed

Practice pointer. In representing a secured party, make sure that the security agreement requires the debtor to give the secured party notice of any name change; if the debtor does not promptly give the secured party notice of a name change it is an act of default. The security agreement should also prohibit any disposition of collateral without the written permission of the secured party, but under Section 9-401 and 9-406 and 9-408 those kinds of prohibitions have no effect of the rights of a person who purchases the collateral from the debtor unless the purchaser **knows** that the transfer is in violation of the rights of the secured party.

8. Description of the Collateral in the Financing Statement (reprised)

We covered the topic of “description of the collateral” in Chapter 2. Here is a case that reminds us that under [Section 9-504\(2\)](#) the description of collateral in a financing statement may be far broader than the description of the collateral in a security agreement.

In re B & M Hospitality LLC, 584 B.R. 88 (Bankr. Ct. E.D. Penn., 2018)

M & T Bank loaned \$85,000 to B & M Hospitality. The security agreement identified the collateral as “general intangibles limited to that certain restaurant liquor license number R-1140 issued by the Pennsylvania Liquor Control Board” and the proceeds of the collateral. The financing statement described the collateral as “all assets of the debtor, whether now existing or hereafter acquired or arising, wherever located.” The court ruled that the description of the collateral in the financing statement was sufficient and that the security interest of M & T Bank in the liquor license was perfected.

Practice pointer. If the debtor owns a particularly valuable piece of property serving as collateral, it would be wise to describe the collateral as “including but not limited to” that item of property.

The next subsection of this chapter gives us the opportunity to study a specialized type of financing statement: the “fixture filing.”

9. Lecture 16. Filing as to Fixtures

There are three ways to perfect a security interest in fixtures. (1) By filing a real property mortgage; (2) By filing a financing statement with the office of the Secretary of State in the state where the debtor is located; and (3) By filing a fixture filing in the county where the fixture is located and in the office where land records are filed, usually the office of the County Recorder. In Chapter 6 we shall study priority in fixtures and we shall learn which kind of filing is appropriate in different situations. For now, however, we shall see an example of where a fixture filing is not appropriate or effective.

Presented below is another Pennsylvania case concerning a security interest in a liquor license. However, the secured party filed a **fixture filing** to perfect the security interest. Is a liquor license a fixture?

In re Tam of Allegheny LLC, 93 U.C.C. Rep. Serv.2d 1139 (Bankr. Ct. W.D. Penn., 2017)

A liquor license is **not** a fixture because it is **not goods**. A liquor license is a general intangible. The court held:

In this case, California filed a UCC financing statement with the Allegheny County Recorder of Deeds on September 22, 2004. The financing statement was filed as a fixture filing and listed the liquor license, among other things, as collateral. At the hearing on this matter, California conceded that it did not file the financing statement with the Secretary of the Commonwealth of Pennsylvania. While the Allegheny County filing may have perfected California’s interest in certain fixtures, it was not operative with respect to the liquor license or other personal property. Due to its failure to properly record the financing statement, California holds an unperfected security interest in the liquor license.

10. Other Forms Related to Financing Statements: Amendments, Continuation Statements, and Termination Statements

A frequently-used UCC Form is the UCC3. This form is used for three different purposes: to amend financing statements, to serve as continuation statements, and to serve as termination statements. Here is the UCC3:

UCC FINANCING STATEMENT AMENDMENT

FOLLOW INSTRUCTIONS

A. NAME & PHONE OF CONTACT AT FILER (optional)
B. E-MAIL CONTACT AT FILER (optional)
C. SEND ACKNOWLEDGMENT TO: (Name and Address) [Large empty box for address]

Print

Reset

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1a. INITIAL FINANCING STATEMENT FILE NUMBER	1b. <input type="checkbox"/> This FINANCING STATEMENT AMENDMENT is to be filed [for record] (or recorded) in the REAL ESTATE RECORDS Filer: attach Amendment Addendum (Form UCC3Ad) and provide Debtor's name in item 13			
2. <input type="checkbox"/> TERMINATION: Effectiveness of the Financing Statement identified above is terminated with respect to the security interest(s) of Secured Party authorizing this Termination Statement				
3. <input type="checkbox"/> ASSIGNMENT (full or partial): Provide name of Assignee in item 7a or 7b, and address of Assignee in item 7c and name of Assignor in item 9 For partial assignment, complete items 7 and 9 and also indicate affected collateral in item 8				
4. <input type="checkbox"/> CONTINUATION: Effectiveness of the Financing Statement identified above with respect to the security interest(s) of Secured Party authorizing this Continuation Statement is continued for the additional period provided by applicable law				
5. <input type="checkbox"/> PARTY INFORMATION CHANGE: Check <u>one</u> of these two boxes: This Change affects <input type="checkbox"/> Debtor or <input type="checkbox"/> Secured Party of record AND Check <u>one</u> of these three boxes to: CHANGE name and/or address: Complete <input type="checkbox"/> item 8a or 8b; and item 7a or 7b and item 7c ADD name: Complete item <input type="checkbox"/> 7a or 7b, and item 7c DELETE name: Give record name <input type="checkbox"/> to be deleted in item 8a or 8b				
6. CURRENT RECORD INFORMATION: Complete for Party Information Change - provide only <u>one</u> name (6a or 6b)				
6a. ORGANIZATION'S NAME				
OR 6b. INDIVIDUAL'S SURNAME FIRST PERSONAL NAME ADDITIONAL NAME(S)/INITIAL(S) SUFFIX				
7. CHANGED OR ADDED INFORMATION: Complete for Assignment or Party Information Change - provide only <u>one</u> name (7a or 7b) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name)				
7a. ORGANIZATION'S NAME				
OR 7b. INDIVIDUAL'S SURNAME				
INDIVIDUAL'S FIRST PERSONAL NAME				
INDIVIDUAL'S ADDITIONAL NAME(S)/INITIAL(S) SUFFIX				
7c. MAILING ADDRESS		CITY	STATE	POSTAL CODE
7d. COUNTRY				
8. <input type="checkbox"/> COLLATERAL CHANGE: Also check <u>one</u> of these four boxes: <input type="checkbox"/> ADD collateral <input type="checkbox"/> DELETE collateral <input type="checkbox"/> RESTATE covered collateral <input type="checkbox"/> ASSIGN collateral Indicate collateral:				

The UCC3 can be used to add or change information that appeared on an earlier financing statement. It can be used as a continuation statement to extend the effectiveness of a financing statement for another five years. And it can be used as a termination statement to end the effectiveness of a financing statement.

Here are three cases illustrating those various uses of the UCC3.

a. Amendments

The UCC3 can be used to add or delete collateral from a financing statement.

Farmer's and Miner's Bank v. Lee, 93 U.C.C. Rep. Serv.2d 1342 (U.S. Dist. Ct. E.D. Ky., 2017)

The Farmer's and Miner's Bank took and perfected a security interest in three specific pieces of equipment belonging to the debtor identified by their serial numbers. Later the bank filed a UCC Amendment, described by the court as follows:

The UCC Amendment stated that the type of amendment was a "Collateral Change—Delete," referenced the initial Financing Statement, and indicated that the amendment covered the Caterpillar 773D Serial #7CS00180 and the SKF 50 Drill Serial #1R68Z44.

The debtor contended that the Amendment should be construed to mean that Bank had reserved a security interest in the two pieces of equipment that were identified in the Amendment and that the Bank no longer had a perfected security interest in the third piece of equipment.

The court noted that the Amendment properly referenced the number of the original financing statement and concluded that the bank had "clearly" deleted the two pieces of equipment from the original financing statement and that the bank implicitly retained a security interest in the third piece of equipment.

Practice pointer. Note that an amendment to a financing statement must reference the original financing statement number. This is true of all UCC forms: addendums, amendments, continuation statements and termination statements must all reference the number of the original financing statement so that the documents are linked to a single file.

b. Continuation Statements

Financing statements are effective for a period of five years from the date of filing. To extend the perfection of a security interest it is necessary to file a continuation statement within the six-month period prior to the expiration date. The consequence of not filing a continuation statement is harsh.

In re Novak, 96 U.C.C. Rep. Serv.2d 728 (Bank. Ct. D. Kansas, 2018)

The Gregory H. Thoman Trust filed a financing statement covering Novak's harvesting and hay equipment on January 14, 2011. The First National Bank and Trust filed its financing statement

covering the same collateral on January 7, 2014. Novak filed for bankruptcy in October of 2017. The first paragraph of the court's opinion is this case summarizes the facts and the holding:

Letting your financing statement lapse is a fatal error when junior secured parties are lurking. The lapse "unperfects" the security interest the financing statement was filed to protect. The Gregory H. Thoman Trust perfected a security interest in the farm equipment and vehicles that it sold to Ronald Novak, but let its financing statement lapse. That allowed Novak's farm lender, the First National Bank and Trust, to vault into first place on nearly all the seller's collateral, including the insurance proceeds of a burnt-up grinder, even before Novak filed this case. ... The Bank is entitled to summary judgment on its complaint that its security interests in Ronald Novak's personal property, including the insurance proceeds, is a valid and perfected first lien.

Practice pointers.

1. The first sentence of the opinion states the principal practical lesson to be drawn from this case: be sure to file a continuation statement! As always consider what procedures a law office would adopt to keep track of dates and UCC filings.
2. There are several other points about the law that we can learn from *In re Novak*. Note that a security interest automatically attaches to the **proceeds** of collateral. Note also that the term "proceeds" is broadly defined and includes **insurance proceeds** as well the proceeds from any sale or other disposition of the collateral. The case also mentions two fundamental rules of **priority**: (1) Between two perfected secured parties the first to file or perfect takes priority; and (2) Between a perfected secured party and an unperfected secured party, the perfected secured party takes priority. We shall study the law governing priority and proceeds in future lessons.

c. Termination Statements

From the GM case in Chapter 1 you are aware of the consequence of accidentally filing a termination statement. What if the mistake is corrected 10 minutes later? Can the damage be undone?

[In re Wheeler, 94 U.C.C. Rep. Serv.2d 528 \(Bankr. Ct. W.D. Kentucky, 2017\)](#)

Farmer's Bank & Trust made a loan to Wheeler, a farmer, in 2005 and filed a timely continuation statement on May 7 2015. A loan processor who was an independent contractor for the bank accidentally filed a termination statement on July 10, 2015, and a correcting amendment was filed 10 minutes later. On April 18, 2016, the bank filed a correction

statement, and on April 27, 2016, the bank filed a new financing statement. Another lender, CPS, took a security interest in the same collateral and filed a financing statement on May 11, 2011, and filed a timely continuation statement.

The Bankruptcy Court granted judgment to CPS because a perfected security interest takes priority over an unperfected security interest and because as between two parties with perfected security interests priority is awarded to “the first to file or perfect” so long as the security interest is continuously perfected. In this case there was a gap in the perfection of the bank’s security interest, so the bank’s date of filing was reset. Moreover, even though the actions of the loan processor were not in accordance with the bank’s instructions the processor had authority to file the termination statement on behalf of the bank, and the processor’s mistake was attributable to the bank.

Practice pointers.

1. *In re Motors Litigation*, cited in the *Wheeler* case, involved the mistaken termination statement that cost Morgan Stanley \$329 million. The entire point of Article 9 and the law of Secured Transactions is to protect lenders and credit sellers from the competing claims of other creditors to the collateral.
2. The court stated: “Authorization relates to the act of filing, not necessarily to the effect of that act.” This is basic agency law. If a principal has given an agent the power to bind the principal then the principal is bound by any acts of the agent within the scope of the agency.

11. Errors by the Filing Office

Until now we have been concerned with errors by secured parties or their agents in filing financing statements, addendums, amendments, continuation statements, and termination statements.

But what if the filing office makes a mistake? As between the person who submitted the correct form to the filing office and the party searching the records in vain for a record that has been misfiled, who will bear the loss? This matter is governed by [Section 9-517](#) and is illustrated by the following case.

[In re Feed Store, LLC, 95 U.C.C. Rep. Serv. 2d 339 \(Bankr. Ct. N.D. West Virginia, 2018\)](#)

[Section 9-517](#) of the U.C.C. provides:

The failure of the filing office to index a record correctly does not affect the

effectiveness of the filed record.

People's Bank submitted a complete and correct financing statement to the West Virginia Secretary of State's office along with the required fee. However, the filing office mistakenly assigned the same filing number that had been used for a previous financing statement. This prevented persons searching under the debtor's name from finding the financing statement. Under Section 9-517 the bank's financing statement is considered valid and effective. The Bankruptcy Trustee contended that Section 9-517 is unconstitutional because the Due Process Clause of the Constitution requires **actual notice** of a security interest; the Trustee argued that **constructive notice** is insufficient and violates due process.

The court ruled that the Due Process Clause does not require actual notice but rather "only notice that is '**reasonably calculated**, under all the circumstances, to apprise interested parties'" of the security interest. The court concluded:

Based on the foregoing, the court finds that the effect of West Virginia Code § 46–9–517 did not violate the Trustee's procedural due process right to notice under the Fifth and Fourteenth Amendments. By properly filing its financing statement, Peoples Bank took reasonable, practicable steps to provide the Trustee with constructive notice under the principles of the UCC, notwithstanding the Secretary of State's indexing error. The court further finds that West Virginia Code § 46–9–517 does not violate the United States Constitution by imposing the risk of filing-office error on searchers rather than filers

Practice pointers.

1. The court finds that a filer who meets the following requirements is protected against filing errors: "a filer who properly and accurately completes a financing statement, delivers it with the proper fee to the Secretary of State, and who receives no information or notice that their filing was mis-indexed." Be sure that the financing statement is complete and accurate; that the correct fee is sent with the financing statement; and to promptly respond to information that the statement has been misfiled.
2. It is frequently the case that two innocent persons suffer a loss because of the action of a third party and that the law must allocate the loss, at least initially, to one of the innocent persons. The law usually allocates the loss to the person who is in the best position to prevent the loss or to the person who is in the best position to insure against the loss. As between the secured party who submitted the correct financing statement that was misfiled and the second party who searched the records and did not find the misfiled financing statement, who should bear the loss? Which of these parties was in the best position to prevent or insure against mistakes by the filing office?

12. Fraudulent Financing Statements

Self-styled “sovereign citizens,” disappointed litigants and incarcerated criminals have abused the U.C.C. filing system by filing fraudulent financing statements against prosecutors, judges, and other persons. The uniform version of the U.C.C. does not provide an effective remedy for this abuse. Termination statements do not remove a fraudulent filing from public view.

Litigation to remove fraudulent statements is expensive and time-consuming. *See, e.g., Bank of New York Mellon v. Hatheway*, 100 U.C.C. Rep. Serv.2d 10 (Superior Court of Connecticut, 2019) (denying a court order to remove obviously fraudulent filings preventing resale of mortgaged properties because the plaintiff bank was not named on the filings); *JP Morgan Chase Bank NA v. Carraker*, 95 U.C.C. Rep. Serv.2d 916 (Court of Appeals of Arizona, 2018) (ruling that a fraudulent filing against the bank based upon an imaginary \$3 trillion claim was void).

Pennsylvania responded to this problem by enacting a non-uniform provision to Article 9, Section 9518(f), which allows a person falsely victimized as a “debtor” to request an administrative hearing before the office of the Secretary of State which can result in the removal of the fraudulent statement from the filing system and a criminal referral. In its biannual [UCC Report for 2018](#) the Secretary for the Commonwealth of Pennsylvania stated:

In accordance with 13 Pa.C.S. §9518(f)(1)(vi), the Department has made 16 referrals to the Office of Attorney General for criminal prosecution of fraudulent filers. Of the referrals acted upon, most have resulted in conviction, with sentences ranging from probation under a plea agreement to 8-16 years in state prison. It is hoped that as word of these convictions reaches the sovereign citizen/freeman community and correctional facilities, the prospect of these penalties will further deter illegitimate and fraudulent Uniform Commercial Code filings.

End of Chapter 4

Chapter 5. Perfection, continued. Automatic Perfection, Perfection by Possession, Perfection by Control, Perfection by Notation on a Certificate of Title, and Perfection of Agricultural Liens

In Chapter 4 we studied how to perfect a security interest in collateral by filing a financing statement. In Chapter 5 we shall study five other ways of perfecting a security interest: automatic perfection, temporary automatic perfection, perfection by possession, perfection by control, and perfection by notation on a certificate of title. We shall also study how to perfect an agricultural lien.

A. Learning Objectives

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Identify the situations and types of collateral where automatic perfection, temporary automatic perfection, perfection by possession, perfection by control, perfection by notation of liens on a certificate of title, or perfection of agricultural liens are possible and appropriate.
2. Distinguish the actions necessary to perfect a security interest by means of automatic perfection, temporary automatic perfection, perfection by possession, perfection by control, perfection by notation of liens on a certificate of title, or perfection of agricultural liens.

B. Automatic Perfection

“Perfection of a security interest” consists of certain steps that must be taken to protect the interest of the secured party after the security interest has “attached,” that is, after value has been given, the debtor has acquired sufficient rights in the collateral, and the debtor and the secured party have entered into a valid security agreement.⁶ We have already studied one “step” that might be taken to perfect a security interest: filing a financing statement.

⁶ Section 9-308(a) supports the view that perfection should be conceived of as “attachment plus steps.” It provides:

Perfection of security interest. Except as otherwise provided in this section and section 9309 (relating to security interest perfected upon attachment), a security interest is perfected if it has

However there are four situations where the law does not require **any** additional steps to be taken to perfect a security interest. In these situations once attachment occurs the security interest is **automatically perfected**. These four situations of automatic perfection are:

1. Purchase-money security interest in consumer goods;
2. Sale of a payment intangible or sale of a promissory note;
3. An assignment of an account or a payment intangible that does not transfer a significant part of the assignors' accounts or payment intangibles; and
4. Perfection of a security interest in certain types of proceeds.

Each of these categories of automatic perfection is described in more detail below.

1. Purchase-Money Security Interests in Consumer Goods

A “purchase-money security interest” (abbreviated PMSI) arises when the secured party provides funds or an extension of credit that enables the debtor to acquire goods. For example if an appliance store permits a person to purchase a refrigerator on credit and the store retains a security interest in the refrigerator until the refrigerator is fully paid for, the store has a “purchase-money security interest” in the refrigerator. Similarly, if a bank lent money to a person to purchase a refrigerator and the bank retained a security interest in the refrigerator until the loan was paid off, that also would be a “purchase-money security interest.” If the refrigerator was purchased for personal purposes and not business purposes then the transaction would create a “purchase-money security interest in consumer goods.”

A purchase-money security interest conveys certain advantages to a secured party. A purchase-money security interest often takes **priority** over non-purchase-money security interests even if the non-purchase-money security interest was perfected earlier in time than the purchase-money security interest. Purchase-money security interests are favored because by giving the debtor the “purchase-money” for goods the seller or lender **enables** the debtor to acquire the goods, thus adding to the amount of property owned by the debtor and serving as collateral. The law governing purchase-money security interests is complex and we shall study it in more detail in Chapter 6. In Chapter 5 our focus is on **perfection**, and under [Section 9-309\(1\)](#) a purchase-money security interest in consumer goods is **automatically perfected**.

attached and all of the applicable requirements for perfection in sections 9310 (relating to when filing required to perfect security interest or agricultural lien; security interests and agricultural liens to which filing provisions do not apply) through 9316 (relating to effect of change in governing law) have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.

Why would a purchase-money security interest in consumer goods be automatically perfected? There are several reasons. Consider how many transactions of this type occur. When a person purchases consumer goods on credit the sales contract likely includes a security agreement; that is, the consumer agrees to grant the seller or lender the right to repossess the goods if the consumer misses a payment. There are untold millions of credit transactions like this every year. Moreover, the vast majority of these transactions are for a relatively low price. It would not be feasible to file a financing statement recording every consumer credit transaction and it would be wasteful to add the cost of filing to the price of every consumer transaction. Nor would it make any sense in most cases for a seller or a lender to perfect a security interest in consumer goods by taking possession of the goods until the goods are paid for. There are situations where consumers and sellers enter into “layaway” plans where the seller retains possession until the goods are paid for in full, but most consumers want possession of consumer goods as soon as they enter into an agreement to buy them. In light of these considerations the law does not require secured parties to take any additional steps after attachment in order to perfect a security interest in consumer goods.

There is one exception to this rule of automatic perfection for a purchase-money security interest in consumer goods: if the property that is financed is a vehicle for which there is a **certificate of title** and state law requires liens to be noted on the certificate of title, the secured party must note the lien on the certificate of title in order to perfect the security interest.

The law governing purchase-money security interests is extremely complex. Here are a few issues that will be addressed in subsequent chapters:

1. If the debtor purchases the goods with their own funds before the lender releases the funds that were intended to be used for the purchase, does the lender acquire a “purchase-money security interest” in the goods? (This issue is addressed in Chapter 6.)
2. If a loan is made for a “dual purpose,” that is both to enable the debtor to acquire goods and for other purposes as well, does the secured party acquire a “purchase-money security interest” in the goods? (This issue is addressed in Chapter 6.)
3. When payments are made on a “dual purpose” loan how are payments to be allocated between the purchase-money portion of the indebtedness and the non-purchase-money portion of the indebtedness? (This issue is addressed in Chapter 6.)
4. If a lender refinances a purchase-money loan does the security interest retain its status as a purchase-money security interest or is it transformed into a non-purchase-money security interest? (This issue is addressed in Chapter 6.)
5. If the goods that are the subject of the purchase-money loan are fixtures is it necessary or advisable for the secured party to file a fixture filing covering the goods? (The answer is “Yes” because a fixture filing is necessary to protect a secured party against persons who may have a pre-existing mortgage on the land or building that the

fixture is attached to. We shall study perfection and priority of security interests in fixtures in Chapter 7.)

6. If the goods that are the subject of the purchase money loan are consumer goods that are valuable is it advisable for the secured party to file a financing statement even though the security interest is automatically perfected? (The answer is “Yes” because otherwise the debtor may sell the item to another consumer who would take free of a security interest that has been perfected automatically. We shall study the rights of buyers of collateral in Chapter 7.)

All of these complex issues are deferred to later chapters of the book. At this time we shall address only one question: are the goods that the debtor purchased “consumer goods?”

At first glance the definition of “consumer goods” seems to be straightforward. Under [Section 9-102](#), consumer goods are goods that are “used or bought for use for personal, family, or household purposes.” A computer that is purchased for the home is “consumer goods;” a computer that is purchased for work is “equipment.” What if the debtor lies to the secured party about their intended use of the goods?

We have not yet studied the validity of security interests in bankruptcy, which will be the subject of Chapters 9 and 10. When a debtor files for bankruptcy it immediately sets up a conflict between secured parties and the bankruptcy trustee. A secured party will attempt to preserve its interest in the property of the debtor that serves as collateral, while the bankruptcy trustee will assert a claim to all of the debtor’s non-exempt property for the benefit of all the creditors. Federal law (the Bankruptcy Code) grants bankruptcy trustees the power to “avoid” security interests in certain circumstances. These powers – the “avoidance powers” – include the “strong arm” power under [Section 544\(a\)](#) of the Bankruptcy Code and the power to avoid preferential transfers under [Section 547](#) of the Bankruptcy Code.

A purchase-money security interest in consumer goods is automatically perfected as soon as the security interest attaches. The issue in the following case is whether the collateral was “consumer goods” or “equipment.”

In re Palmer, 365 B.R. 816 (2007)

A John Deere & Company dealership sold a compact utility tractor and front loader to Joseph Palmer. The sales agreement, which contained a security agreement, contained a printed promise by the buyer that “unless I indicate otherwise” the item was purchased for personal, not commercial, use. On page 6 of the agreement there was a paragraph with a check box and a signature line indicating that the item was being purchased for commercial use; the box was unchecked and the signature line was blank. However, after purchasing the tractor Palmer used it in his business, a kennel for racing greyhounds.

The court ruled that the seller was entitled to rely on the buyer's representations in the sales agreement regarding the intended use of the goods, and that the seller had no duty to investigate whether the goods were actually being used in that manner. Accordingly, John Deere's purchase-money security interest in the tractor was automatically perfected and the bankruptcy trustee did not have the right to avoid the security interest.

Practice Pointers.

1. Would you advise a client who sells computers or machinery or appliances to expressly ask their customers whether the goods are being purchased for personal use or for use in a business? Or should they simply allow the customer to check a box on the sales contract indicating whether the intended use was business or personal?
2. Would you advise a client who sells items like these that instead of relying on the rule that purchase-money security interests in consumer goods are automatically perfected, to be safe the client should file a financing statement whenever they sell an item on credit?

2. Sale of a Payment Intangible or a Promissory Note

The second type of secured transaction that is automatically perfected is the sale of payment intangibles or promissory notes. There are two issues that frequently arise in connection with this rule.

- 1. Categorization of the collateral?** A sale of **accounts** must be perfected by filing a financing statement. However, under Section 9-309(3) and (4) sales of **payment intangibles** and **promissory notes** are automatically perfected.
- 2. Sale or Security Agreement?** If a party **sells** a payment intangible or a promissory note then the buyer does not have to file a financing statement because the transaction is automatically perfected. But if a party borrows money and grants the lender a **security interest** in the payment intangible or promissory note then the lender must file a financing statement recording the transaction.

These two issues are the subject of the following problem.

Problem 17. Gurus' Assets

Computer Gurus, Inc., has the following assets.

1. Legate Company owes Computer Gurus, Inc. \$100,000 for computers that Legate purchased from Computer Gurus.
2. Computer Gurus has a promissory note in the amount of \$85,000 signed by Northeast Industries that Northeast gave to Computer Gurus on account of services performed by Computer Gurus.
3. Terabyte Consolidated owes Computer Gurus \$200,000 because Computer Gurus loaned Terabyte that amount of money earlier this year.
 - a. Assume that Computer Gurus assigned all of these assets to Midwest Bank for \$350,000 and that Midwest had no recourse against Computer Gurus in the event that it was unable to collect the full amount of the money that Legate, Northeast, and Terabyte owed to Computer Gurus. Should Midwest file a financing statement covering any of these assignments from Computer Gurus?
 - b. Assume that Computer Gurus assigned all of these assets to Midwest Bank for \$350,000 and that under their agreement Computer Gurus guaranteed to pay Midwest for any amounts that Legate, Northeast, and Terabyte failed to pay in full. Should Midwest file financing statements covering any of these assignments from Computer Gurus?

3. Assignment of Accounts or Payment Intangibles That Do Not Transfer a Significant Part of the Assignor's Accounts or Payment Intangibles.

Section 9-309(2) of the Code provides that there is automatic perfection of an assignment of accounts or payment intangibles if the assignment did not transfer a "significant part" of the assignor's accounts. But how should a court determine whether an assignment constitutes a "significant part" of a debtor's accounts? There are two tests – the "casual and isolated test" and the "percentage test" – that are used to determine whether an assignment or series of assignments transfers a "significant part" of the debtor's accounts. The following case illustrates the factors that the courts consider in applying each of these tests.

In re Meridian Reserve, 1994 WL 903895 (U.S. Bankruptcy Court, W.D. Oklahoma, 1994)

In a series of six transactions Roy T. Rimmer, an experienced investor, purchased 5% of the royalties owing to Poll Gas, Inc., amounting to \$30,000 per month, but he did not file a financing statement. This was a sale of accounts, so Rimmer's interest in the accounts was unperfected unless an exception to Article 9 applies. The only possibly relevant exception was Section 9-309(2), which applies if Rimmer's purchases did not constitute a "significant part" of the accounts of Poll Gas.

The court ruled that the purchases were not “casual” because Rimmer was a sophisticated investor, and they were not “isolated” because there were six transactions in total. The court also ruled that even though the purchases only accounted for 5% of the company’s accounts it was a “significant” amount because it amounted to \$30,000 per month – a not insignificant amount. The court found that these transactions might occur again; that the amounts were not so small that no-one would care; and that this was not a situation where a small, unsophisticated investor would have burdened by having to pay a filing fee. Taking all of the relevant factors into account, these transactions were governed by Article 9 and Rimmer was required to file a financing statement. Rimmer’s interest in the accounts was unperfected and subject to avoidance by the Bankruptcy Trustee.

Practice Pointer. If your client acquires an account or payment intangible is it safe to assume that the transaction is automatically perfected under [Section 9-309\(2\)](#)?

4. Perfection in Certain Proceeds.

Under [Section 9-315](#) when collateral is leased or sold or exchanged or otherwise generates revenue the security interest automatically attaches to the proceeds and is automatically perfected. The period of automatic perfection may be temporary (a period of 20 days) or it may be permanent (at least so long as the financing statement on the original collateral stays in effect). We shall study attachment, perfection, and priority of security interests in proceeds in Chapter 8.

C. Temporary Automatic Perfection

There are six situations where a secured party is granted automatic perfection for period of 20 days. These periods of automatic perfection give a secured party extra time to perfect a security interest. Pay particular attention to the **purpose** of each of these rules.

1. [Section 9-312\(e\).](#) Temporary automatic perfection of security interests in **certificated securities, negotiable documents, or instruments that are taken for “**new value**.”**

When a lender takes a security interest in a certificated security, a negotiable document, or an instrument by giving the debtor new value (that is, a new loan or extension of credit), after the security interest attaches the security interest is automatically perfected for a period of 20 days.

Purpose. It may take a few days for a secured party to perfect a security interest in a certificated security, a negotiable document, or an instrument. Section 9-312(e) gives the secured party a period of 20 days to file a financing statement or

take possession or delivery of the collateral. This grace period is extended only to secured parties who give the debtor “new value” in return for the security interest.

2. Section 9-312(f). Temporary automatic perfection in **goods** (or a **negotiable document** covering the goods) released to debtor **for sale or exchange**.

When a secured party has possession of goods that are collateral and the debtor needs possession of the goods to sell them or prepare them for sale, the secured party may release the goods to the debtor and the secured party will still have automatic perfection in the goods for a period of 20 days. This exception also applies to negotiable documents representing the goods that are in the possession of the secured party.

Purpose. Normally if the secured party has perfected a security interest in goods by taking possession of the goods and the secured party gives up possession of the goods, then the security interest becomes unperfected the moment the secured party loses possession. Section 9-312(f) allows the secured party to release the goods to the debtor for a period of 20 days to make a sale or to prepare the goods for sale.

3. Section 9-312(g). Temporary automatic perfection in a certificated security or instrument that is released to the debtor for sale, collection, or registration.

This provision is analogous to Section 9-312(f) but it applies to certificated securities and instruments. When a secured party has perfected its security interest by taking delivery of a certificated security or taking possession of an instrument, and it releases the certificated security or instrument to the debtor so that the debtor can sell the item, present, collect or enforce the instrument or renew or register the security, the security interest is automatically perfected for a period of 20 days.

Purpose. The purpose of Section 9-312(g) is the same as the purpose of Section 9-312(f). Normally if the secured party has perfected a security interest in a certificated security or an instrument by taking delivery or possession, the security interest will become unperfected if the secured party gives up possession of the item. Section 9-312(g) allows the secured party to release the certificated security or instrument to the debtor for purposes of sale, collection, or registration and the security interest will remain perfected for a period of 20 days.

4. Section 9-315(d). Temporary automatic perfection in proceeds of collateral.

When collateral is sold or leased or traded “proceeds” are generated. Under Section 9-315(d) if the security interest in the original collateral was perfected, then the security interest in the proceeds is automatically perfected for a period of 20 days.

Purpose. When the debtor acquires proceeds by selling, leasing, or trading collateral for other property, it may take a while for the secured party to learn about the transaction. The 20-day period of temporary automatic perfection gives the secured party time to track down the proceeds and to take steps (if necessary) to perfect a security interest in the proceeds.

5. Section 9-324(a). Purchase-money security interest in equipment.

When a lender or a seller extends credit to a debtor that enables the debtor to purchase goods the lender or seller is entitled to take a “purchase-money security interest” in the goods that the debtor purchased. A secured party with a “purchase money security interest” in goods that are not inventory or livestock takes priority over a conflicting security interest if the security interest is perfected within 20 days after the debtor receives possession of the collateral. Technically this is not “temporary automatic perfection” but rather a “grace period” for filing a financing statement.

Purpose. A secured party can obtain “super-priority” over previous secured parties if they provide credit that enables the debtor to acquire the goods that constitute the collateral. It may be difficult for the secured party to determine whether the debtor has acquired the goods for which the secured party has advanced credit. If the collateral is equipment a secured party can establish its rights to “super-priority” in the collateral if the secured party files its financing statement within 20 days after the debtor obtains possession of the equipment.

6. Section 9-334(d). Purchase-money security interest in fixtures.

When a lender or a seller extends credit to a debtor that enables the debtor to purchase a fixture the lender or seller is entitled to take a “purchase-money security interest” in the fixture that the debtor purchased. A secured party with a “purchase money security interest” in a fixture takes priority over the interest of an owner or encumbrancer of the real property if the security interest is perfected by filing a fixture filing within 20 days after goods become fixtures. As with Section 9-324(a) this provision does not create “temporary automatic perfection” but rather a grace period for filing a fixture filing.

Purpose. The purpose of Section 9-334(d) is the same as the purpose of Section 9-324(a). The secured party may need some time after the debtor has installed the fixture to file a fixture filing. If the secured party files a fixture filing within 20 days after the goods become a fixture then the secured party may qualify as a purchase-money secured party as against the owner or mortgagee of the real property.

D. Perfection by Possession

The oldest and simplest way to give notice to the public that a creditor had a security interest in the debtor's property was for the creditor to take **possession** of the collateral. The practice of "pledging" collateral and the business of "pawnbroking" has been common throughout recorded history. The act of granting possession of the collateral to the secured party is sufficient to place third parties on notice that the property is encumbered, and is also evidence that the parties agreed to the encumbrance. Recall that under [Section 9-203](#) if the secured party is granted possession of the collateral then the security agreement does not have to be in writing.

There is a seeming contradiction between the rule allowing a secured party to perfect a security interest by maintaining possession of goods and the rule that a secured party may have a valid security interest in collateral even though the debtor has the right to retain, use, and even sell the collateral. However, these two legal principles are perfectly consistent with each other. If a secured party elects to perfect its security interest by filing then the debtor is free to use and, if the security agreement allows, dispose of the collateral. If the secured party elects to perfect its security interest by taking possession of the collateral then by definition the debtor is prohibited from exercising dominion or control over the collateral. See [Section 9-205\(a\)](#) and [\(b\)](#).

1. What Is "Possession?"

Perfection by possession is governed by [Section 9-313](#) of the Code; however, "possession" is not defined in the Code. Hawkland contends that a secured party does not have possession of collateral unless it is "complete, unequivocal, and exclusive of the debtor's possession." *Hawkland, § 9-313:3 [Rev] Possession.* Problem 17 illustrates issues that can arise when the secured party's possession of collateral is less than perfect.

Problem 18. Possession of Collateral

In the following situation has the secured party established that it had possession of the collateral?

Janet Kendrick owned and lived on a farm. On the farm there were cattle, equipment and machinery. Janet's son John operated the farm. Janet sold the cattle, equipment and machinery to John and retained a security interest in that personal property, which remained on the farm. Was Janet's security interest in the cattle, equipment and machinery perfected by her "possession" of the goods? See *Kendrick v. Headwaters Production Credit Ass'n*, 523 A.2d 395 (Super. Ct. Pa., 1987).

2. What If Possession Is Interrupted?

The law authorizes a secured party to use more than one method to perfect a security interest. However it is important is to make sure that there is not a “gap” in the perfection of a security interest. [Section 9-308\(c\)](#) governs the concept of “continuous perfection.” It provides:

Continuous perfection; perfection by different methods. A security interest or agricultural lien is perfected continuously if it is originally perfected by one method under this division and is later perfected by another method under this division without an intermediate period when it was unperfected.

The consequence of a “gap” in perfection is that perfection lapses. If the secured party takes steps to re-perfect its security interest then the date of perfection would be the date when the secured party re-perfected its security interest. See Comment 4 to Section 3-308.

The consequence of a gap in perfection is explored in the following problem.

Problem 19. The Double Eagle

Avery Lore lawfully owns a 1933 Double Eagle gold coin. In 2017 Avery needed money and borrowed \$200,000 from Oak Leaf Bank. The loan agreement granted the bank a security interest in the coin. The bank immediately took possession of the coin but did not file a financing statement. Avery asked the bank to lend him the coin so that the coin could be displayed at a televised patriotic event on July 4, 2019. The bank agreed and it released the coin to Avery at noon for a period of six hours on that date. The coin was promptly returned to the bank at 6:00 p.m.; a loan officer met Avery at the bank that evening to receive the return of the coin.

- a. Was the bank’s security interest in the coin “temporarily automatically perfected” during the six hour period that Avery had possession of the coin? See [Section 9-312\(f\)](#).
- b. Unknown to the bank Avery had borrowed \$300,000 from the Eclipse Financing Co. on April 1, 2019, granting Eclipse a security interest in the coin. Eclipse filed a financing statement with the office of the Secretary of State on that same date. In a priority dispute between Oak Leaf Bank and Eclipse Finance Co., what is the date that each party perfected its security interest? See [Section 9-313\(d\)](#). As between Oak Leaf Bank and Eclipse Finance Co., which party takes priority? See [Section 9-322\(a\)\(1\)](#). (We shall study priority among competing security interests in Chapter 7.)
- c. Assume that Avery did not obtain an additional loan from Eclipse Financing, but that instead Avery filed for bankruptcy on August 1, 2019. Because there is a substantial delay between the original attachment of the bank’s security interest in 2017 and the bank’s re-perfection of the security interest on July 4, 2019 the bankruptcy trustee may be permitted to “avoid” the bank’s security interest as a “preferential transfer.” Preferential transfers are governed by [Section 547](#) of the Bankruptcy Code. We shall study the power of a bankruptcy trustee to avoid “preferences” in Chapter 10.

3. Possession by a Third Party and Field Warehousing

The law of agency applies to perfection by possession. If an agent of the secured party is in possession of the collateral then the law considers that the secured party is in possession. If an agent of the debtor is in possession of the collateral then the law considers that the secured party is not in possession. In many situations it may be unclear whether a bailee or an escrow agent is holding the collateral on behalf of the debtor or the secured party. The Code offers a solution to this problem. Under [Section 9-313\(c\)](#) if the third party who is in possession of the collateral authenticates a record stating that the third party holds the collateral for the benefit of the secured party then the secured party is deemed to have possession of the collateral. However, [Section 9-313\(f\)](#) provides that the person in possession is not required to acknowledge that it holds the collateral for the benefit of the secured party.

The law affords another remedy for situations where it is inconvenient for the secured party to take physical possession of collateral: the “field warehouse.”

Problem 20. The Pile of Aluminum

Gilmour Industries has stockpiled 100 tons of aluminum ingots which it uses to manufacture bicycle frames. Gilmour only needs 4 tons of aluminum per week for the manufacturing process. Gilmour decides to use most of the aluminum as collateral to raise working capital. Gilmour borrows \$80,000 from Kincaid Investors and grants Kincaid a security interest in the aluminum ingots owned by Gilmour as inventory. Here are three different scenarios in which Kincaid might attempt to perfect a security interest in the aluminum. Will any of these be effective?

- a. The aluminum is stored a large warehouse on Gilmour’s property. The lot is locked and Kincaid is given the only keys to the lot. Whenever Gilmore needs aluminum it must call Kincaid for an employee of Kincaid to unlock the warehouse.
- b. The aluminum is stored in a large warehouse belonging to Arrow Distribution Company. Arrow has signed a receipt stating that Arrow is holding the aluminum on behalf of Kincaid Investors, and that Arrow will follow Kincaid’s instructions as to distribution of the aluminum.
- c. The aluminum is stored a large warehouse on Gilmour’s property. The lot is locked and Rory, Gilmour’s chief custodian, is given the only keys to the lot. Whenever Gilmore needs aluminum it must call Rory to unlock the warehouse. Kincaid pays Rory \$1 per year to perform this function.

4. Possession of Money, Instruments, Tangible Chattel Paper, and Tangible Negotiable Documents

Money is a curious kind of property, isn't it? Money is defined in [Section 1-201\(b\)\(24\)](#) as:

A medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries.

Dollar bills and coins are of no value by themselves; they are nearly worthless pieces of paper and metal. They are not goods yet they are tangible property; their only value is that they are accepted as a form of payment.

There is only one way to perfect a security interest in money: through **possession**. Possession of money is possible precisely because money is tangible. Moreover, if a person possesses money other people are justified in assuming that the possessor has **rightful possession**. Possession may no longer be "nine points of the law" but at a minimum if a secured party has possession of the debtor's money it serves to give notice to other parties that the secured party has some legal rights to the money.

There are three other types of writings that can be possessed and whose value is that they embody rights to payment or to goods. An **instrument** such as a check or a promissory note is a tangible writing that when presented to the maker constitutes a right to payment. A **tangible negotiable document** such as a warehouse receipt, a bill of lading, or an airbill is similarly a tangible writing that when presented entitles the bearer to the right to goods held by the warehouse or the carrier. **Tangible chattel paper** is a combination of a right to payment and a right to goods. Tangible chattel paper might be a conditional sales contract, a loan agreement with a security clause, a promissory note attached to a security agreement, or a lease of goods. Like money, a secured party can perfect a security interest in instruments, tangible negotiable documents, and tangible chattel paper by taking possession of these writings. As with goods, if the secured party surrenders possession of these writings and there is no period of temporary automatic perfection the secured party may create a gap in perfection that would have the effect of resetting the date of perfection in a priority dispute.

E. Perfection by Control

1. Perfection by Control

Article 9 authorizes a secured party to perfect a security interest in investment property, deposit accounts, letter of credit rights, electronic chattel paper and electronic documents by taking control of the property. These types of collateral are all **intangible personal property**, so

physical possession is not possible. To deal with this problem Article 9 allows for perfection by **control** of the collateral. Perfection by **control** is analogous to perfection by possession.

The Code specifies **how** to establish control over these types of intangible personal property in a series of provisions: [Sections 9-104](#) (deposit accounts), [9-105](#) (electronic chattel paper), [9-106](#) (investment property), [9-107](#) (letter of credit rights) and 7-106 (electronic documents).

a. Control over Deposit Accounts

Bank accounts, called “deposit accounts” under Article 9, are a particularly valuable source of collateral. Usually deposit accounts contain a business’s operating funds. Accordingly control of a debtor’s deposit accounts gives a secured party tremendous leverage in its relationship with the debtor.

“Control” is the exclusive method of perfecting a security interest in deposit accounts. [Section 9-104\(a\)](#) identifies three ways for a secured party to establish control over a debtor’s deposit accounts:

Section 9-104(a) Requirements for control.

A secured party has control of a deposit account if:

- (1) the secured party is the bank with which the deposit account is maintained;
- (2) the debtor, secured party and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or
- (3) the secured party becomes the bank's customer with respect to the deposit account.

Note that these three methods of establishing control are in the alternative. If the secured party is the bank where the deposit account is maintained then the bank’s security interest in the deposit account is automatically perfected. If the debtor, the debtor’s bank, and the secured party mutually agree in writing that the secured party may draw upon the account without further consent of the debtor then the security interest in the debtor’s deposit account is perfected. And if the account is placed in the name of the secured party then the secured party’s security interest in the account is perfected.

These three methods of perfecting a security in a deposit account by means of control are not equal. In Chapters 7 and 8 we shall see that a security interest in a deposit account that is perfected by control takes priority over a security interest that is perfected by other methods and that control that is achieved by becoming the bank’s customer takes priority over control by agreement.

The bank may also have a security interest in its customer's account. Moreover under Section 9-340 a depository bank has rights of recoupment and setoff against its customers' accounts.

The following problem illustrates the difficulty of perfecting a security interest in a deposit account.

Problem 21. Perfecting a Security Interest in a Deposit Account

Waterland Fisheries, Inc. opened a checking account at United Bank. Joanne Anderson, the Secretary and Treasurer of the corporation, was a signatory on the account. The corporation owed Anderson \$500,000 and had granted her a security interest in the deposit account. Anderson filed a financing statement covering the account. Did Anderson properly perfect her security interest by filing, possession, or control? See *In re Anderson*, 599 B.R. 504 (U.S. Dist. Ct., D. Md, 2019).

b. Control over Electronic Chattel Paper

Chattel paper is similar to an account in that it represents an obligation to pay for goods that have been sold or leased. However, chattel paper is more valuable than accounts because the right to payment is coupled with a right to repossess the goods that were sold or leased. All other things being equal a secured party would prefer to have chattel paper as collateral rather than accounts.

Chattel paper also differs from accounts in that the debt is evidenced in writing. Accounts are mere bookkeeping entries. Chattel paper consists of documents: a loan agreement with a security clause, a promissory note and a security agreement, a conditional sales contract, or a lease of goods. **Tangible chattel paper** is on paper and **electronic chattel paper** consists of computer files. A security interest in tangible chattel paper may be perfected by filing or possession. A security interest in electronic chattel paper may be perfected by filing or by taking control under Section 9-105.

Section 9-105 used to provide that there had to be a single authoritative copy of an electronic record of chattel paper. That standard proved to be difficult to achieve, so the rule was amended so that a secured party has control of electronic chattel paper if the system "reliably establishes the secured party as the person to which the chattel paper was assigned." The "single authoritative copy" standard is relegated to a "safe harbor" in subsection (b) of Section 9-105. This change in the law has made it easier for secured parties to create, maintain, assign and sell electronic chattel paper. In the future it is likely that the market for electronic chattel paper will expand and that this type of collateral will become commonplace. Jane K. Winn tells the story of the Code's recognition of electronic chattel paper in *Electronic Chattel Paper: Invitation Accepted*, 46 Gonz. L.Rev. 407 (2010-2011), accessible at http://blogs.gonzaga.edu/gulawreview/files/2011/05/Winn.FINAL_.pdf.

c. Control over Investment Property

A century ago almost all wealth was in the form of land, buildings, machinery, crops, and herds. Over the last 50 years, however, more and more wealth is held in the form of financial wealth. Article 9 refers to financial wealth as **investment property**. Investment property has become an increasingly important form of collateral.

There are two broad categories of investment property: **securities** and **commodities**. Within those two categories there are six different types of Investment property. They are:

Securities:

- Certificated security
- Uncertificated security
- Security entitlement
- Securities account

Commodities:

- Commodity contract
- Commodity account

There are two principal ways to perfect a security interest in investment property: by filing a financing statement covering the property or by taking control of the property. A person can take control over investment property by complying with [Section 8-106](#). Under Section 8-106 there are four principal ways for a secured party to take control over investment property.

1. If the secured party is a broker or a securities intermediary then its security interest in investment property is automatically perfected.
2. If the collateral is an uncertificated security then a secured party can gain control by becoming the registered owner of the shares on the books of the issuer or if the issuer, the owner, and the secured party enter into an agreement where the issuer agrees to comply with the instructions of the secured party without further consent by the registered owner.
3. If the collateral is a securities entitlement then the secured party can gain control by becoming the entitlement holder (that is, the secured party becomes the owner of the securities account); or if the securities intermediary (the brokerage firm, for example), the entitlement holder of the securities, and the secured party enter into an agreement where the securities intermediary agrees to obey the instructions of the secured party without further consent by the entitlement holder.
4. If the collateral is a certificated security then instead of gaining control a person can perfect by taking delivery of the certificated security with any necessary indorsements in

accordance with [Section 9-313\(a\)](#) and 8-301. (Certificates in bearer form do not need an indorsement.)

Priority of security interests in investment property is governed by [Section 9-328](#). Just as with deposit accounts, as between two perfected secured parties, the secured party who has control over the property will take priority over a secured party who has merely filed a financing statement. Furthermore a secured party who achieves control by becoming the record owner of a security or a securities entitlement takes priority over a secured party who has merely entered into a three-way agreement with the debtor and the issuer or securities intermediary giving the secured party the right to liquidate the collateral. Obviously the secured party is in a safer position if it is the actual owner of the security or security entitlement, rather than filing a financing statement or entering into an agreement with the issuer or securities intermediary.

These and other nuances regarding priority of security interests in investment property are covered in Chapter 6.

d. Control over Letter-Of-Credit Rights

A letter of credit is method of guaranteeing that goods will be paid for upon delivery. If a seller is reluctant to ship goods to a buyer merely in exchange for the buyer's promise to pay for the goods, the seller may demand for the buyer to provide the seller with a letter of credit issued by a bank. A letter of credit is created when a buyer (the "applicant") requests a bank (the "issuer") to make payment to a seller (the "beneficiary") as soon as the seller delivers goods or a document of title to the goods to the buyer. Letters of credit are defined and regulated by Article 5 of the Uniform Commercial Code.

However, a letter of credit is not a negotiable instrument like a check or a promissory note. Possession of a letter of credit is of no legal significance. The seller cannot assign a letter of credit to another party. Instead, the seller can assign **letter-of-credit rights** – its right to payment under the letter-of-credit – to other parties. A seller may use letter-of-credit rights as collateral for a loan, and a secured party will then have a security interest in the letter-of-credit rights.

But how can a secured party perfect its security interest in letter of credit rights? A security interest in letter-of-credit rights cannot be perfected by filing a financing statement or by taking possession of the letter of credit. Instead there is only one way to perfect a security interest in letter-of-credit rights, and that is to obtain control. And there is only one way to obtain control over letter-of-credit rights, and that is if the issuer consents to an assignment of the proceeds of the letter of credit. This rule is set forth in [Section 9-107](#).

e. Control over Electronic Documents of Title

Documents of title are receipts that entitle a person to recover goods from a shipper ("bill of lading," "airbill") or a storage facility ("warehouse receipt"). Documents of title are governed by

Article 7 of the Uniform Commercial Code. Section 7-106 of the U.C.C. is the rule governing control over electronic documents of title; it is virtually identical to [Section 9-105](#) governing control over electronic chattel paper.

A person has control of an electronic document of title if a system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred.

As with electronic chattel paper if the electronic document of title is proven to be a “single authoritative copy” then it is conclusively deemed to “reliably establish” the secured party’s right to the document.

2. The Timing of Perfection by Control.

[Section 9-314](#) explains the **timing** of perfection by control; that is, the time when the security interest becomes perfected and the time when it becomes unperfected. In general a security interest that is perfected by control of these types of collateral becomes unperfected when the secured party loses control over the collateral. There are special rules that govern expiration of perfection a security interest in investment property. If a secured party loses control of collateral that is investment property, the security interest remains perfected until the debtor acquires possession of a certificated security, the issuer registers an uncertificated security in the name of debtor, or the debtor becomes the entitlement holder of a security entitlement.

3. Perfection of a Security Interest in Certain Intangible Property by Filing

[Section 9-312\(b\)](#) provides that security interests in deposit accounts and letter-of-credit rights can **only be perfected by taking control** of the collateral. However, other methods of perfecting a security interest are permissible for certain specific types of intangible collateral. [Section 9-312\(a\)](#) allows a secured party to perfect a security interest in chattel paper, negotiable documents, instruments and investment property by **filing** a financing statement. Keep in mind, however, that in the usual case **control takes priority over filing**.

F. Notation of Liens on Certificate of Title

1. Introduction to Certificates of Title

[Section 9-311](#) of the Code provides that financing statements are not effective to perfect a security interest in property if state or federal law requires security interests to be recorded on a certificate of title. The simplest and most common example is automobiles. State laws require security interests in automobiles to be recorded on the certificate of title. Trucks and motorcycles are also typically covered by certificate of title laws, and about half the states require notation of liens on certificates of title for boats. Airplanes and ships over a certain size (“documented vessels”) are governed by registration systems established by federal laws and regulated by federal agencies such as the Federal Aviation Administration and the Coast Guard.

Here is a law firm blog about boat and ship registration: <https://www.stimmel-law.com/en/articles/boat-liens-and-mortgages>. And here is information from the F.A.A. on how to file a notice of a lien on an airplane. https://www.faa.gov/licenses_certificates/aircraft_certification/aircraft_registry/record_aircraft_lien/.

2. Certificates of Title from Any State May Control Perfection.

We learned in Chapter 5 that in most cases financing statements must be filed in **the state where the debtor is located**. In a few situations where the collateral is intimately connected to the land (fixtures, timber to be cut, as extracted collateral) the financing statement or fixture filing must be filed in **the state where the collateral is located**. However, a security interest in an automobile can be recorded on the certificate of title **in any state!** [Under Section 9-303](#), a security interest can be perfected on a certificate of title issued by a state “even if there is no other relationship between the jurisdiction under whose certificate of title the goods are covered and the goods or the debtor.” This means that a lien that is recorded on a certificate of title in one state governs perfection no matter where the debtor lives and no matter where the collateral is located.

The principle that the recording of a security interest on a certificate of title in any state is effective to establish perfection is repeated in [Section 9-311\(a\)](#), which states:

Except as otherwise provided in subsection (d), the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to:

...

(2) a statute of **this Commonwealth** or regulations promulgated thereunder, to the extent such statute or regulations provide for a security interest to be indicated on certificate of title as a condition or result of perfection; or

(3) a statute of **another jurisdiction** which provides for a security interest to be indicated on a certificate of title as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the property.

Practice pointer. If a lender is considering extending credit to a borrower and wishes to take a security interest in collateral that is covered by a certificate of title, what documentation should the lender inspect and what steps should the lender take to perfect its security interest?

3. Exception for Inventory.

There is, however, an important exception to the rule requiring notation of security interests on certificates of title for automobiles and certain other vehicles. This exception applies to collateral held as inventory, and it is illustrated by the following problem.

Problem 22 – The Used Car Dealer

Pat's Used Cars, Inc., borrowed \$200,000 from Northern Finance and granted Northern a security interest in its inventory. How should Northern perfect its security interest? See [Section 9-311\(d\)](#).

G. Perfection of Agricultural Liens

1. Creation of Agricultural liens.

"Agricultural liens" are defined in [Section 9-102](#). Agricultural liens are governed by Article 9, but they are different from normal security interests in that they are not created by contract; there is no "security agreement" between the creditor and the debtor. Instead these are involuntary, nonpossessory, statutory liens in farm products that arise when a farmer fails to pay a person who leased the land to the farmer or who provided goods or services in connection with the debtor's farming operations.

It is relatively difficult to perfect an agricultural lien because it is necessary to comply with both Article 9 and with the state statute that authorizes agricultural liens.

Let's unpack the separate elements of the law governing agricultural liens.

First, agricultural liens are **created by state statutes**. Some states (generally farming states) have very broad agricultural lien statutes. Other states have only a few very specific statutes that apply in limited situations. The National Agricultural Law Center maintains a chart of agricultural lien statutes in each state. See <https://nationalaglawcenter.org/state-compilations/agricultural-liens/>.

Second, agricultural liens are **involuntary**. They are not created by security agreements but rather arise by operation of law.

Third, agricultural liens are **nonpossessory**. A mechanic who repairs a tractor may be entitled to retain possession of the tractor until they are paid under state law, but this would not be an "agricultural lien," merely an "artisan's lien." (Moreover, a tractor is not "farm products;" see below.) The relative priority of Article 9 security interests and artisan's liens is covered in Chapter 8.

Fourth, agricultural liens are liens on **farm products**. Farm products include crops, (including crops grown on trees but not including standing timber), livestock, products of aquaculture, livestock, products of crops or livestock in their unmanufactured states (like manure), and

supplies used or produced in a farming operation (like fertilizer that is purchased and stored on the farm or hay grown for livestock).

Fifth, agricultural liens arise in favor of **landlords** and **persons who provide goods or services to farmers**. If a farmer fails to pay the person who leased the land to the farmer, or if the farmer fails to pay a person who sold goods used in farming operations to the farmer, or if the farmer fails to pay a person who assists in the farming operations like a mechanic or farmworker, then if there is an agricultural lien statute in that state then the **farm products** that were raised on the leased land or that the person who provided goods or services in the farming operation helped to grow or harvest are subject to an agricultural lien in favor of the landlord or the person who supplied the goods or services.

2. Perfection of Agricultural Liens

As noted above, agricultural lien statutes vary from state to state. Not every state has an agricultural lien statute. Of the states that do have such a statute, many require the lienholder to file a public notice of the lien in the state where the farm is located. Some of these states require the agricultural lien notice to be filed centrally with the office of the Secretary of State and some require the agricultural lien notice to be filed with the office of the county land records in the county where the farm is located. The contents of an agricultural lien notice vary from state to state and usually require more information than is required of an Article 9 financing statement.

In addition, however, because agricultural liens are governed by Article 9 it is also necessary for the party claiming an agricultural lien to file an Article 9 financing statement covering the farm products. The Article 9 financing statement must be filed with the office of the Secretary of State **in the state where the debtor is located!** Moreover, the requirements for the form and contents of the agricultural lien filing are often different from the form and contents of a financing statement.

The possibility of filings in different states and the varying requirements to perfect an agricultural lien are described in the aptly-titled article *Agricultural Liens—More Than One Trap for the Unwary* by Fred H. Miller and William H. Henning in 42 No. 10 U.C.C. Law Letter 4 (December 2008). The authors of that article analyze the case of *Stockman Bank of Montana v. Mon-Kota, Inc.*, 180 P.3d 1125 (Mont. 2008) which involved a dispute between Stockman Bank which had lent money to the farmer, and Capital Harvest, which had sold chemicals used on the crops. Stockman Bank filed an Article 9 financing statement in North Dakota where the debtor was located and Capital Harvest filed its notice of agricultural lien in Montana where the crops were grown. The court ruled that Capital Harvest had properly perfected its agricultural lien in accordance with Montana's agricultural lien statute. Moreover, the Montana agricultural lien statute has a "super-priority" provision that grants agricultural liens priority over other liens such as Article 9 security interests. The Montana statute states:

The lien for labor or services performed or material furnished as specified in this part shall be prior to and have precedence over any mortgage, encumbrance, or other lien upon said grain or crops.

Article 9 expressly authorizes states to grant super-priority to agricultural liens if they so choose. [Section 9-322\(g\)](#) provides:

(g) Priority under agricultural lien statute. A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides.

Accordingly, the Montana Supreme Court ruled that Capital Harvest's perfected agricultural lien took priority over Stockman Bank's perfected Article 9 security interest even though the bank had filed and perfected first.

A similar dispute between a lender bank (Adams Bank & Trust) with an Article 9 security interest in crops and a chemical supplier (AG-Land) with an agricultural lien on the crops was the subject of *Matter of Hill*, 95 U.C.C. Rep Serv 2d 854 (Bankr. Ct., D. Nebraska, 2018). In that case the court ruled in favor of the bank because although the chemical supplier timely filed its agricultural lien notice in the proper office, the supplier failed to include all of the information required on the notice by the agricultural lien statute. The agricultural lien notice was missing the date of the transaction, the farmer's signature, and the supplier's tax identification number. As a result, the supplier's agricultural lien was unperfected and the bank took priority. In conclusion the court stated:

While AG-Land is a small company and appears to have made a good-faith effort to protect its right to payment for the products and services it provided to the debtors, it did not adequately perfect its statutory lien. The statutes are clear on what an agricultural products input supplier is required to do to protect itself, and when those requirements are not met, the supplier's ability to receive payment falls behind other creditors who properly perfected their security interests. Accordingly, Adams Bank & Trust is entitled to the crop proceeds currently held by the Chapter 7 Trustee.

Practice Pointer. The creation, perfection and priority of agricultural liens is governed in part by state agricultural lien statutes outside of Article 9. However, Article 9 also expressly governs agricultural liens. If you are representing a lender or a supplier who is considering extending credit to a farmer be sure to check the filing records both in the state where the debtor is located and in the state and locality where the crops are grown or the livestock is raised. Be sure that any filings you make comply with all of the requirements of all of the applicable laws. In representing a supplier selling goods to the farmer on credit it would be wise to comply with the filing requirements of both Article 9 and the agricultural lien statute.

End of Chapter 5

Chapter 6. Priority of Security Interests; Perfection and Priority of Purchase Money Security Interests; Priority with Respect to Deposit Accounts, Investment Property, and Letter of Credit Rights

The vast majority of litigation under Article 9 consists of disputes between creditors claiming priority to property that is serving as collateral. Everything we have learned so far about the **scope** of Article 9, **attachment** of security interests, and **perfection** of security interests has been in preparation for the lessons we are about to undertake on **priority** of security interests. Lenders and sellers who extend credit take a security interest in collateral to secure repayment. However their security interest in the collateral may be useless to them if other creditors take priority over them in the collateral.

Chapters 6 through 10 are concerned with priority. Chapter 6 deals with priority disputes between secured parties, the priority of purchase-money security interests, priority over fixtures and accessions, and priority over deposit accounts, investment property, and letter-of-credit rights. Chapter 7 covers priority disputes between secured parties and persons who buy the collateral from the debtor; judgment creditors of the debtor; lessors and lessees of the collateral; persons who assert claims to the collateral under Article 2; and priority when the secured party makes a future advance or when the debtor obtains after-acquired property. Chapter 8 deals with attachment, perfection, and priority of security interests in proceeds. And Chapters 9 and 10 deal with the validity of security interests in bankruptcy, which can be framed as priority disputes between secured parties and bankruptcy trustees.

A. Learning Objectives

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Resolve priority disputes between two secured parties with non-purchase-money security interests.
2. Resolve priority disputes between a secured party with a non-purchase-money security interest and a secured party with a purchase-money security interest.
3. Resolve priority disputes between a secured party and another claimant to the collateral when the collateral is fixtures, accessions, commingled goods, deposit accounts, investment property, or letter-of-credit rights.

Before discussing priority disputes between two secured parties let us consider the priority of an **unperfected** security interest as against other claimants to the collateral.

B. Priority Disputes Involving Unperfected Security Interests

1. Secured Party with an Unperfected Security Interest v. Debtor

A security agreement is a contract between the secured party and the debtor. In the absence of fraud, unconscionability, or other invalidating defense the contract is binding between the parties. As against the debtor, the secured party has no obligation to perfect the security interest. If the debtor defaults, the secured party is entitled to enforce the agreement by repossessing the collateral and reselling it **even if the security interest is unperfected**. We shall study **enforcement** of a security agreement – the rights and responsibilities of the secured party and the debtor to each other – in Chapters 11 and 12.

2. Secured Party with an Unperfected Security Interest v. Lien Creditor, Bankruptcy Trustee, or Good Faith Buyer

If a secured party fails to perfect its security interest in the collateral then other creditors are likely to take priority over the collateral. Specifically:

- a. Under [Section 9-317\(a\)\(2\)](#) a judgment creditor (whom Article 9 refers to as a “lien creditor”) takes priority over a secured party with an unperfected security interest.
- b. Under [Section 9-102\(a\)\(52\)\(C\)](#) a bankruptcy trustee is considered to be a “lien creditor” and therefore takes priority over a secured party with an unperfected security interest.
- c. Under [Section 9-317\(b\)](#) a buyer of goods or other tangible collateral who gives value and receives delivery without knowledge of the previous security interest takes free of an unperfected security interest.

Priority disputes between secured parties and lien creditors and buyers are covered in Chapter 7.

Problem 22. The Stationery Store

Peoples’ Supplies is a store that sells office supplies like printer paper, printer ink, pens, markers, and staplers. In 2019 Alpha Finance lent money to People’s Supplies and took a security interest in People’s inventory. Alpha did not file a financing statement or otherwise perfect its security interest in People’s inventory. Consider these alternative situations:

- a. In 2020 Philo Landscaping sued Peoples' Supplies for unpaid bills and recovered a judgment against Peoples' in the amount of \$25,000. Philo then applied for and was granted a judgment lien on People's inventory. As between Philo Landscaping and Alpha Finance, which takes priority over the inventory? See [Section 9-317\(a\)\(2\)](#).
- b. In 2020 Peoples' Supplies filed for bankruptcy. As between Alpha Finance and the Bankruptcy Trustee, whose claim to the inventory is stronger under the law? See [Section 9-102\(a\)\(52\)\(C\)](#).
- c. In 2020 Peoples' Supplies contacted Meade University and offered to sell all its inventory to Meade at reduced prices. Meade checked the U.C.C. filings and confirmed that there were no financing statements on record against Peoples' Supplies. Meade then agreed to purchase all of Peoples' inventory in bulk. Did Meade University acquire Peoples' inventory **subject to** or **free of** Alpha's security interest? See [Section 9-317\(b\)](#).
- d. In 2020 Peoples' Supplies stopped making payments on the loan that it owed to Alpha Finance. Alpha then repossessed Peoples' inventory and resold it to pay down the loan. Is Alpha entitled to take these steps in light of the fact that it failed to perfect its security interest in the inventory? See [Sections 9-609](#) and [9-610](#).

Practice Pointer. If you are representing a secured party the obvious lesson is to make sure that your client's security interest has been perfected. If you are representing another party seeking to purchase property from the debtor in a transaction that is outside the ordinary course of business the lesson is to carefully check the U.C.C. records and other sources to make sure that the property is not subject to a perfected security interest.

C. [Lecture 17. Priority Disputes Between Secured Parties](#)

Priority disputes between secured parties are governed by [Section 9-322](#). If competing security interests are unperfected then the party whose security interest was the **first to attach** takes priority. If one secured party perfected its security interest and the other secured party did not then the **perfected security interest takes priority over the unperfected one**. If both parties perfected their security interests then the **first to file or perfect** takes priority.

Problem 23. The Drives



Minerva Shipping, Inc., is an online ordering and shipping service similar to Amazon. Minerva has set up shipment centers in several rural locations in Pennsylvania. On October 1, 2018 Minerva purchased thousands of “drives” (pictured here) for its shipment centers. The drives are used to move and sort the goods that flow through Minerva’s shipment centers. On March 1, 2019, Minerva borrowed \$20 million from Pennsylvania

National Bank for operating capital. As collateral Minerva granted the bank a security interest in all of its equipment, including the drives. Yankee Finance, another creditor of Minerva, also has a security interest in the drives. In the following situations determine whether Pennsylvania National Bank or Yankee Finance takes priority over the drives.

- a. Yankee Finance Co. loaned \$200,000 to Minerva on February 1, 2019. However, Minerva and Yankee Finance did not sign a security agreement granting Yankee a security interest in Minerva’s equipment until April 1, 2019. Neither Pennsylvania National Bank nor Yankee Finance ever perfected its security interest. See [Section 9-322\(a\)\(3\)](#).
- b. Yankee Finance Co. loaned \$200,000 to Minerva on February 1, 2019 and the parties signed a security agreement granting Yankee a security interest in Minerva’s equipment on the same date. Pennsylvania National Bank perfected by properly filing a financing statement on June 1, 2019. See Section 9-322(a)(2).
- c. Yankee Finance Co. loaned \$200,000 to Minerva on February 1, 2019 and the parties signed a security agreement granting Yankee a security interest in Minerva’s equipment on the same date. Yankee Finance Co. properly filed its financing statement on February 1, 2019 and Pennsylvania National Bank properly filed its financing statement on March 1, 2019. See [Section 9-322\(a\)\(1\)](#).
- d. Yankee Finance Co. loaned \$200,000 to Minerva on February 1, 2019 and the parties signed a security agreement granting Yankee a security interest in Minerva’s equipment on the same date. Yankee Finance Co. properly filed its financing statement on February 1, 2019. Pennsylvania National Bank properly filed its financing statement on January 15, 2019, when it first entered into negotiations with Minerva about a possible loan. (Yankee Finance was the first to perfect its security interest but Pennsylvania National Bank was the first to file.) See [Section 9-322\(a\)\(1\)](#) and [Section 9-502\(d\)](#).

D. Purchase-Money Security Interests

1. [Lecture 18A. Introduction to Purchase-Money Security Interests](#)

Purchase-money security interests (PMSIs) are defined in [Section 9-103](#). As noted in Chapter 5, purchase-money security interests are created when a lender advances funds or a seller extends credit that **enables** a debtor to acquire goods. Purchase-money security interests are superior to non-purchase-money security interests because under [Section 9-324](#) a PMSI often take priority over a non-PMSI even if the non-PMSI was perfected first!

When a seller delivers goods to a buyer on credit and reserves a security interest in the goods it is obviously a purchase-money transaction. But when a lender advances funds to the debtor to purchase goods it is not always clear that the loan “enabled” the debtor to acquire the goods. For example, the debtor may purchase the goods before receiving the funds from the lender. The funds from the lender are then used to replenish the debtor’s operating funds. This type of “**reverse chronology**” is relatively common. In that circumstance should the lender be granted a “purchase-money security interest” in the goods?

There is another problem that frequently arises specifically with purchase-money security interests in livestock. To achieve “super-priority” over other parties with a perfected security interest in inventory or livestock then [Section 9-324\(b\)](#) or [Section 9-324\(d\)](#) requires the secured party to send a **notice** to persons who have a perfected security interest in the same inventory or livestock and that notice must be received by those secured parties **before the debtor receives possession of the collateral**. But what if the debtor **never** receives possession of the collateral? If the collateral is inventory then it would be unusual for the debtor not to receive possession, but if the collateral is livestock then the livestock might be held at a feed lot owned by the secured party and never come into actual or constructive possession of the debtor. In that circumstance is the party asserting a purchase-money security interest in the livestock obligated to send a notice of the purchase-money security interest to previous secured parties?

First National Bank in Munday v. Lubbock Feeders, L.P., 183 S.W.3d 875 (Ct. App. Texas, 2006)

Two legal issues were present in this case: a **reverse chronology** issue and a **notice** issue.

Lubbock Feeders promised to provide funding for John William Cox to purchase cattle. However, Cox used his own money to purchase the cattle and Lubbock Feeders repaid Cox within a few days of each purchase. The court found that the payments from Lubbock Feeders to Cox were “closely allied” with Cox’s purchases of the cattle and therefore Lubbock Feeders “enabled” Cox to purchase the cattle. Accordingly Lubbock Feeders acquired a purchase-money security interest in the cattle.

In addition, Cox never took possession of the cattle. The cattle were delivered directly to the feed lots owned by Lubbock Feeders. [Section 9-324\(d\)](#) requires the secured party to send a notice to other secured parties who have financing statements before the debtor receives possession of the collateral. First National Bank in Munday had previously filed a financing statement covering all of the cattle belonging to Cox, and Lubbock Feeders never notified the bank of its purchase-money security interest. Citing the language of the statute and a previous

case, the court ruled that Lubbock Feeders was not required to notify the bank of its PMSI in the cattle and that Lubbock Feeders took priority over the bank despite the lack of notice.

Practice Pointers.

1. What is your opinion of the “closely allied” standard in “reverse chronology” cases? Would it make more sense for the law on the creation of purchase-money security interests to require the debtor to use the precise funds supplied by the secured party to purchase the goods?
2. As a practical matter how can a secured party who wishes to gain a PMSI establish beyond any doubt that it “enabled” the debtor to acquire the goods?
3. Does it make sense for the law to absolve a secured party who wishes to gain a PMSI in livestock or inventory from having to give notice to other secured parties of record where the debtor does not obtain possession of the collateral?

2. Lecture 18B. Perfection and Priority of a Purchase-Money Security Interest

The rules governing **attachment** of a purchase-money security interest are the same as for a nonpurchase-money security interest. And we have already seen in Chapter 5 that if the collateral that is subject to a purchase-money security interest is **consumer goods** then the security interest is **automatically perfected** as soon as the security interest attaches. However, for a security interest in equipment or inventory to qualify as a purchase-money security interest the secured party must take additional steps when perfecting the security interest.

The rules governing priority of purchase-money security interests are in Section 9-324. The principal advantage of a “purchase-money security interest” (PMSI) over nonpurchase-money security interests is that a party with a purchase-money security interest takes priority over a party with a nonpurchase-money security interest even if the party with the non-purchase-money security interest filed and perfected before the party with the purchase-money security interest. More concisely, a PMSI has “super-priority” over a non-PMSI.

1. Purchase-Money Security Interests in Equipment

Under Section 9-324(a) “a perfected purchase-money security interest ... has priority over a conflicting security interest in the same goods.” To achieve super-priority when the goods are equipment, the secured party must file a financing statement covering the equipment within 20 days after the debtor receives possession of the equipment. This rule is illustrated by the next problem.

Problem 24. The SLS Machine

Ringgold Fabricators has a \$2 million line of credit from TriStar Bank, and TriStar has a security interest in all of Ringgold's equipment. TriStar filed a financing statement covering the equipment when the loan originated in 2018. Ringgold wishes to purchase another piece of equipment for its factory, a selective laser sintering (SLS) machine from Modern Technologies, Inc. The SLS machine will cost about \$250,000. TriStar Bank is unwilling to increase Ringgold's line of credit to enable it to purchase the SLS machine, but another company, Manufacturer's Finance, is willing to loan Ringgold the funds necessary to purchase the SLS machine. Modern Technologies is not willing to extend credit to Ringgold but states that it can deliver the SLS machine to Ringgold within two weeks after it is paid. If Manufacturer's Finance agrees to finance Ringgold's purchase of the SLS machine, what steps should Manufacturer's Finance take to ensure that it will have a security interest in the SLS machine that takes priority over the security interest of TriStar Bank?

Practice Pointer. Why would the law grant "super-priority" to a secured party with a perfected purchase-money security interest?

2. Purchase Money Security Interests in Inventory or Livestock

It is more difficult for a secured party to obtain super-priority with respect to inventory or livestock than it is for equipment. As we have already seen in the *Lubbock Feeders* case, a secured party must take several additional steps to establish a purchase-money security interest in inventory or livestock. The secured party must perfect the security interest before the debtor obtains possession of the collateral; the secured party must send an authorized notification to the holder of a conflicting security interest; the holder of the conflicting security interest must receive the notification before the debtor acquires possession of the collateral; and the notification must state that the secured party has or expects to acquire a purchase-money security interest in the inventory or livestock and describes the inventory or livestock.

In Chapter 1 we studied a portion of *In re TWAWD Holdings, Inc.* In that case Sports Dimension consigned goods to TSAWD for sale, but TWAWD declared bankruptcy while still in possession of the goods belonging to Sports Dimension. In that portion of the case the Bankruptcy Court found that the debtor TSAWD was not "generally known" by its creditors to be "substantially engaged" in the business of selling the goods of others. As a result the Bankruptcy Court ruled that this transaction was a "consignment" within the meaning of Article 9 and that therefore Sports Dimension should have filed a financing statement to perfect its interest in the consigned goods.

A consignment that is subject to Article 9 is essentially the same as a “purchase-money security interest” in inventory. The consignor supplies goods to the consignee at no cost. The consignee holds the goods for sale as inventory. [Section 9-103\(d\)](#) provides:

The security interest of a consignor in goods which are the subject of a consignment is a purchase-money security interest in inventory.

The summary of *In re TWAWD Holdings, Inc.* in Chapter 1 established that the transaction in question was a consignment that was governed by Article 9. In a separate portion of its ruling the court addressed the question of whether the consignor Sports Dimension took sufficient steps to perfect its purchase-money security interest in the sporting goods that were delivered to TWAWD.

[In re TWAWD Holdings, Inc., 601 B.R. 599 \(Bank. Ct. D. Delaware, 2019\)](#)

A consignment transaction is similar to a purchase-money transaction in inventory, and so the law of secured transactions treats them the same. Under [Section 9-324\(b\)](#) a consignor whose transaction is subject to Article 9 must take the same steps as a creditor with a PMSI in inventory to take priority over secured parties who have previously filed financing statements.

In this case Sports Dimension filed a financing statement before consigning the goods to TWAWD, but it neglected to send the required notice to other secured parties who had filed previously. The court therefore granted summary judgment in favor of the other secured parties and held that the security interests of the other secured parties took priority over the ownership rights of the consignor.

Practice Pointers.

1. To establish the purchase-money status of a security interest in inventory it is necessary to send a notice to other secured parties of record before the goods are delivered to the debtor. Before sending this notice be sure to check the most recent U.C.C. filings to make sure of the party and the address to which the notice must be sent.
2. Why does the law require a notice of the PMSI to be sent before the goods are delivered to the debtor when the collateral is inventory or livestock? Why would a secured party with a previously-perfected security interest in inventory need to know of an impending PMSI in inventory? What steps would the previous secured party likely take upon receiving this notice?

Problem 25. The Diamonds

Craig Drake Manufacturing, Inc., was a jewelry manufacturer. In 1989 Drake borrowed money from Sovereign Bank. Drake granted the bank a security interest in Drake's inventory and accounts, and the bank properly filed a financing statement covering that collateral and properly filed continuation statements. In 1997 T. Gluck & Co. agreed to supply Gluck with diamonds and entered into a consignment agreement with Drake. Gluck properly filed a financing statement and sent proper notice of the consignment arrangement to Sovereign Bank that was received before Drake received possession of the diamonds. Like Sovereign Bank Gluck properly filed continuation statements every five years. However, Gluck did **not** send the bank any more notices of the consignment arrangement after the initial one in 1997. In 2009 Drake went out of business. The diamonds on consignment were sold and the proceeds were given to Sovereign Bank. Who has priority as to the proceeds? See [Section 9-324\(b\)\(3\)](#).

Practice Pointers.

1. Why does the law require party with a security interest in inventory to both file a continuation statement **and** send a notice to previous secured parties every five years?
2. Here is a link to an attorney's description of this case online:
[https://www.nixonpeabody.com/en/ideas/articles/2013/09/04/regular-re-noticing-can-keep-the-metal-jewelry-consignor-from-melting.](https://www.nixonpeabody.com/en/ideas/articles/2013/09/04/regular-re-noticing-can-keep-the-metal-jewelry-consignor-from-melting)

3. Lecture 18C. Creating and Retaining the Status of a Purchase-Money Security Interest

[Section 9-103\(e\), \(f\), \(g\),](#) and [\(h\)](#) deal with situations where it is difficult to determine whether a security interest is a purchase-money security interest or a non-purchase-money security interest. There are three common situations where this problem arises:

1. When a loan is made not only to provide a debtor with the funds to purchase goods but also to provide the debtor with funds for other purposes;
2. When a purchase-money loan is refinanced and some additional funds are provided for other purposes;
3. When some of the collateral that secures a purchase-money loan was not purchased with the funds from the loan.

In all of these situations the courts might elect to recognize that the security interest has a "dual status," that is, that the security interest is in part a purchase-money security interest and in part a non-purchase-money security interest. [Section 9-103](#) supports the "dual status"

interpretation because it provides that “a security interest in goods is a purchase-money security interest ... **to the extent** that the goods are purchase-money collateral” (emphasis added). However there are situations, particularly with consumer transactions, where the courts find that what was originally a purchase-money security interest has been **transformed** into a non-purchase-money security interest.

There is also an additional issue that arises in each of these situations. When payments are made on a loan that has both purchase-money and non-purchase money elements, how are those payments to be allocated between the purchase-money and non-purchase-money aspects of the debt?

Problem 26. The Restaurant

The Tea Kettle, a new restaurant in Sewickley, Pennsylvania, borrowed \$200,000 from Keystone Bank and Trust and the restaurant gave the bank a security interest in all of the restaurant’s equipment, “now owned and hereafter acquired.” Half of the money from the loan was used to purchase new tables and chairs and half was used to pay employees’ salaries for the first three months of operation.

- a. Under [Section 9-103](#), was the bank’s security interest in the equipment a “purchase-money security interest?”
- b. Beginning with the second month after the loan was made Tea Kettle was obligated to pay Keystone \$10,000 per month until the debt was paid off. If the loan is regarded as a “dual status” loan then how should payments be allocated between the purchase-money and non-purchase-money aspects of the debt? See [Section 9-103\(e\)\(3\)](#).

A complicating factor in maintaining PMSI status turns in part upon whether the collateral is **consumer goods** or **non-consumer goods**. Subsections [\(e\)](#), [\(f\)](#), and [\(g\)](#) of Section 9-103 recognizing the validity of dual-status security interests all involve transactions where the goods are **not consumer goods**. Subsection [\(h\)](#) reserves to the courts the discretion to determine whether dual status should be allowed when the collateral is **consumer goods**. Professor Richard H. Nowka contends that the courts ought to be willing to confer dual status on security interests even when the collateral consists of consumer goods. *See Allowing Dual Status for Purchase-Money Security Interests in Consumer-Goods Transactions*, accessible at <https://trace.tennessee.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1234&context=transactions>. Many courts do not agree with this view.

Why is it important to determine whether a security interest in consumer goods is a purchase-money security interest or a non-purchase-money security interest? There are two reasons. First, a purchase-money security interest in consumer goods is automatically perfected. [Section 9-309\(1\)](#). If, however, a transaction loses its purchase-money status, the security interest of a

party who has not filed a financing statement would be unperfected. Second, in bankruptcy a debtor is allowed to treat certain types of consumer goods as exempt and may retain that property free of any liens on that property. Bankruptcy Code Section 522(f). However this right to retain exempt property free of liens does not apply to **purchase-money liens** on that property. Under B.C. Section 522(f) a debtor may take free of only “a nonpossessory, nonpurchase-money security interest” on exempt property. If the lien is a purchase-money security interest then the debtor can retain exempt property free of bankruptcy only if the debtor agrees to pay the purchase-money debt.

The courts have come to different conclusions in different states about whether to recognize “dual status” security interests in consumer transactions or whether security interests in consumer goods should simply be considered to be “non-purchase-money security interests” if any of the three situations listed above apply (original loan was for dual purposes, loan was refinanced for dual purposes, or the loan was secured with both purchase-money collateral and non-purchase-money collateral). What conclusion would you come to in the following problem?

Problem 27. The Living Room Set

In April of 2006 newlyweds Pat and Tam Rivers purchased a beautiful living room set of furniture for their little house. The total purchase price was \$8,000. To pay for the furniture and to cover their household expenses for a few months they borrowed \$25,000 from Homeowners Finance Company.

- a. Pat and Tam filed for bankruptcy in April 2008 when they both lost their jobs in the economic crash. Under Section 522(b) and 522(f) of the Bankruptcy Code they would like to retain the living room set as exempt property free of the finance company’s security interest. Can they?

- b. Add one additional fact. Between April 2006 when the original loan was made and April 2008 when Pat and Tam declared bankruptcy they refinanced the loan three times with different lenders as interest rates dropped, the last time with Potsdam Lending, Inc. Is Potsdam’s security interest in the furniture a purchase-money security interest?

Practice Pointer. What can a secured party do to ensure that its security interest in collateral will be treated as a purchase-money security interest when the original loan is made, when the loan is refinanced, and as payments are allocated to the purchase-money and non-purchase-money aspects of the transaction?

Another common problem that arises is with the allocation of the debtor's payments when there are successive purchase-money loans under security agreements with cross-collateralization clauses. If the collateral is **equipment** then the secured party must be careful to allocate payments so that any outstanding debts are secured by equipment that is still in the possession of the debtor. If the collateral is **inventory** then the problem is resolved by statute and tracking and allocation is unnecessary. The next problem illustrates this issue.

Problem 28. The Excavation Equipment and Inventory

In 1997 Excavations, Inc., borrowed \$3 million from Midwestern Bank for operating capital, and it gave Midwestern Bank a security interest in all of its equipment and inventory, "now-owned and hereafter acquired." Midwestern properly filed a financing statement covering this collateral and has properly filed continuation statements since then. Excavations still owes Midwestern \$2 million.

In 2005 Excavations began borrowing \$1 million annually from Construction Lending Co. to finance the purchase of new equipment and inventory. Using these annual loans from Construction Lending, Excavations has purchased many pieces of equipment (bulldozers, steam shovels, and cranes) and has purchased enormous amounts of inventory (sand, gravel, lime, and rock). The security agreement between Excavations and Construction Lending contains a "cross-collateralization clause" that makes all of the inventory and equipment purchased with loans from Construction Lending collateral for all of the debts that Excavations owes to Construction Lending. Construction Lending took all steps necessary to perfect a purchase-money security interest in Excavations' equipment and inventory. Over the years some of the equipment has worn out and other pieces of equipment have been sold but Excavations still owns \$1 million worth of equipment that it had purchased with funds from Construction Lending. Similarly most of the inventory has been used up in construction projects although there is still \$1 million worth of inventory on hand that was purchased with funds from loans advanced by Construction Lending. Excavations presently owes Construction Lending \$2 million.

Excavations has suspended operations and is seeking to wrap up the company. Construction Lending contends that it should take priority because it has a PMSI in all of Excavations' remaining equipment and inventory. Midwestern Bank claims priority in the equipment and inventory because it was the first to file or perfect. Midwestern takes the position that Construction Lending cannot prove that the equipment and inventory still owned by Excavations are collateral for the \$2 million of indebtedness that is still owed to Construction Lending. Midwestern contends that there is no proof that the outstanding debts owed to Construction "match up" with the remaining collateral. Midwestern claims that over the years Excavations paid off the loans that were used to purchase the equipment and inventory that is left. According to Midwestern, Construction Lending does not have a purchase-money security interest in the remaining equipment and inventory, and that the "first to file or perfect" rule of Section 9-322 governs in this case, not the "super-priority" rule of Section 9-324.

Resolve this case using [Section 9-103\(b\)](#) and [\(e\)](#). See *In re Damon Pursell Construction Co.*, 2011 WO 6130528 (Bankr. Ct. W.D. Mo., 2011).

Practice Pointer. To preserve a PMSI status in inventory be sure to include a cross-collateralization clause in the security agreement. To preserve a PMSI in equipment it is also necessary to pay close attention to how payments on the loan are allocated. Be sure to include a clause in the security agreement allowing the secured party to allocate the debtor's payments so that loans on pieces of equipment that have diminished in value or that have been disposed of are paid off first. The allocation of payments on loans that were used as purchase-money for equipment should be targeted to pay off purchase-money loans for which the original purchase-money collateral no longer exists. For example, when the debtor seeks to sell a piece of equipment that is purchase-money collateral, be sure to apply the proceeds from that sale to paying off the purchase-money loan for that specific piece of equipment.

E. [Lecture 19. Priority in Fixtures](#)

1. Definition of a Fixture

One of the murkiest areas of the law is the definition of a “fixture.” In 1946 the Supreme Court of Washington expressed its frustration over the lack of clarity on this subject:

We will not undertake to write a treatise on the law of fixtures. Every lawyer knows that cases can be found in this field that will support any position that the facts of his particular case require him to take. As early as 1899, the court said, ... “There is a wilderness of authority on this question of fixtures * * * cases * * * are so conflicting that it would be profitless to undertake to review or harmonize them.”

Strain v. Green, 25 Wash.2d 692, 695 (1946). Nevertheless in any particular case judges, lawyers, lawmakers and law students must be able to resolve what is and what is not a fixture.

Article 9 applies to security interests in fixtures. [Section 9-109\(a\)](#). The term “fixture” is defined in [Section 9-102\(a\)\(41\)](#). Fixtures are:

Goods which have become so related to particular real property that an interest in them arises under real property law.

A foundation case in the law of fixtures is *Teaff v. Hewitt*, a decision by the Ohio Supreme Court in 1853. In that case the court had to decide whether machinery in a woolen mill consisting of carding machines, spinning machines, and a power loom were “fixtures.” The machines were

attached to the floor of the mill by cleats and to the steam engine by bands and straps. The court announced the following three-part test for determining whether the machines were "fixtures."

The true criterion of a fixture, is the united application of the following requisites, to wit: 1st. Actual annexation to the realty, or something appurtenant thereto. 2d. Application to the use, or purpose, to which that part of the realty with which it is connected, is appropriated. 3d. The intention of the party making the annexation, to make a permanent accession to the freehold.

Teaff v. Hewitt, 1 Ohio St. 511 (1853). The court ruled that the machines were not fixtures:

The machinery in a woollen factory, consisting of carding machines, spinning machines, power looms, &c., connected with the motive power of the steam engine by bands and straps, but in no wise attached to the building in which used, except by cleats, or other means to confine them to their proper places for use, and subject to removal whenever convenience or business may require without injury, are not fixtures, but chattel property.

Under *Teaff* the three factors that the courts take into account in determining whether collateral constitutes a fixture are: (1) the degree to which the property is **attached** to the real property and whether it can be removed without destroying the structure; (2) whether the collateral is essential to the **use** to which the real property is put; and (3) whether the parties **intended** for the collateral to become a permanent part of the real property.

Problem 29. Attachments to Buildings

Quoted below are passages from two cases describing attachments to buildings.

Applying the three-factor test from *Teaff*, **attachment**, **use**, and **intent**, are these attachments goods, fixtures, or real property?

1. In re Marble Cliff Crossing Apartments, LLC, 484 B.R. 175, 180 (Bankr. Ct. S.D. Ohio, 2012)

The collateral includes several pieces of electronic equipment and related hardware. There are security cameras attached to the buildings merely by screws. They are removable, and in fact have been relocated when necessary, with no harm to the buildings. It is anticipated that periodically the cameras will be replaced to keep pace with technological advances. The wires, track mold, and other miscellaneous hardware used to mount the cameras are also removable. The controller for the wireless internet equipment is a computer attached to a rack, which is freestanding. These items are removable with no harm to the buildings. The wireless access points are attached with screws and can be easily removed or moved. Finally, Mr. Beatty [Ed. – the managing

member of the company that sold and installed the security equipment] and Mr. Deibel [Ed. – the president of the company that managed the apartment building] testified that there was no intent to make any of these items permanent additions to the property.]

2. *Lewiston Bottled Gas Co. v. Key Bank of Maine*, 601 A.2d 91, 94 (Me. 1992)

The heating and air-conditioning units were installed when the Inn was under construction and are part of the walls of the building. The units are attached by bolts and although they could be removed, their removal would create a large hole in the walls of each room.

...

The real estate was designed and built as an inn to accommodate overnight guests. The heating and air-conditioning units help create a liveable atmosphere for those guests by providing heat and cooling to the rooms.

...

... the agreements between [the owner of the hotel and the seller of the heating and air conditioning units] granted to [the seller] a purchase money security interest in the units and expressly stated that the units would remain personal property [However,] it is not the hidden subjective intent of the person making the annexation that must be considered but rather “the intention which the law deduces from such external facts as the structure and mode of attachment, the purpose and use for which the annexation has been made and the relation and use of the party making it.”

Practice Pointer. The three-part multi-factor test from *Teaff v. Hewitt* is commonly used to determine whether collateral for a loan is a fixture. Notice that the “intent” prong rests primarily on what the parties have **done**, not what they have **said**.

Additional confusion regarding the determination of whether an item of property is a “fixture” can arise because the term is defined differently in different fields of law. For example, Article 2 does not use the term “fixture” but it adopts only the **annexation** test for determining whether Article 2 applies to a transaction. [Section 2-107](#) states that Article 2 applies to the sale of “things attached to realty and capable of severance without material harm thereto.” However, Article 2 also applies to the sale of minerals and structures and building materials (such as bricks or siding removed from a building) if these types of property are **severed by the seller**.

Moreover the laws of some states recognize the concept of “trade fixtures” – that is, equipment that is necessary to the conduct of a business but not permanently affixed to the realty. In those states the courts would have treated the woolen mill machinery from *Teaff v.*

Hewitt as fixtures. Still other states recognize the “assembled industrial plant doctrine.” This is similar to the “trade fixture” doctrine, treating all items connected with an ongoing business as fixtures. This used to be the law in Pennsylvania but it was abolished in 2001 with the enactment of 12 P. C.S. §9801.

Practice Pointers. The principal reason why it is important to determine whether property is a fixture, goods, or real property is that this will determine how you should perfect your client’s security interest in the property.

1. If the property that is being used as collateral for a debt owed to your client is clearly goods and not a fixture then file a financing statement covering that property with the office of the Secretary of State or Secretary of the Commonwealth in the state of the debtor’s location.
2. If the property that is collateral is clearly real property and not a fixture then you must file a mortgage in the office of the County Recorder in the county where the real property is located.
3. If the property that is collateral is clearly a fixture and not goods or real property then a real property mortgage will perfect the security interest as against owners or encumbrancers of the real property; a financing statement filed with the Secretary of State in the state where the debtor is located will perfect the security interest as against other Article 9 secured parties; and a fixture filing in the state and county where the fixture is located will perfect the security interest as against **both** owners and encumbrancers of the real property and Article 9 secured parties.
4. The form used as a fixture filing, the Addendum to a financing statement (UCC1ad), is displayed in [Chapter 4 Part C.3](#). Recall that there are four additional pieces of information that must be included in a fixture filing. In addition to containing the information required for all financing statements under [Section 502\(a\)](#), under [Section 502\(b\)](#) a fixture filing must also state that it is a fixture filing; it must state that it must be filed with the real estate records; it must describe the real property to which the fixture is attached; and it must state the name of the owner of the real property as well as the name of the debtor.
5. If you are not sure whether the property serving as collateral for the debt owed to your client is goods or fixtures then it is usually wise to file both a financing statement in the state where the debtor is located and a fixture filing in the county where the fixture is located. See the “Radio Telescope” questions in Quiz 19 on Blackboard.

2. Priority Rules for Security Interests in Fixtures

Priority in fixtures is governed by [Section 9-334](#). There are twelve rules that govern priority of security interests in fixtures.

1. Secured Party v. Secured Party. If two parties have an Article 9 perfected security interest in the same fixture, the **normal rules** under Article 9 control. Normally the party who is first to file or perfect prevails. [Section 9-322](#). However, a secured party with a purchase money security interest takes priority over parties with non-purchase money security interests so long as the party with the PMSI complies with [Section 9-324](#). **As against another Article 9 secured party, a secured party may perfect its security interest in a fixture by any means permitted under Article 9**, including by filing a regular financing statement with the Secretary of State's office or by filing a fixture filing with the County Recorder's office. A security interest in fixtures could be perfected automatically if it is a purchase-money security interest in consumer goods, and temporary automatic perfection also applies in some situations. It is not possible for a secured party to perfect a security interest in a fixture by taking possession because by definition a fixture must be attached to real property.

2. Secured Party v. Buyer of the Fixture. The **normal rules** of [Section 9-320](#) apply if the priority contest is between an Article 9 secured party with a security interest in the fixture and a buyer of the fixture. **As against a buyer of the fixture a security interest can be perfected by any means permitted under Article 9, either a regular financing statement or a fixture filing.** A buyer will take the goods free of the security interest if the secured party consented to the sale free of the security interest; if the secured party was unperfected and the buyer was a good faith purchaser for value without knowledge of the security interest; if the buyer was a buyer in the ordinary course; or if the transaction was a consumer-to-consumer sale and the secured party had not previously filed a financing statement. Otherwise the buyer acquires the fixture subject to the security interest.

3. Secured Party v. Lien Creditors and Bankruptcy Trustees. The **normal rules** also apply to priority disputes with lien creditors and bankruptcy trustees. A secured party that has a security interest that is **“perfected by any method permitted by this article”** prevails over a subsequent lien creditor or bankruptcy trustee. (The reason that is offered for this rule is that a lien creditor and a bankruptcy trustee are not “reliance creditors” – they don’t check the filing systems before they acquire their interests.) [Section 9-334\(e\)\(3\)](#).

4. Secured Party v. Debtor. If the debtor owns the property and the secured party takes a security interest in a fixture on the property, then the **normal rule** applies. The security interest is good against the debtor even if it isn’t perfected.

5. Secured Party v. Buyer of the Real Property. This priority dispute is governed by a **first to file rule**. If a party has a security interest in a fixture and the debtor then sells the real property to another person, then the interest of the secured party is subordinate to the interest of the new owner of the property unless the secured party filed a **fixture filing** before the new owner filed their deed. [Section 9-334\(e\)\(1\)\(i\)](#).

6. Secured Party v. Mortgagee of the Real Property. This priority dispute is governed by a **first to file rule**. If the debtor grants a mortgage in the real property to a lender who files a mortgage on the property, the mortgagee will take priority over an unperfected security interest in a fixture. To prevail, the secured party must make a **fixture filing** before the lender files a mortgage deed. [Section 9-334\(e\)\(1\)\(i\)](#).

7. Secured Party with a Security interest in Trade Fixtures v. Owner Other Than Debtor or Mortgagee of Real Property Containing Trade Fixtures. As against an owner of the real property other than the debtor or a mortgagee of the real property, If state law recognizes the category of “trade fixtures” – that is, readily removeable factory or office machines used in the operation of a business – then the secured party prevails if the security interest is perfected before the item becomes a fixture. The secured party does not have to file a fixture filing. A secured party with a security interest in a trade fixture will prevail if the security interest is **perfected before affixation by any method permitted by Article 9**. (This will usually be a UCC-1 filing with the office of the Secretary of State.) [Section 9-334\(e\)\(2\)\(i\) and \(ii\)](#).

8. Secured Party with Security Interest in Readily Removeable Replacements of Consumer Goods v. Owner Other Than Debtor or Mortgagee. If the collateral is readily removeable replacements of consumer goods, the secured party will prevail over the owner or mortgagee of the real property if the security interest is **perfected by any method permitted by Article 9**. (This will usually be automatic perfection because in most case the security interest will be a purchase-money security interest.) [Section 9-334\(e\)\(2\)\(iii\)](#).

9. Secured Party with Security Interest in a Manufactured Home v. Owner Other Than Debtor or Mortgagee. If the collateral is a manufactured home which has become a fixture, but the secured party has a security interest which has been perfected by recording the lien on a **certificate of title**, then the secured party will prevail over the owner or encumbrancer of the real estate. [Section 9-334\(e\)\(4\)](#). (This is not the only way for the secured party to win – there are other ways as well, such as by perfecting a PMSI by means of a **fixture filing** within 20 days of delivery of the home (number 11 below).

10. Owner Other Than Debtor or Mortgagee Who Consents to Granting of Security Interest or Where Debtor Has Right to Removal. If the owner or mortgagee consents to debtor's granting of the security interest or if the debtor has a right as against the owner or encumbrancer to remove the fixture, then a secured party with a security interest in the fixture will prevail over the owner or encumbrancer. [Section 9-334\(f\)](#).

11. Secured Party with a Purchase-Money Security Interest in a Fixture v. Owner Other Than Debtor or Mortgagee. If the secured party has a purchase-money security interest in the fixture, and makes a **fixture filing** before the goods become fixtures or **within 20 days** thereafter, then the secured party takes priority over the owner or encumbrancer of the real property. [Section 9-334\(d\)](#).

11A. Construction Mortgagee. ... unless the encumbrancer is a construction mortgagee, in which case even a PMSI is subordinate to the interest of the construction mortgagee, if the property was made a fixture before the construction was completed. [Section 9-334\(h\)](#). However, the rights of a construction mortgagee are subject to the rights of secured parties who qualify under Sections 9-324(e) and 9-324(f) (numbers 6 through 10 in the list above).

12. General Rule. If none of the foregoing exceptions apply, an owner of real property who is not the debtor or a mortgagee of the real property takes priority over a secured party with a security interest in fixtures. [Section 9-334\(c\)](#).

Here is another problem on fixtures.

Problem 30. Three Pools

Three families purchased swimming pools that were installed in their back yards. Each family purchased its pool on credit from Pools Unlimited, granting the seller a security interest in the pool until it was entirely paid for. In addition each family had also borrowed money from Homeowners Bank to purchase their home. The mortgage on each family's home granted the bank a mortgage that covered the land, the house, and any "appurtenances" (meaning "fixtures").



Above-ground pool. For \$1,000 the Sotherbys purchased an above-ground aluminum pool with a small filtration system. The pool is 18 feet in diameter and it consists of aluminum sides kept in place by aluminum poles that are driven ten inches into the ground. There is a thick plastic liner. The pool can be disassembled and removed in less than an hour.



A swim spa. For \$20,000 the Westins purchased a partially in-ground elongated hot tub made out of acrylic. The unit is 17 feet long and weighs 2000 pounds without water. It was installed in the back yard on a one-foot thick cement base that is three-feet underground, and the pool extends two feet above the ground. The only connections between the swim spa and the house are an electrical plug into a 240-volt electrical outlet and a ground wire connected to a water pipe in the basement. The pool was delivered on a flatbed truck and was lowered onto the cement base by a 60-foot crane, and it could be removed in the same manner with about 4 hours of work consisting mainly of digging around the pool to accommodate the straps from the crane. The machinery in the pool will wear out in time and will have to be replaced but the pool itself will last indefinitely.



In-ground pool. For \$80,000 the Eastons ordered a traditional kidney-shaped in-ground pool. The pool cannot be removed; it could be destroyed and covered over.

1. Are these pools goods, fixtures, or real property? Does Homeowner's Bank have any claim to any of these pools?
2. Can Pools Unlimited perfect its security interest in any of these pools in order to take priority over Homeowner's Bank? If so, how?

The following portion of this chapter covers types of property that are analogous to fixtures: **accessions** and **commingled goods**.

F. [Lecture 20. Priority in Accessions and Commingled Goods](#)

Accessions are goods that are attached to other goods but which can be removed. Accessions are analogous to fixtures except that they are attached to goods, not real property. A top load carrier that is attached to the roof of an automobile is an accession; a hot water heater that is installed in a house is a fixture. A security interest in goods that become an accession to other goods continues in the accession.

Commingled goods are goods that become part of other goods and cannot be separated or removed from those other goods. Commingled goods are analogous to goods that become part of the real property. Flour that is added to a cake is commingled goods; a glaze that is spread upon a driveway to protect it from water damage becomes part of the real property. A security interest in goods that become commingled with other goods continues in the commingled product.

The priority rules for accessions are contained in [Section 9-335](#). The priority rules for goods that are commingled with other goods are set forth in [Section 9-336](#). But there are some additional factors that affect the outcomes in these cases:

1. Security interests in accessions and commingled goods are usually purchase-money security interests. The security interests in accessions and commingled goods arise because the goods are purchased on credit to be added to other goods.
2. Accessions are usually added to motor vehicles. In general security interests in motor vehicles are governed by certificates of title. Security interests that are perfected on a certificate of title take priority over security interests in accessions. [Section 9-335\(d\)](#).

3. Accessions to motor vehicles are often added by garages that are granted a **possessory artisan's lien** on the vehicle. Artisan's liens are created by statute or common law outside of Article 9, but priority between artisan's liens and Article 9 security interests are governed by Article 9, specifically [Section 9-333](#).

4. Accessions are also commonly added to motor homes. In these cases it is necessary to investigate a number of additional factors:

- a. Are the items still goods? See *In re Edwards*, 94 U.C.C. Rep Serv 2d 607, (Bankr. Ct., E.D. North Carolina, 2017) (holding that the stove, refrigerator, washer, dryer, and air conditioning unit were ordinary consumer goods and not accessions to the motor home).
- b. Is the motor home still a vehicle that is subject to certificate of title laws?
- c. Has the motor home become part of the real property? If so, are the additions to the motor home fixtures?

The following problem will test your understanding of the definition of accessions and commingled goods as well as the rules governing perfection and priority of these types of collateral.

Problem 31. The Modified Pick-Up

Angel purchased a pick-up truck. Fisher Finance loaned Angel the money to purchase the truck and recorded its security interest on the certificate of title. Angel brought their new pick-up truck into Mom & Pop's Garage and ordered two modifications to be added to the truck: a large toolbox and a snowplow. Mom & Pop's Garage purchased the toolbox and the plow with its controls. The toolbox is attached to the bed of the truck with screws. It could be removed from the truck in minutes. The snowplow is attached to the front of the truck and the undercarriage and the controls for the plow are incorporated into the dashboard. It would take several hours to remove the plow and the controls for sale to another person. Mom & Pop's Garage has Angel sign a security agreement covering the toolbox and the snowplow, and filed a financing statement covering all three items.

1. Are each of these items goods, accessions, or commingled goods?
2. When the work is finished but not yet paid for can Mom & Pop's Garage allow Angel to take the truck home and yet retain a security interest in the items that were added to the truck? Will Mom & Pop's security interest in those items take priority over the security interest of Fisher Finance?

3. If Mom & Pop's Garage is not paid when the work is finished and the garage retains possession of the truck, could the garage take priority over Fisher Finance as to any of these items? See [Section 9-333](#). (We shall study artisan's liens in Chapter 7.)

Practice pointer. We learned earlier that careful categorization of collateral is the key to resolving priority disputes. Not only are there different categories of collateral that are goods (equipment, inventory, consumer goods and farm products) but goods must also be classified by whether they are ordinary goods, accessions, or fixtures. Moreover different priority rules may come into play depending upon whether a creditor has a regular Article 9 security interest, a purchase-money security interest, a lien recorded on a certificate of title, a real property mortgage, or a possessory lien created by statute.

The last portion of this chapter applies to certain financial forms of wealth: investment property, deposit accounts, and letter-of-credit rights.

G. Lecture 21. Priority Over Investment Property, Deposit Accounts, and Letter-of-Credit Rights

The basic rule of priority that applies to deposit accounts, investment property, and letter-of-credit rights is that **control defeats other methods of perfection**. There are many other rules to keep in mind, but that basic rule runs throughout this corner of the law of Secured Transactions.

1. Deposit Accounts

We learned in Chapter 1 that the law does not permit a person to take a security interest in a consumer deposit account as part of a consumer transaction. However, a consumer deposit account may be used as collateral in a commercial transaction. Commercial deposit accounts can be used as collateral in any circumstance.

There are two ways in which a deposit account may become subject to a security interest. The debtor may expressly agree to this arrangement in a **security agreement**, or the funds in the deposit account may include **proceeds** of the original collateral. If the funds in the deposit account are "identifiable" – that is, if the funds in the account can be traced to the sale or other disposition of collateral that is subject to a security interest – then the security interest automatically attaches to the funds in the account and the security interest in those funds is automatically perfected.

If a security agreement creates a security interest in the debtor's deposit account (that is, if the security interest in the deposit account does not arise because the deposit account is proceeds of the original collateral) then the **only** way to perfect a security interest in the deposit account is by taking **control** of the account. [Section 9-312\(b\)\(1\)](#). [Section 9-104\(a\)](#) establishes three ways to establish control over a deposit account:

(a) Requirements for control. A secured party has control of a deposit account if:

- (1) the secured party is the bank with which the deposit account is maintained;
- (2) the debtor, secured party and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or
- (3) the secured party becomes the bank's customer with respect to the deposit account.

Priority over deposit accounts is governed by [Section 9-327](#). That section of the Code establishes the following hierarchy among secured parties, ranked from highest priority to lowest:

1. A security interest held by a secured party who has perfected by becoming the bank's customer with respect to the deposit account;
2. A security interest held by the bank with which the deposit account is maintained;
3. A security interest held by a secured party who has perfected by entering into an agreement with the debtor and the bank requiring the bank to comply with instructions of the secured party without further consent of the debtor;
4. A security interest held by a secured party who has perfected a security interest in the account by other means (such as automatic perfection in proceeds of other collateral).

A party with control over a deposit account takes priority over a party that does not have control. And parties who have perfected by means of certain methods of control over deposit accounts take priority over parties who have perfected by means of other methods of control. This same pattern of priority is repeated when the collateral is investment property or letter-of-credit rights.

The following problem illustrates priority among parties with different types of control over a deposit account. Priority disputes among parties with a security interest in deposit accounts as **proceeds** of collateral are covered in Chapter 8.

Problem 32. The Business Checking Account

Sunlight & Associates, LLP, is a commercial real estate developer in suburban Dayton, Ohio. Sunlight has a checking account at Ohio National Bank with a present balance of \$1 million. Sunlight has borrowed \$800,000 from Ohio National Bank; Sunlight has borrowed \$700,000 from Realty Investors, Inc.; and it has borrowed \$600,000 from Terry Baltimore, a wealthy investor. All three creditors were granted a security interest in Sunlight's deposit account. Ohio National Bank did nothing to perfect its security interest. Realty Investors filed a financing statement covering the account. And Terry Baltimore entered into an agreement with Sunlight and with Ohio National Bank under which Sunlight agreed that Ohio National Bank would comply with any instructions from Terry regarding the account without further consent of Sunlight.

- a. Does Sunlight still have access to the deposit account? Could Sunlight withdraw funds from the account without the consent of Terry Baltimore? See [Section 9-104\(b\)](#).
- b. Did the bank perfect its security interest in Sunlight's deposit account? See [Section 9-104\(a\)\(1\)](#).
- c. Did Realty Investors properly perfect its security interest in the deposit account? See [Section 9-312\(b\)\(2\)](#).
- d. Did Terry Baltimore properly perfect their security interest in Sunlight's deposit account? See [Section 9-104\(a\)\(2\)](#)
- e. If Sunlight defaults on all three of these loans what would the relative priority be among the three secured parties: Ohio National Bank, Realty Investors, and Terry Baltimore? See [Section 9-327](#).
- f. Could Realty Investors or Terry Baltimore have perfected in such a way as to take priority over Ohio National Bank? See [Section 9-104\(a\)\(3\)](#) and [Section 9-327\(4\)](#)

2. Investment Property

A secured party can perfect a security interest in investment property either by filing a financing statement or by taking control of the collateral. However, a secured party who perfects a security interest in investment property by taking control takes priority over parties who perfect by other means. **Control prevails over filing.** Moreover some methods of taking control take prevail over other methods of taking control. Priority over investment property is governed by [Section 9-328](#).

The following problem illustrates the application of the rules governing perfection and priority over investment property.

Problem 33. The Investment Portfolio

Lennox Watts is the owner and managing member of FarHorizon LLC. Lennox personally owns \$5 million worth of stocks, bonds, and mutual funds, all of which are in an investment account (No. LR-55827) at Gloucester Brokerage, Inc. Lennox lives in Colorado. FarHorizon LLC is registered in Massachusetts. Gloucester Brokerage is registered in Delaware. The following three transactions occurred:

1. In 2017 Lennox borrowed \$3 million for commercial purposes from First Wisconsin Bank. The loan agreement granted First Wisconsin a security interest in "all of the debtor's investment property." First Wisconsin filed a financing statement in the State of Delaware, where Gloucester Brokerage is located.
 - a. Does the security agreement adequately describe the collateral? See [Section 9-108\(d\)](#) and [\(e\)](#).
 - b. Did First Wisconsin file its financing statement in the proper state? See [Section 9-305\(a\)\(3\)](#) and [\(c\)](#).
2. In 2018 FarHorizon LLC borrowed \$3 million from Erie Finance. Lennox guaranteed the debt and granted Erie Finance a security interest in "Account No. LR-55827" at Gloucester Brokerage. Erie sought to perfect its security interest by entering into an agreement with Lennox in which Lennox agreed that Erie Finance could issue orders to Gloucester Brokerage with respect to the account without further consent from Lennox. Is Gloucester Brokerage entitled under the law to refuse to enter into this agreement? If Gloucester Brokerage refuses to enter into this agreement would Erie Finance have control over the investment account? See [Section 8-106\(d\)](#) and [\(g\)](#).
3. In 2019 Lennox borrowed \$3 million from Gloucester Brokerage and Lennox granted Gloucester Brokerage a security interest in the securities entitlement. Gloucester Brokerage took no action to perfect its security interest in the securities entitlement. Is the security interest of Gloucester Brokerage perfected? See [Section 8-106\(e\)](#) and [Section 9-106](#).
4. Assume that in 2020 all three of these loans were in default. Assume further that First Wisconsin properly perfected by filing in 2017, Erie Finance properly perfected by taking control through agreement in 2018, and that Gloucester Brokerage properly perfected by virtue of its status as securities intermediary in

2019. What would the proper order of priority be among those three creditors? See [Section 9-328](#).

The final topic that is covered in this chapter is priority in letter-of-credit rights.

3. Letter-of-Credit Rights

A party may directly obtain a security interest in letter-of-credit rights by entering into a security agreement expressly granting the secured party an interest in the debtor's letter-of-credit rights. There is only one way to perfect a security interest in letter of credit rights, and that is to obtain control. Under [Section 9-107](#) there is only one way to obtain control over letter-of-credit rights, and that is if the issuer consents to an assignment of the proceeds of the letter of credit.

However, a security interest in letter-of-credit rights may also arise **implicitly**. A letter of credit is a "supporting obligation" of an account (an amount owed for the delivery of goods). [Section 9-308\(d\)](#) provides: "Perfection of a security interest in collateral also perfects a security interest in a supporting obligation for the collateral."

As between a security interest in letter-of-credit rights that is automatically perfected as the supporting obligation of an account and a security interest in letter-of-credit rights that is perfected by control, which takes priority? Consider the following problem. (By this time you have probably guessed the right answer.)

Problem 34. Brass Accessories

Brass Unlimited is a company that makes door handles, hinges, and locking mechanisms. In 2018 First American Bank made a loan to Brass Unlimited in the amount of \$200,000. Brass Unlimited granted First American Bank a security interest in its accounts and letter-of-credit rights. First American filed a financing statement indicating the collateral as "all accounts and letter-of-credit rights" belonging to Brass Unlimited. On October 4, 2019 Brass Unlimited entered into a contract with Ivanhoe Doors to deliver 5000 door handles, hinges, and locking mechanisms to Ivanhoe. The handles, hinges and locks were delivered on October 15. At the time of delivery Ivanhoe gave Brass Unlimited a letter of credit issued by Cross Street Bank payable in 60 days (December 14) in the amount of \$80,000. In November of 2019 Brass Unlimited borrowed \$100,000 from Downtown Lending and granted Downtown Lending a security interest in its letter-of-credit rights under the Cross Street Bank letter of credit. Upon request Cross Street Bank consented to Brass Unlimited's assignment of the proceeds of the letter of credit to Downtown Lending. On December 10, 2019, Brass Unlimited ceased operations.

As between First American Bank and Downtown Lending, which secured party takes priority to the right to payment under the Cross Street Bank letter of credit? See [Section 9-329](#).

Practice Pointer. “Accounts” are money that is owed for goods or services, but the definition of “accounts” expressly excludes “letter-of-credit rights.” [Section 9-102](#). However, letter-of-credit rights are a **supporting obligation** of an account, so a security interest in an account automatically attaches and is automatically perfected in any associated letter-of-credit-rights. In addition, if a letter of credit is given to the seller **after** the contract for goods or services was entered into then the letter-of-credit rights are **proceeds** of the account. Keep in mind that the party with **control** takes priority over parties who perfect by other means, and that there is only one way to gain control over letter-of-credit rights; by obtaining the consent of the issuer.

In Chapter 7 we will study a number of other types of priority disputes between secured parties and other claimants to the collateral.

End of Chapter 6

Chapter 7. Priority, continued. Priority as to Buyers; Lien Creditors; Lessors and Lessees; Article 2 Claimants; Holders of Possessory Liens That Arise by Operation of Law

A. Learning Objectives

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Recognize when a secured party has either explicitly or implicitly authorized the sale of collateral free of the security interest.
2. Identify the nine elements necessary to qualify as a buyer in the ordinary course.
3. Analyze whether a third party is a buyer in the ordinary course.
4. Distinguish “consumer goods” from things that are “not consumer goods.”
5. Resolve priority disputes between secured parties and buyers.
6. Resolve priority disputes between secured parties and lien creditors.
7. Resolve priority disputes between secured parties and lessors and lessees.
8. Resolve priority disputes between secured parties and parties who have a possessory lien by operation of law.

B. Lecture 22. Priority Disputes Between Secured Parties and Buyers

The general rule is that a security interest continues in collateral despite sale or exchange of the collateral. In other words a security interest in collateral is valid against a person who buys the collateral. This rule – the “Golden Rule” of Secured Transactions -- is so fundamental that it is stated in [Section 9-201](#) and repeated in [Section 9-315](#).

A person who buys the collateral from the debtor takes free of a security interest only if one of the following exceptions applies:

1. If the security interest in goods, instruments, tangible documents, tangible chattel paper, or a certificated security is unperfected and the buyer gave value and was without knowledge of the security interest;
2. If a secured party explicitly or implicitly consents to the sale of the collateral free of the security interest;
3. If a buyer of goods other than farm products qualifies as a “buyer in the ordinary course;”
4. If a consumer debtor sells consumer goods to another consumer;
5. If a buyer of farm products has complied with the requirements of the federal Food Security Act;
6. If a buyer purchases goods that are subject to a certificate of title, the lien does not appear on the certificate of title, and the buyer gave value and was without knowledge of the security interest; or
7. If the goods are sold to a buyer in a different state and the secured party fails to file a financing statement in the other state within one year then the security interest becomes unperfected.

The following portion of this textbook explains the seven exceptions to the Golden Rule as priority disputes between a secured party and different types of buyers.

1. Party with Unperfected Security Interest v. Buyer Who Gives Value and Receives Delivery Without Knowledge of the Security Interest

Under [Section 9-317\(b\)](#) a buyer takes free of a security interest if three elements are satisfied:

- (1) The security interest is unperfected;
- (2) The buyer gives value; and
- (3) The buyer is without knowledge of the security interest.

In considering the third element of this priority rule it is necessary to distinguish **knowledge** from **notice**. Knowledge and notice are defined in [Section 1-202](#).

Knowledge is **subjective**. A person has knowledge if they are consciously aware of a fact. Notice is **objective**. A person has notice if they have “reason to know” a fact.

It is more difficult to prove that a person has knowledge than it is to prove that person has notice.

In each of the following cases the secured party had an unperfected security interest in property that the debtor sold to the buyer. Did these buyers have **knowledge** of the unperfected security interests or did they merely have **notice** of the unperfected security interests?

In re SemCrude, L.P., 87 U.C.C. Rep. Serv.2d 295 (D. Del., 2015)

A group of oil producers sold oil to SemCrude, L.P., on credit. Two purchasers (BP Oil Supply Co. and J. Aron & Company) purchased the oil from SemCrude. SemCrude failed to pay the producers for the oil before going bankrupt. Under the law of the states where the **oil wells** were located the producers are automatically granted a perfected security interest in any oil that they sell on credit. However, the law of the state where the **debtor** is located determines whether a secured party's security interest is perfected and because SemCrude is registered in Delaware the oil producers were each bound to perfect their security interest pursuant to the law of Delaware. The producers failed to file a financing statement against SemCrude in Delaware, so their security interests were unperfected.

The purchasers were aware that SemCrude had purchased the oil from the producers; the purchasers were aware that those sales had occurred in states that granted the producers an automatic security interest in the oil; and the purchasers were aware that those sales were on credit. However, the court found that there was no evidence that the purchasers were aware that the producers were still unpaid at the time that the purchasers bought the oil from SemCrude. Accordingly the court found that the purchasers did not have knowledge of the producers' security interest in the oil. Therefore the purchasers of the oil took free of the unperfected security interest of the producers.

Four County Bank v. Tidewater Equipment Co., 771 S.E.2d 437 (Ga. Ct. App. 2015)

The Four County Bank took a security interest in two pieces of equipment belonging to the debtor Shepherd Brothers Timber Company, LLC, in 2003 and 2005. Shepherd sold the equipment to Tidewater Equipment Co. in 2007 and 2008. Tidewater did not check the UCC filings to see whether the equipment was encumbered. Four County Bank then failed to file continuation statements covering the equipment on time; the continuation statements were filed a few months late in 2008 and 2011.

Under Section 9-515(b), if a continuation statement is not filed on time then the security interest is deemed never to have been perfected as against a purchaser for value. The bank argued that Tidewater should be deemed to have had "knowledge" of the Bank's interest in light of the fact that an effective financing statement was on file when Tidewater purchased the

equipment from Shepherd. The court rejected this argument and ruled that Tidewater at most had **notice**, not **knowledge**, of the Bank's security interest. The court added that despite the "harshness" of result in this case the perfection and priority rules of Article 9 must be strictly enforced to encourage reliance on the Code.

Practice Pointers.

1. In criminal law *mens rea* often determines how serious a crime the accused has committed or even whether a crime has been committed at all. Similarly under the of tort the defendant's liability often depends upon whether their conduct was intentional, reckless, or merely negligent. In Commercial Law there is often a vast difference between action that is taken with "notice" of certain facts and actions that are taken with "knowledge" of those facts. In practice be sure to distinguish the concepts of "notice" and "knowledge" in situations where the law deems that distinction relevant.
2. In representing a secured party be sure to file a continuation statement at the proper time even after the debtor is in bankruptcy.
3. Under the Uniform Commercial Code **a secured party is not a "buyer" but a secured party is a "purchaser."** See Section 1-201(29) and (30) (defining "purchase" and "purchaser.") Can a secured party who gives value take free of an unperfected security interest under Section 9-317(b)? Under Section 9-515, if the secured party fails to properly file a continuation statement does the security interest become unperfected as to another secured party?

2. Priority of Secured Party Who Consented to Sale to Buyer Free of the Security Interest

Section 9-315(a) acknowledges that a secured party may authorize a debtor to sell the collateral free of the security interest. That subsection provides:

Except as otherwise provided in this division and in section 2-403(b) (relating to transfer by merchant entrusted with possession of goods):

- (1) a security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and
- (2) a security interest attaches to any identifiable proceeds of collateral.

Authorization may be **express** or **implied**. The security agreement between the secured party and the debtor may explicitly state whether the debtor must notify or obtain the consent of the secured party before selling any of the collateral.

The express terms of an agreement must be interpreted in light of course of performance, course of dealing, or trade usage. See [Section 1-303](#). A secured party's consent to a debtor to dispose of collateral might implicitly arise out of a usage of trade. For example, if the secured party is granted a security interest in the inventory of the debtor common commercial practice would imply that the debtor will sell the collateral and that the secured party reasonably expects to be repaid from the **proceeds** of the inventory.

Implied authorization to sell the collateral may also arise from course of dealing (the conduct of the parties in the performance of previous contracts) or course of performance (the conduct of the parties in the performance of this specific contract). The following case deals with "authorization" by a secured party under a prior course of dealing.

Security National Bank of Sioux City v. Welte, 924 N.W.2d 877 (Iowa Ct. App., 2018)

Roger Rand loaned money to Frank Welte II and took a security interest in Welte's farm-related property. Despite the fact that the security agreement prohibited Welte from assigning or transferring any of the collateral without prior written consent, on several occasions Welte had sold collateral without Rand's prior consent. On this occasion, however, Welte sold two tractors worth \$205,000 to his son Matthew for a price of \$55,000. The court noted that Welte had the burden of proving both the existence of the prior course of dealing and that the sale of the collateral was consistent with the course of dealing. The court ruled that this transaction was mainly a gift from father to son and that it was not within the prior course of dealing between Rand and Frank Welte. Accordingly the court ruled that the tractors were still subject to Rand's perfected security interest.

Practice Pointers.

1. Before your client purchases a piece of equipment from a seller be sure to check the U.C.C. filings to make sure that the equipment is not encumbered with a security interest.
2. When invoking the "implied terms" of a contract It is not enough to prove that our clients have established a "course of dealing" or "course of performance" under a contract. It is also necessary to prove that our clients acted in good faith and in accordance with the course of dealing or course of performance.

3. Secured Party v. Buyer in the Ordinary Course

A person who buys collateral from a debtor in the ordinary course of business takes free of a security interest **created by the buyer's seller**. [Section 9-320\(a\)](#).

To be a buyer in the ordinary course nine elements must be satisfied. [Section 1-201\(b\)\(9\)](#).

These elements are:

1. The buyer buys goods other than farm products;
2. In good faith;
3. In the ordinary course;
4. Without knowledge that the sale violates the rights of the secured party;
5. From a person who deals in goods of that kind other than a pawnbroker;
6. The buyer comports with the usual or customary practices in the kind of business in which the seller is engaged, or with the seller's usual or customary practices;
7. The buyer took possession of the goods or has a right to recover the goods from the seller under Article 2 (Sections 2-502 or 2-716);
8. The buyer did not acquire the goods in a bulk transfer; and
9. The buyer did not acquire the goods in satisfaction of a money debt.

Before examining each of those nine elements, the following problem illustrates an important limitation on the buyer-in-the-ordinary-course doctrine. A buyer in the ordinary course does not take free of every perfected security interest in the property; the doctrine only protects a buyer from security interests "created by the buyer's seller."

Problem 35. The Lathe

Grenville Machine Shop was indebted to Pinetree Bank and had granted the bank a security interest in its equipment. Pinetree Bank perfected its security interest by filing a financing statement against Grenville covering the equipment. During a business slowdown Grenville sold a piece of equipment (a large metal lathe) for \$8,000 to Wellington Associates, a company that regularly deals in used factory equipment. Wellington in turn sold the lathe to Lionshead Aluminum for \$13,000. Lionshead meets all nine of the foregoing elements for qualifying as a buyer in the ordinary course.

Pinetree Bank sues Lionshead for replevin (seeking the return of the lathe) or for conversion (seeking the fair market value of the lathe). Pinetree Bank will prevail despite the fact that Lionshead meets all nine of the foregoing elements for qualifying as a buyer in the ordinary course. Why will Lionshead lose this lawsuit to Pinetree Bank?

Practice Pointer. When your client buys used goods even if your client qualifies as a "buyer in the ordinary course" there is a risk that the goods are subject to a security interest that was created by a debtor earlier in the chain of title. If your client is spending a significant amount of

money on used goods it would be wise to check the chain of title to make sure that there are no U.C.C. filings against owners earlier in the chain.

Here are brief explanations of each of the nine elements necessary to qualify as a “buyer in the ordinary course,” some of which are illustrated with cases and problems.

1. The buyer buys goods other than farm products.

The “buyer in the ordinary course” rule does not apply to sales of farm products; the rule potentially applies only to goods that are inventory, equipment, or consumer goods. As a practical matter **only inventory can be sold in the ordinary course**. If the goods are **equipment or consumer goods** in the hands of the seller then the seller would be usually **not** be selling those goods in the ordinary course of business.

2. In good faith.

Every contract or duty under the Uniform Commercial Code imposes an obligation of good faith. [Section 1-304](#). “Good faith” consists of “honesty in fact and the observance of reasonable commercial standards of fair dealing.” [Section 1-201\(b\)\(20\)](#). If a buyer does not check the U.C.C. filing system for financing statements filed against the debtor does that indicate that the buyer is not acting in good faith? The following case addresses that issue.

Arthur Click Auto Sales, Inc. v. Stephen East Corp., 2012 WL 6592343 (S.D.N.Y. 2012)

Arthur Click Auto Sales sold two chassis for fire trucks to Wolverine Fire Apparatus Company and retained a security interest in the chassis. Wolverine intended to construct two fire trucks upon the chassis and Wolverine entered into contracts with two Fire Districts (Beaverkill Valley and Forest Waverly) to purchase the fire trucks that Wolverine was building. Wolverine entered bankruptcy and the Fire Districts took delivery of the uncompleted trucks and hired other companies to complete the manufacture of the trucks. Arthur Click Auto Sales was never paid for the two chassis. Arthur Click sued the Fire Districts claiming that the Fire Districts purchased the chassis subject to Arthur Click’s perfected security interest. The Fire Districts defended on the ground that they were buyers in the ordinary course. The secured party contended that the Fire Districts did not act in good faith because did not check the U.C.C. filing system when they purchased the chassis.

The court found that the Fire Districts did qualify as buyers in the ordinary course. A buyer bears the burden of proving that they are a buyer in the ordinary course, but in the absence of contrary evidence there is a presumption that a party has acted in good faith. Moreover a buyer is not disqualified from being a buyer in the ordinary course even if they have knowledge that the goods were subject to a security interest; a buyer is disqualified from being a BIOC only if the buyer has **knowledge that the sale was in violation of the security interest**. No such

knowledge can be imputed to the Fire Districts, and there was no evidence that the Fire Districts acted in bad faith. Accordingly the Fire Districts took clear of the security interest of Arthur Click Auto Sales.

Practice Pointer.

1. The buyers (the Fire Districts) initially had the burden of proving that they acted in good faith, but the court ruled that there is a **presumption** that the buyers acted in good faith. In this and similar contexts a “presumption” operates to shift the burden of proof.
2. It is extremely common in the field of Commercial Law for the party that wrongfully caused a loss to be either absent or insolvent. That typical and unfortunate state of affairs makes it necessary for the law to allocate the loss among the remaining parties to the transaction, each of whom may be innocent of any wrongdoing. In determining which of two innocent parties should bear a loss the law will often seek to allocate the loss to the party who was in the best position to **prevent** the loss or the party who was in the best position to **insure** against the loss.

3. In the ordinary course.

To qualify as a buyer in the ordinary course the buyer must buy the goods in the ordinary course of the seller’s business. The following case illustrates a transaction that was **not** in the ordinary course.

[Chen v. New Trend Apparel, Inc., 8 F. Supp.3d 406 \(S.D.N.Y. 2014\)](#)

Lender Hana had a valid security interest in the inventory of New Trend Apparel, Inc. New Trend then sold its inventory in bulk to Chang and other entities at “closeout price,” well below fair market value. New Trend also insisted that these sales be in cash. The court ruled that Chang and the other purchasers were not “buyers in the ordinary course.” Accordingly the goods were still subject to Hana’s security interest in the goods.

Practice Pointers.

1. The “buyer in the ordinary course” doctrine is an affirmative defense. If you intend to raise an affirmative defense on behalf of a client then in the answer to the complaint be sure to **plead** that defense; in opposition to the plaintiff’s motion for summary judgment be sure to at least present **sufficient evidence to establish a genuine dispute of material fact** as to every element of that defense; and at trial be ready to **prove** every element of that defense by a **preponderance of the evidence**.

2. If you intend to sue another party for conversion be sure to first make a **demand** for return of the goods.
3. When your client spends a significant amount of money to purchase goods it is good practice to check the chain of title and the U.C.C. filings.

4. Without knowledge that the sale violates the rights of the secured party.

This element is related to the requirement of good faith. If the buyer **knew** that the sale violated the rights of the secured party then it would be unfair to allow the buyer to acquire the goods free of the security interest. Note the difference between the requirement that the buyer must not have **knowledge of the security interest** and the requirement that the buyer not have **knowledge that the sale violates the rights of the secured party**. A buyer can still qualify as a buyer in the ordinary course even if the buyer knows that the goods are subject to a security interest. A buyer is disqualified from being a buyer in the ordinary course only if the buyer knows that the sale is **prohibited** by the security agreement. This element is discussed by the court in *Arthur Click Auto Sales, Inc. v. Stephen East Corp.*

5. From a person who deals in goods of that kind other than a pawnbroker.

If the seller does not sell goods of that kind then the secured party would have had no notice that the collateral might be sold in the ordinary course of business. See *Madison Capital Co. v. S & S Salvage, LLC*, 765 F. Supp.2d 923 (W.D. Ky. 2011) (ruling that the debtor “is not in the business of selling mining equipment, he is in the business of mining,” and that therefore the debtor’s sale of mining equipment that was collateral was not in the ordinary course of business).

6. The buyer comports with the usual or customary practices in the kind of business in which the seller is engaged, or with the seller’s usual or customary practices.

If the buyer does not follow customary practices of the industry or of the seller then the buyer is not a “buyer in the ordinary course.” (This element is discussed in the following case, *In re Western Iowa Limestone, Inc.*)

7. The buyer took possession of the goods or has a right to recover the goods from the seller under Article 2 (Sections 2-502 or 2-716).

A buyer does not qualify as a buyer in the ordinary course unless they have possession or the right to possession of the goods. If the buyer does not even have the right to possess the goods then there is no reason to allow the buyer to take free of a security interest created by the seller. (This element is also discussed in the following case.)

What if the buyer has entered into a contract to purchase the goods, inspected the goods, and paid for the goods, but the goods are still in the possession of the seller? In that case does the buyer qualify as a “buyer in the ordinary course?” Consider the next case.

In re Western Iowa Limestone, Inc., 538 F.2d 858 (8th Cir. 2008)

Western Iowa Limestone, Inc. (WIL) operated quarries in the state of Iowa. United Bank had made loans to WIL and had a perfected security interest in WIL’s inventory. WIL sold agricultural lime to several different dealers. The dealers would order ag lime from WIL, inspect it, and pay for it. However, the dealers did not take **possession** of the ag lime until they found buyers for it; the ag lime that the dealers had purchased remained in a single undifferentiated pile at the quarry. WIL declared bankruptcy and United Bank asserted that it had priority over the ag lime still in the possession of WIL.

Under Section 1-201(b)(9) a buyer qualifies as a buyer in the ordinary course only if they take **possession** of the goods or if they have a **right to possession** under Article 2. The buyers in this case did not contend that they had a right to possession of the ag lime, although they certainly did have that right under the contract of sale. Instead they argued that they had **constructive possession** of the ag lime, and that this was sufficient to satisfy the “possession” element of Section 1-201(b)(9).

The Eighth Circuit ultimately ruled in favor of the buyers (the dealers). On the question of law the court ruled that constructive possession is equivalent to possession. In applying the law to the facts the court found that WIL and the dealers had expressly agreed that WIL would store the ag lime for each of the dealers until they picked it up; and that the dealers had paid for the lime, inspected the lime, and accepted the lime. The court therefore found that the dealers had constructive possession of the lime and satisfied this element of being a buyer in the ordinary course.

Practice Pointers.

1. In *Western Iowa Limestone* the sales contract between the debtor and the dealers provided that the sale would be complete when the seller issued a bill of sale; the dealers inspected the ag lime and paid for it; and the debtor issued the bill of sale stating that the ag lime was the property of the dealers. If one or more of these factors were missing the court might not have found that the dealers qualified as buyers in the ordinary course of business. See *In re Hatfield 7 Dairy, Inc.*, 71 U.C.C. Rep. Serv. 225 (Bankr. Ct., S.D. Ohio, 2010) and *Hockensmith v. Fifth Third Bank*, 79 U.C.C. Rep. Serv. 2d 176 (S.D. Ohio 2012).
2. If your client is buying goods but leaving them in the possession of the seller make it crystal clear in the contract that your client is the owner of the goods and has the right to possession of the goods. If you don’t then the seller’s creditors may assert a claim to the goods.

3. If the dealers in *Western Iowa Limestone* were your clients what other action could have been taken to indicate that the ag lime that was still in the possession of WIL belonged to the dealers?

8. The buyer did not acquire the goods in a bulk transfer.

When a person purchases all or substantially all of a merchant's inventory the transaction is not a sale of goods in the ordinary course. Bulk transfers do not qualify as sales to a buyer in the ordinary course.

Practice Pointer.

Beware successor liability from a bulk transfer. Goods that are sold in a bulk transfer are subject to a valid security interest in the goods; but the buyer's liability may extend beyond any security interests in the goods.

If one business entity purchases another business entity then the purchaser assumes responsibility for the debts of the company that it purchased. Similarly if companies merge or consolidate then the new entity assumes responsibility for the debts of the previous entities. To avoid "successor liability" a company will typically purchase only **the assets** of the other company, not the stock or other ownership interest. However, there are four circumstances where an asset transfer carries with it liability for the debts of the business entity whose assets were purchased.

it is well settled that under the doctrine of successor liability in Pennsylvania, a purchaser of assets is generally not liable for the seller's debts and obligations. See *Philadelphia Elec. Co. v. Hercules, Inc.*, 762 F.2d 303, 308 (3d Cir. 1985); *Fizzano Bros. Concrete Prod. V. XLN, Inc.*, 42 A.3d 951, 956 (2012). Nevertheless, this rule, while broad, is subject to four exceptions. See *Philadelphia Elec. Co. v. Hercules, Inc.*, 762 F.2d 303, 308 (3d Cir. 1985). Under Pennsylvania law, a purchaser of assets will not be liable to the debts and obligations of the seller, unless

(1) the purchaser of assets expressly or impliedly agrees to assume obligations of the transferor; (2) the transaction amounts to a consolidation or de facto merger; (3) the purchasing corporation is merely a continuation of the transferor corporation; or (4) the transaction is fraudulently entered into to escape liability

Id. at 308-09.

American Global Logistics v. Elk Group International, LLC, 2019 WL 1320793, at *8 (M.D. Penn. 2019). In those four circumstances a business entity that purchases all the assets of another business assumes the debts of the selling entity.

9. The buyer did not acquire the goods in satisfaction of a money debt.

If a buyer could pay for collateral by canceling a pre-existing debt owed to the debtor and still qualify as a buyer in the ordinary course it would be grossly unfair to the secured party. The buyer would take the collateral free of the security interest and there would be no proceeds generated by the sale, depriving the secured party of all protection.

The following case illustrates the requirement that a buyer in the ordinary course must not have paid for the goods by canceling a prior indebtedness and reviews the concept of “authorization” by a secured party.

Inland Bank & Trust v. ARG International AG, 2018 WL 3543905 (S.D.N.Y., 2018)

In 2014 Inland Bank & Trust loaned \$5 million to Metallic Conversion Corporation and took a security interest in Metallic's inventory. Inland Bank perfected its security interest by properly filing a financing statement in Illinois. In June of 2016 Metallic purchased 300 metric tons of aluminum T-bars from ARG International for \$517,000. The T-bars were stored in a warehouse, and ARG directed the warehouse to release the T-bars to Metallic. However, before paying for the aluminum and before taking delivery Metallic determined that it did not need the material. In July of 2016 Metallic and ARG entered into another agreement under which ARG agreed to repurchase the aluminum T-bars at a slightly higher price, \$531,000, because of an increase in the cost of aluminum. The parties “netted-out” the two contract prices and as a result ARG owed Metallic \$14,000 for the aluminum.

Inland sued ARG on the ground that aluminum T-bars that ARG purchased were subject to Inland's security interest. Is ARG liable to Inland Bank?

ARG claimed that when it repurchased the aluminum bars from Metallic that it was a buyer in the ordinary course. The court rejected this argument because “a buyer in ordinary course of business does not include a person that acquires goods ... in total or partial satisfaction of a money debt.”

ARG also claimed that Metallic had on many previous occasions resold materials to suppliers if the materials were not needed, thus implicitly consenting to the resale of the goods free of the bank's security interest. This was also a common practice in the industry. The court found that the security agreement was supplemented by the parties' course of performance and by the relevant trade usage. Therefore ARG repurchased the aluminum from Metallic free of the bank's security interest.

Practice Pointer.

The *Inland Bank* case illustrates that there are several different alternative ways for a buyer to

take goods free of a secured party's security interest. In this case the buyer claimed (1) that the sale of the debtor's property was authorized by the secured party and (2) that the buyer was a buyer in the ordinary course. Success on either theory was sufficient for the buyer to prevail. To represent clients effectively it is necessary to have a firm grasp of the "roadmap" of a field of law – not simply to know the factors and elements of each separate claim and defense in a field of law, but to know how all of the different claims and defenses relate to each other.

4. Secured Party v. Buyer in Consumer-to-Consumer Transaction

Section 9-320(b) is sometimes referred to as the "garage sale" exception to the general rule that "security follows the collateral." Recall that a purchase-money security interest in consumer goods is automatically perfected upon attachment. The vast majority of consumer transactions are for small sums and it is not feasible for a lender or a credit seller to file a financing statement every time that a debtor purchases consumer goods on credit. In the absence of a filed financing statement people who innocently purchase used consumer goods from another consumer have no way to investigate whether the goods are subject to a security interest. But if we allow consumers to purchase consumer goods from other consumers free of a security interest then secured parties would be at risk. The compromise that the drafters of the Code adopted is Section 9-320(b). That Section provides that a person who buys consumer goods from another person who held those goods as consumer goods then the buyer takes the goods free of the security interest **unless the secured party has filed a financing statement**. The following problem illustrates this rule.

Problem 36. The Fish Tank

Dr. Sweeney purchased a large salt water fish tank filled with fish and other sea creatures from Antares Fish Store and had it installed at the office. The entire installation cost \$12,000. The sale was on credit and Antares retained a security interest in the tank and sea life. Antares also filed a financing statement covering the tank and the sea creatures. After a month Dr. Sweeney decided that it was taking too much time to maintain the tank so Dr. Sweeney advertised the tank for sale. Drew, who had always wanted a salt water fish tank for their home, purchased the tank with all the fish and had the tank installed in their living room. Unfortunately, Dr. Sweeney never paid Antares for the tank and the fish. Antares has sent a repossession team to Drew's home to retrieve the tank and everything in it. Drew's attorney makes this argument on Drew's behalf:

"The fish tank and everything in it is consumer goods. It certainly isn't medical equipment! It's not like Drew purchased a heart monitor or an ultrasound machine from Dr. Sweeney. The tank is consumer goods, Drew is a consumer, and therefore under Section 9-320(b) Drew purchased the tank and its contents free of Antares' security interest."

This argument fails for two reasons. What are the two fatal flaws in the position that Drew's attorney has articulated?

Practice Pointer.

If your client is a secured party who sells expensive consumer goods on credit, your client should consider filing a financing statement to protect against the "garage sale" exception.

5. Secured Party v. Buyer of Farm Products

Under [Section 9-320\(a\)](#), buyers of farm products are categorically excluded from the protection offered to buyers in the ordinary course. This exclusion creates a dilemma for brokers, processors, and distributors of farm products. How can these parties purchase a farmer's crops or livestock with the confidence that they can take free of a lender's security interest? Should the buyer make payment to the farmer, the secured party, or jointly to both?

The exclusion of sales of farm products from Section 9-320(a) left a gap in the law. That gap was filled by federal law; specifically, the Food Security Act, 7 U.S.C. 1631.

The Food Security Act establishes two different systems for protecting purchasers of farm products: "central filing" or "direct notice." Each state may choose which system to adopt. Sixteen states have chosen to establish central filing systems. These filing systems are similar to but often separate from the U.C.C. filing system. Banks and other lenders who have taken a security interest in farm products are required to file an "effective financing statement" (EFS) with the state. The EFS form differs from state to state. The EFS may contain instructions to the buyer regarding payment: for example, whether to pay the farmer or the lender. If the EFS does include payment instructions then the buyer must follow those instructions. If the EFS does not contain payment instructions then the buyer must contact the secured party to obtain instructions for payment and must comply with those instructions.

In "direct notice" states (the great majority of states) the secured party has a heavier burden. Instead of filing an EFS the secured party must send the buyer a notice that contains certain information, and the buyer must receive this information within a year before the sale of the farm products to the buyer. (Farmers are obligated under the law to send secured parties a list of the buyers who may purchase their farm products.) The contents of the notice that the secured party must send to the buyer is set forth in Section 1631(e)(1)(A) of the Farm Security Act, which provides:

(e) Purchases subject to security interest. A buyer of farm products takes subject to a security interest created by the seller if—

(1)(A) within 1 year before the sale of the farm products, the buyer has received from the secured party or the seller written notice of the security interest organized according to farm products that—

- (i)** is an original or reproduced copy thereof;
- (ii)** contains,

- (I)** the name and address of the secured party;
- (II)** the name and address of the person indebted to the secured party;
- (III)** the social security number, or other approved unique identifier, of the debtor or, in the case of a debtor doing business other than as an individual, the Internal Revenue Service taxpayer identification number, or other approved unique identifier, of such debtor; and
- (IV)** a description of the farm products subject to the security interest created by the debtor, including the amount of such products where applicable, crop year, and the name of each county or parish in which the farm products are produced or located

Secured parties occasionally make errors in the notices that are sent to buyers of farm products. In *State Bank of Cherry v. CGB Enterprises, Inc.*, 984 NE.2d 449 (Ill. 2013), the bank sent the buyer a notice of its security interest; however, the notice did not include the name of the county where the farm products were produced or located. The issue before the Illinois Supreme Court was whether the notice was valid; specifically, does the law require the lender to **strictly comply** with the requirements of the Food Security Act or is **substantial compliance** sufficient? The Illinois Supreme Court concluded, “a secured party must strictly comply with the notice requirements of Section 1631(e) in order to provide sufficient direct written notice under the Act.” As a result the court ruled that the bank’s notice to the buyer was invalid and that the buyer purchased the farmer’s crops free of the bank’s security interest.

Do not confuse the Food Security Act with “agricultural liens.” The Food Security Act is a federal statute whose purpose is to establish clear rules governing the rights of buyers of farm products. The FSA mandates what lenders must do to inform buyers of their security interests in farm products. The federal law also protects buyers of farm products if those buyers make payment in accordance with the valid instructions of lenders who have properly filed an EFS (in a central filing state) or who have properly given notice to the buyer (in a direct notice state). In contrast, an agricultural lien is created by a non-U.C.C. state statute that grants a nonpossessory lien to people who lease land to farmers or who provide goods or services to farmers to enable a farmer to grow or raise farm products. Agricultural liens are governed by Article 9, which means that the agricultural lienholder (a landlord or seller or service provider) must not only comply with the requirements of the agricultural lien statute but must also file a U.C.C. financing statement covering the farm products.

Practice Pointers.

1. Legal representation of farmers, farm lenders, and buyers of farm products in the field of Secured Transactions requires mastery of the provisions of Article 9, the federal Food Security Act, the federal Perishable Agricultural Commodities Act (discussed in Chapter 9) and state agricultural lien statutes.
2. The attorney's task regarding agricultural liens is made harder by the broad variation in laws among the states. Only about half the states have agricultural lien statutes, and these statutes vary widely from state to state. And while the federal Food Security Act should be uniformly enforced across the United States, only 16 states have elected to be "central filing" states under the federal law, and the requirements regarding the contents of the EFS forms also vary from state to state.

6. Secured Party v. Buyer of Vehicle with Clean Certificate of Title

If a security interest is perfected in one state and a clean certificate of title covering the collateral is issued in another state, then a buyer who is not a merchant dealing in goods of the kind takes free of the security interest if the buyer gives value and receives delivery of the goods without knowledge of the security interest. [Section 9-337](#).

These cases are relatively common. Whether because of corruption or mistake, state bureaus of motor vehicles sometimes issue certificates of title that fail to list security interests that have been perfected in another state. If a consumer obtains a vehicle under these circumstances then the consumer has the status equivalent to a good faith purchaser for value and takes free of the security interest that was perfected in the other state. However, this "safe harbor" is not available to dealerships. If a dealership obtains a vehicle with a certificate of title from which a perfected lien has been omitted, the dealership takes the vehicle subject to the rights of the secured party.

Problem 37. The "Clean" Certificate of Title

Taylor Lyons borrowed \$25,000 from Cleaver Finance to purchase a Toyota Camry in Pennsylvania. The lien was noted on the Pennsylvania certificate of title. Taylor then drove the car to Georgia and persuaded a clerk with the County Tag Office to issue a Georgia certificate of title that did not list any liens. Taylor then sold the car to Cameron who paid \$22,000 cash for the car. Cleaver Finance then tracked down the car and sought to repossess it from Cameron.

1. Is Cameron subject to Cleaver Finance's security interest or does Cameron take the car free of Cleaver Finance's security interest? See [Section 9-337\(1\)](#).

2. What if to finance the purchase from Taylor, Cameron had borrowed \$22,000 from Macon Bank and the bank had taken a security interest in the car. Which secured party would have priority in the car: Cleaver Finance or Macon Bank? See [Section 9-337\(2\)](#).

7. When Goods Are Sold to a Buyer in a Different State

In Lecture 15 and [Chapter 4 Part C.7](#), we learned that when the debtor moves to a different state the secured party has **four months** to refile under the name of the debtor in the other state. [Section 9-316\(a\)\(2\)](#). Similarly, when the goods are sold to a buyer in a different state the secured party has **one year** to refile in the name of the buyer in the other state. [Section 9-316\(a\)\(3\)](#). In either circumstance if the secured party fails to refile within the proper time then the security interest becomes unperfected and is deemed to have been unperfected from the time that the security interest attached.

Problem 38. The Out-of-State Buyer

In 2006 First Bank & Trust (FB&T) loaned money to Concrete Contractors, Inc. (CCI). FB&T took a security interest in CCI's equipment. The security agreement prohibited CCI from selling any of the equipment without written consent from FB&T. FB&T filed a financing statement with the office of the South Dakota Secretary of State and thereafter properly filed continuation statements with the same office. On October 1, 2015 CCI sold the equipment to H&S Contracting in Minnesota, which in turn sold the equipment to Kinetic Leasing, Inc., which leased the equipment back to H&S Contracting. H&S Contracting failed to make payments to Kinetic Leasing, so Kinetic arranged to have the equipment sold at auction to pay off the unpaid balance of the lease. On September 15, 2016, an attorney for FB&T contacted Kinetic Leasing. FB&T and Kinetic Leasing agreed to move forward with the auction on September 16 and to hold the funds in abeyance until it was determined whether FB&T or Kinetic Leasing had priority over the funds. FB&T did not file a financing statement in Minnesota. Who takes priority? See *H&S Contracting, Inc. v. Kinetic Leasing, Inc.*, 2018 WL3340372 (D. Minn., 2018) and [Section 9-316](#).

Practice Pointer.

If your client is a secured party advise them to keep track of where the collateral is. They should check at least once a year to make sure that the collateral has not been sold to a buyer in another state.

C. [Lecture 23. Priority Disputes Between Secured Parties and Lien Creditors](#)

Under [Section 9-317\(a\)\(2\)](#) a secured party with **perfected** security interest takes priority over a judgment creditor. Moreover, a secured party who has filed a financing statement and who has entered into a valid security agreement takes priority over a judgment creditor. The lesson for secured parties is clear and simple. Enter into a valid security agreement and file or perfect as soon as possible.

Under [Section 544\(a\)](#) of the Bankruptcy Code a bankruptcy trustee has the same rights as a lien creditor. If a debtor files for bankruptcy at two seconds after 1:00 p.m. and the secured party files its financing statement at three seconds after 1:00 p.m. then the bankruptcy trustee will prevail over the secured party.

D. Lecture 24. Priority Disputes Between Secured Parties and Lessors and Lessees

A lease is a contract between a lessor and a lessee. A lessor is a person who owns goods and who leases those goods to another person (the lessee). A lessee is a person who leases goods from a lessor. Pursuant to a lease the lessor grants the lessee the right to possess and use goods for a defined period of time.

A secured party who enters into a security agreement with a debtor who is a **lessor** in which the secured party takes a security interest in the **inventory** of the lessor must accept that the security interest is subject to the rights of the lessee in the ordinary course. [Section 9-317\(c\)](#). The secured party will not be able to repossess the property until the lease is terminated. Furthermore the secured party runs the risk that **the lease was actually a sale** and that the lessee is the true owner of the goods. In that case the security interest would be subject to the claim of any creditor of the lessee or to the claim of any person who purchased the goods from the lessee.

A secured party who enters into a security agreement with a debtor and who takes a security interest in the debtor's **equipment** that the debtor has purchased from another party runs the risk that the transaction in which the debtor acquired the equipment was actually a lease and not a sale. If the transaction was a true lease then the debtor would not be the true owner of the goods and the security interest would be subject to the lease and subordinate to the ownership rights of the lessor.

We studied the difference between a lease and a sale with a retention of a security interest in Chapter 1 in order to determine whether Article 9 applies to a transaction. In the following problem we return to that issue to resolve a priority problem.

Problem 39. The Towmotors



Higginbotham Distributing acquired 14 towmotors to use in its warehouses. Higginbotham obtained the towmotors from Cat/Smith Towing. The contract between Higginbotham and Cat/Smith was titled "Lease Agreement." Under the terms of the agreement Higginbotham leased the towmotors from Cat/Smith for 10 years. Higginbotham had no right to terminate the lease before the end of the 10-year lease term. At the time of purchase the towmotors had an expected useful economic life of 20 years. At the end of the 10-year lease term Higginbotham will have an option to purchase the towmotors for \$1.

1. Cat/Smith Towing has applied for a loan from your client, Main Street Bank. Should the bank take a security interest in the towmotors as collateral for the loan?
2. Higginbotham Distributing has applied for a loan from your client Alpine Investors. Should Alpine take a security interest in the towmotors as collateral for the loan? What precautions should Alpine take before accepting the towmotors as collateral?

Practice Pointers.

1. If your client is lending money to a debtor who is in the business of leasing goods to others be sure to advise your client that their security interest is **subject to the terms of those leases**, and that your client may not be able to repossess the collateral until the lease has expired.
2. If your client is lending money to a debtor who is in the business of leasing goods to others be sure to inspect the leases and the business practices of the debtor to determine whether the inventory is truly being **leased** or whether it is being **sold** to the debtor's customers. If the inventory is being sold to customers in the ordinary course of business then those customers will take the collateral free of your client's security interest.
3. If your client loans money to a debtor and takes a security interest in the debtor's equipment be sure to determine whether the debtor truly owns the equipment or is simply leasing the equipment from another party. True lessors have no obligation to file a financing statement; the secured party cannot rely upon the U.C.C. filing system to determine whether the equipment is actually the property of a lessor.
4. If your client is in the business of leasing goods to others it is critical to determine whether the transactions are true leases or whether they are sales. If the transaction is a sale then any "retention of title" will be deemed to be a "retention of a security interest" and the lessor/seller must file a financing statement to perfect its security interest in the goods. [Section 9-505](#) permits a secured party to file a financing statement as "lessor" to avoid any implication that the party is admitting that the lease was actually a sale and a security agreement.

E. Lecture 25. Priority Disputes Between Secured Parties and Article 2 Claimants

A secured party may have a security interest in property belonging to a debtor. But there may be a third party – a party who has sold property to the debtor or a party who has purchased property from the debtor – who has a right to the goods under one of the “special remedies” of Article 2. The special remedies of Article 2 include the following:

1. A seller’s right to reclaim the goods under Section 2-702

If the goods are delivered to the debtor on credit while the debtor is insolvent, the seller may reclaim the goods by making a demand within 10 days. (The bankruptcy code extends this to deliveries made within 45 days of the filing of bankruptcy.) A seller trying to reclaim goods from a defaulting insolvent buyer under [Section 2-702](#) will lose to a secured party with a security interest in the property of the buyer because Section 2-702 is expressly subject to the rights of a **good faith purchaser for value**, which is what a secured party is.

2. A buyer’s right to specific performance under Section 2-716(1)

Under [Section 2-716\(1\)](#) a seller may be required to perform the contract (that is, deliver the goods) when the goods are “unique” or in “other proper circumstances.”

3. A buyer’s right to replevin of the goods under Section 2-716(3)

If the seller breaches and the buyer is unable to “cover” under [Section 2-716\(3\)](#) the buyer has the right to recover goods that have been identified to the contract from the seller even though the goods are not “unique.”

4. A buyer’s right to recover the goods under Section 2-502

If the buyer has paid all of the purchase price, then in certain situations the buyer has the right to recover identified goods from the seller, and if the buyer has paid part of the purchase price the buyer may recover the identified goods by tendering the rest of the purchase price to the seller. [Section 2-502](#) applies if the goods are purchased for personal, family, or household purposes and the seller fails or refuses to deliver, and in all cases if the seller becomes insolvent within ten days after receipt of the first installment of the price.

5. A buyer’s security interest in the goods under Section 2-711(3)

Under [Section 7-711\(3\)](#) on rightful rejection or justifiable revocation a buyer has a security in goods in its possession or control to secure repayment of the purchase price, and may resell the goods for that purpose.

In the absence of another claim such as **authorization** by the secured party or the **buyer in the ordinary course doctrine** the first four of these “special remedies” are subordinate to the rights of a secured party. For example, here is a question about **specific performance**.

Problem 40. The Rembrandt

Rensselaer County Museum borrowed \$18 million from Holland Bank and granted the bank a security interest in a small Rembrandt painting that it owned. J.K. Watt Gallery entered into a contract to purchase the painting for \$14 million; then the museum breached the contract and refused to deliver the painting to the gallery. The gallery responded by suing the museum for specific performance under Section 2-716(1).

1. Can the gallery qualify as a buyer in the ordinary course even though it does not yet have possession of the painting? See [Section 9-320\(a\)](#).
2. If the gallery qualifies as a buyer in the ordinary course would it take the painting free of the bank’s security interest? [See Section 9-320\(a\)](#).
3. Assume that the Holland Bank did not authorize the Rensselaer Museum to sell the painting and also assume that the J.K. Watt Gallery does not qualify as a buyer in the ordinary course. Assume further that the painting is “unique.” Will the gallery take free of the bank’s security interest on the ground that the gallery is entitled to specific performance of the contract?

The fifth “special remedy” listed above **does take priority** over a prior security interest. Here is a question about the **buyer’s right to a security interest in rightfully rejected goods**.

Problem 41. The Wine Vats

Oak Hill Bank has a perfected security interest in the equipment of Anselm Winery. Anselm Winery sold 40 wine vats to Great Lakes Vineyards. Assume that this sale was made in violation of the security agreement between the bank and the winery.

1. Did Oak Hill Bank explicitly authorize Anselm Winery to sell the equipment free of the security interest?
2. Under what circumstances might a court find that Oak Hill Bank implicitly authorized the sale of the equipment free of the security interest?
3. Assume that when the vats were delivered and Great Lakes Vineyards inspected them Great Lakes discovered that the vats were defective and could not be used, so Great Lakes rejected the vats. However, assume further that

Great Lakes had paid Anselm Winery \$2,000 in advance and had incurred \$800 in storage costs for the vats, and that Great Lakes retained the vats and asserted a security interest in them to secure repayment of the purchase price and storage costs. As between Great Lakes Vineyards and Oak Hill Bank, who takes priority as to the vats? See [Sections 2-711\(3\)](#) and [9-110\(d\)](#).

F. [Lecture 26. Priority Disputes Between Secured Parties and Parties Who Have a Possessory Lien by Operation of Law](#)

The most common type of possessory lien is an “artisan’s lien.” When an automobile repair shop or a marina performs services on a car or a boat most states have laws that grant the garage or marina the right to keep the car or the boat until the work has been paid for.

As between the repair shop and a lender who has a security interest in the car or the boat, who takes priority? [Section 9-333\(b\)](#) provides:

A possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise.

The following case explains this rule.

[In re Cam Trucking LLC, 84 U.C.C. Rep. Serv.2d 588 \(Bankr. Ct., D. Ariz., 2014\)](#)

Auto Title Loans USA, LLC had a purchase money security interest in three trucks owned by Cam Trucking. Transwest Truck Trailer RV's had a garagemen's lien in the same vehicles. The trucks were titled in Arizona but Transwest performed the work in Colorado and had possession of the trucks there. At first the issue seemed to be which state law applied to the case. As it turned out, however, Transwest lost to Auto Title under either law.

Under Colorado law a garagemen's lien takes priority over a previously perfected security interest only if the garagemen's lien is created by statute and the statute expressly provides that the garagemen's lien is superior. (This is not consistent with the standard version of Section 9-333(b) which provides that a statutory possessory lien takes priority unless the lien is statutory and the statute expressly makes the possessory lien subordinate.) So under Colorado law Transwest, the repair shop, lost to Auto Title, the secured party.

Under Arizona law the statute creating a possessory lien for persons making repairs to goods expressly provides that the possessory lien is subordinate to recorded liens like Auto Title's perfected security interest. So Auto Title takes priority over Transwest under Arizona law as well.

The court found that the intent of both Arizona and Colorado law was to grant priority to a previously-perfected purchase-money security interest over a garagemen's lien, and entered judgment for Auto Title.

Practice Pointer.

Notice how important “choice of law” provisions are. Notice also how the court cuts through the choice of law issues and instead looks to the policy of Arizona and Colorado law in deciding this case.

Artisans’ Liens and Mechanic’s Liens in Pennsylvania.

Under Pennsylvania law a “mechanic’s lien” is a lien on real property that a contractor has made improvements to. In contrast, an “artisan’s lien” arises when a person such as an auto mechanic performs repairs on goods and is not paid.

An artisan’s lien is a possessory lien; the lien exists only so long as the person holding the lien retains possession. That is why a business that repairs a car or a boat will retain possession of the item until the bill is paid. A mechanic’s lien is by its nature not possessory; their work product has been incorporated into real property that belongs to someone else.

The artisan’s lien statute in Pennsylvania ([6 P.S. Section 11](#)) is very short and vague, and the summary procedures in the statute allowing the artisan to resell the goods have been declared unconstitutional. *Parks v. “Mr. Ford”*, 556 F.2d 132 (3rd Cir. 1977). The mechanic’s lien statute in Pennsylvania (49 P.S. Sections 1301 *et seq.*) is long and complex, and sets forth valid and specific procedures that the lienholder must follow to enforce the lien, starting with the requirement that the contractor give the owner of the land notice that the contractor will be performing work or providing materials for the improvement of the real property.

The most recent Pennsylvania case to analyze a priority dispute between an artisan’s possessory lien in Pennsylvania and an Article 9 security interest is *Northrup v. Ben Thompson Enterprises*, 220 B.R. 855 (Bankr. Ct. E.D. Pa. 1998). In *Northrup* the court expressed surprise that this issue had not been definitively resolved by the Pennsylvania courts. The court began its discussion of this issue by stating:

Although, intuitively, it would seem that disputes between which owners and repair persons similar to that at issue would be sufficiently common to have permitted the development of a body of coherent modern case law, in fact we found that a dearth of authority, much of which is in conflict or vague in its expression, addressing the issues relevant to the instant dispute. It therefore serves a useful purpose to establish several basic principles in this surprisingly arcane area of the law.

In *Northrup* the Bankruptcy Court discussed some case law in Pennsylvania holding that in order for the repair shop’s artisan’s lien to take priority the party with the security interest must consent to the repair work. However the courts in those cases did not discuss the effect of Section 9-333 on the rights of the parties. In the end the *Northrup* court suggested that Section 9-333 changes Pennsylvania law in this respect and the court assumed that the repair shop

should prevail. However the court left the door open for the secured party to intervene and challenge this ruling on the ground that it had not consented to the repairs.

As to this specific issue – a priority dispute between a secured party and the holder of an artisan's lien in Pennsylvania – the law in Pennsylvania is still unsettled, but as the *Northrup* court suggested under Section 9-333 the artisan's lien should take priority.

End of Chapter 7

Chapter 8. Perfection and Priority as to Proceeds; Chattel Paper; and Future Advances

The proceeds of collateral are critically important to a secured party. If the collateral is inventory then it is expected that the collateral will be sold or used up and that the secured party will look to the proceeds of the inventory for continued security, replenishment of the inventory, or repayment. If the collateral is accounts or chattel paper the parties expect that the collateral will be converted into some form of payment that will either substitute for the original collateral or will be used to repay the secured party. Even if the collateral is equipment and the parties expected the collateral to remain unchanged when the equipment is nevertheless sold or leased the secured party will expect the proceeds of the equipment to be used to purchase new equipment or to be used for repayment. If the debtor defaults the secured party will look both to the original collateral and to the proceeds of collateral to secure payment of the debt.

A. Learning Objectives

The principal subject of this chapter is the law governing security interests in proceeds. In this chapter we shall study the different types of proceeds; attachment and perfection of a security interest in proceeds; and priority in proceeds. The chapter concludes with a lesson about “future advances” and “after-acquired property” in the law of Secured Transactions.

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Identify property that is “proceeds” or “cash proceeds” of collateral;
 2. Determine whether property is “identifiable” proceeds of collateral to which a security interest automatically attaches;
 3. State whether the security interest is continuously perfected in the proceeds or only temporarily perfected for a period of 20 days; and
 4. Resolve various priority disputes that arise among competing claimants to proceeds of collateral.
- ...
5. State whether it is appropriate or necessary to include a future advance clause and an after-acquired property clause in a security agreement or a financing statement.

6. Resolve priority disputes over collateral that secures repayment of a future advance.

B. Lecture 27, Proceeds – The Definition of “Proceeds”

“Proceeds” are defined by Section [9-102\(a\)\(64\)](#). Paraphrasing the statute, proceeds include:

1. Anything received on sale, lease, exchange or other disposition of the collateral;
2. Interest, dividends, royalties, license fees, or other property or rights acquired as a result of holding the collateral;
3. Claims or insurance proceeds resulting from damage to or loss of the collateral and nonconformity of or interference with the collateral.

Funds that are generated by **the collateral itself** are proceeds. Funds that are generated from **the use of collateral** are not proceeds.

The next problem requires you to distinguish proceeds from non-proceeds and illustrates different types of proceeds.

Problem 42. Proceeds or Non-Proceeds?

Quill Landscaping is a landscaping business that owns a fleet of trucks and lawnmowers. Sixth Street Bank has a security interest in all of Quill’s equipment. Do the following transactions generate “proceeds” of the collateral?

- a. Quill sells one of its lawnmowers to Esterhaus Manufacturing for **\$3,200**.
- b. Quill trades in one of its trucks to Jo’s Used Cars for **another truck**.
- c. Quill leases three of its trucks and six lawnmowers to Brightwing Lawn Service for one month for **\$1,800**. See *In re National Truck Funding LLC*, 94 U.C.C. Rep Serv 2d 920 (United States Bankr. Ct. S.D. Mississippi, 2018).
- d. Quill transports the lawnmowers to Robin’s Nest Golf Course to cut the grass for **\$1,000**.
- e. One of Quill’s trucks is damaged in an auto accident with a bakery delivery truck. Quill asserts a **claim in the amount of \$10,000** against the other driver and the bakery for damage to Quill’s truck and for profits that were lost due to the interruption in Quill’s business.
- f. Quill received **\$5,000 in insurance proceeds** for the damage to the truck that was involved in the auto accident.

g. Quill purchased a new lawnmower from Bednarz Garden Supplies. After a month the new lawnmower began to malfunction and Bednarz has been unable to fix it. Quill intends to either revoke acceptance of the lawnmower and demand a full refund in the amount of **\$8,000** or keep the lawnmower and assert a claim for breach of warranty, in the amount of **\$3,000**.

The following cases illustrate the principle that proceeds of collateral arise from disposition of collateral or rent, royalties, license fees, dividends or interest earned by the collateral itself, but that proceeds do not include income earned as a result of performing services using the collateral.

In re Gamma Center, Inc., 489 B.R. 688 (N.D. Ohio 2013)

Gamma Center, Inc. (the debtor), was a medical imaging clinic in Ohio. In 2004 the Commercial Savings Bank (the “bank” or “secured party”) loaned Gamma Center, Inc., \$300,000 to purchase a Millennium Myosight Integrated Systems—Xelesis Nuclear Stress Test Camera (the “Camera”). The security agreement identified the Camera as well as the “proceeds” and “products” of the camera as collateral. The bank did **not** expressly take a security interest in the debtor’s accounts. The security agreement contained a checkbox to indicate whether the security agreement covered accounts receivable, but the box was left unchecked. Similarly the financing statement covered the Camera but not the accounts of the medical practice. Gamma filed for bankruptcy in 2010. Gamma had accounts receivable in the amount of \$325,000, which were claimed by the bankruptcy trustee.

The attorney for the bank offered an affidavit signed by the clinic’s owner stating that the accounts receivable were the “product” of the camera. However, the court found that the clinic’s accounts receivable were **not** proceeds of the camera. The accounts receivable were generated by the **use** of the camera, not by the camera itself. The court entered summary judgment on behalf of the bankruptcy trustee.

Practice Pointers.

1. Proceeds of an imaging device **would** include rents or royalties earned by leasing the device to another clinic. Proceeds of an imaging device **does not include** income generated by professional services from using the device, such as medical bills to patients for imaging or for interpreting the results.
2. The original opinion in *In re Gamma Center* cites to another case that was decided in 1984. The citation to the other case is omitted from this textbook because the provision of Article 9 that the case relied upon has been amended and the result in the case would now be different. Beware of any caselaw in the field of Secured Transactions that was handed down before 2001. Article 9 was substantially revised in 1999 and the amendments were adopted by the states in

2001. More revisions were adopted in 2010. Longtime practitioners still refer to the current law as “Revised Article 9.” Be skeptical of judicial authority interpreting and applying earlier versions of the law, and update any citations to older caselaw to make sure that the same result would obtain under Revised Article 9.

C. The Definition of “Cash Proceeds”

It is important to be able to distinguish “cash proceeds” from non-cash proceeds. A security interest in cash proceeds is automatically perfected and remains perfected past the 20-day period of automatic perfection. However, it is easy for a secured party to lose its security interest in cash proceeds either because the cash proceeds become intermingled with other funds that are not collateral or because the cash proceeds are transferred to other parties under circumstances in which the transferees take free of the security interest.

Section 9-102(9) defines cash proceeds as “proceeds which are money, checks, deposit accounts or the like.”

Problem 43. Cash Proceeds of the Dry Cleaning Machines

Sandoval Cleaners exchanged 7 dry cleaning machines to Nova Dry Cleaning for the following property. Which of the following are “cash proceeds?”

1. \$4,000 in cash money.
2. A check in the amount of \$3,000.
3. The cash money and the check were deposited to Sandoval’s checking account.
4. One truck.
5. A bitcoin.

D. Automatic Attachment of a Security Interest in Proceeds

The “Golden Rule,” you will recall, is the rule that “security follows the collateral.” It is the general rule that a security interest continues in collateral unless there is an exception such as where the secured party authorizes disposition of the collateral free of the security interest, or where collateral is purchased by a buyer in the ordinary course, or where a consumer debtor sells consumer goods to another debtor.

There is another rule relating to proceeds that supplements the Golden Rule. A security interest also **automatically attaches to the proceeds** of collateral. Like the Golden Rule this rule as to proceeds is so important that it is repeated twice in Article 9. [Section 9-203\(f\)](#) states that “a security interest in collateral gives the secured party the rights to proceed provided by Section 9-315.” [Section 9-315](#) expresses the Golden Rule in conjunction with the rule regarding automatic attachment to proceeds. Section 9-315 states:

...

- (1) a security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and
- (2) a security interest attaches to any identifiable proceeds of collateral.

The operation of the rule that a security interest continues in collateral despite sale or other disposition and the rule that a security interest continues in the proceeds of collateral means that when collateral is sold in violation of a security agreement the security interest continues in **both** the original collateral and the proceeds of the collateral. The following problem illustrates that point.

Problem 44. Second-Level Proceeds

Hampton Contractors borrowed \$250,000 from Linden Investors. Linden took a security interest in the Hampton’s equipment. Under the security agreement Hampton was not permitted to sell any of its equipment without written authorization. In violation of the agreement and without Linden’s permission Hampton traded a **steam shovel** for a **bulldozer and 13 tons of gravel**. Hampton then traded the bulldozer for a **crane** and sold the gravel for **\$20,000**.

1. Which of these is the original collateral?
2. Ignoring for the moment the potential rights of other parties, which of these are proceeds?
3. Again ignoring the results of any priority disputes, which of these items does Linden Investors have a security interest in?

E. “Identifiable” Proceeds

[Section 9-315](#) provides that a security interest continues in **identifiable** proceeds. Under Section 9-315(b) if the proceeds are **goods** then we must use [Section 336](#) to determine whether

the goods are “identifiable” proceeds, and if the proceeds are **not goods** then we must use **other law** to determine whether the proceeds are identifiable. Here is Section 9-315(b):

Proceeds that are commingled with other property are identifiable proceeds:

- (1) if the proceeds are goods, to the extent provided by Section 9-336; and
- (2) if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved.

If proceeds that are **goods** are commingled with other goods then the security interest in the original collateral is lost but continues in the proceeds, that is, the commingled goods. Under Section 9-336 if goods that are collateral are united with other goods such that their identity is lost in the product or mass then the security interest continues in the product or mass in proportion to the value of the goods that were the original collateral.

If proceeds that are **non-goods** are commingled with other property the result depends upon the rules of tracing, including equitable principles, as determined by other areas of law. The most common situation where this problem arises is where cash proceeds are commingled in a deposit account with other funds. Whether or not the secured party’s security interest in those funds continues depends upon which method of tracing funds is adopted.

There are three standard ways to trace funds in a deposit account: FIFO (first-in, first out), LIFO (last-in, first-out), and the lowest intermediate balance test. FIFO and LIFO have their uses, but when the rights of third party are at stake in funds that have been commingled in an account the “lowest intermediate balance” test is used because it is the test that is usually the most favorable to the third party. The lowest intermediate balance test arises from equitable principles. Imagine that a fiduciary has stolen funds that belong to a beneficiary and has deposited those funds to an account that also contains funds that belong personally to the beneficiary. The lowest intermediate balance test assumes that **any** funds left in the account between the time when the beneficiary’s funds were deposited and the present belong to the beneficiary. In the same way if identifiable cash proceeds are commingled in a deposit account with other funds the presumption is that **any** funds remaining in the account are presumed to be proceeds in which the secured party has a security interest unless the balance of the account drops below the amount of proceeds that were deposited. When identifiable cash proceeds are deposited to an account that is mixed with other funds, it is presumed that funds from **other** sources are withdrawn before the funds belonging to the third party. The following problem illustrates how to determine whether cash proceeds are **identifiable** and contains an example demonstrating how to trace funds in a deposit account using the lowest intermediate balance test.

Problem 45. Tracing Identifiable Cash Proceeds

Yonder Thrift Shop owes the Valley Bank \$10,000 on a loan. The bank has a security interest in the store's inventory. Which of the following are **identifiable** cash proceeds of the store's inventory?

- a. Zoro, the owner of the thrift shop, has **\$1,200**, the week's receipts for the thrift store, in a safe in Zoro's office. There are no other funds in the safe.
- b. Zoro deposited the money into the store's checking account at Valley Bank. No funds have been withdrawn from the account since the money was deposited.
- c. Zoro deposited the \$1,200 cash into the store's checking account on Monday. At the time of the deposit there was already \$1,300 in the account, so the deposit brought the balance up to \$2,500. On Tuesday Zoro wrote checks to creditors for valid debts in the amount of \$20, \$50, \$100, \$500, \$700, and \$800. These checks were presented to the bank and paid against the checking account in that order on Wednesday. These debit items reduced the balance in the account to \$330. On Thursday Zoro deposited a check for \$1,500 in insurance proceeds resulting from water damage during a storm to the basement of the store (no inventory was damaged as a result of the flooding), increasing the balance in the account to \$1,830. On Friday Zoro wrote a check in the amount of \$750 for property taxes, drove to City Hall, and gave the check to the City Finance Department. The check was presented electronically and \$750 was drawn from the store's checking account the same day. This left a balance of \$1,080 in the store's checking account. At the end of the week how much of the money in the deposit account is identifiable cash proceeds of the inventory?

F. Automatic Perfection of a Security Interest in Proceeds.

Perfection of a security interest in proceeds is governed by Section [9-315\(c\)](#), [\(d\)](#), and [\(e\)](#). There is automatic perfection for some types of proceeds and 20-day temporary automatic perfection for other types of proceeds. The language of these three subsections of the Code is difficult to parse, so the text of each subsection appears below with a more detailed explanation.

§ 9-315 (c) Perfection of security interest in proceeds. A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.

Subsection (c) broadly states that if the security interest in the original collateral was perfected then the security interest in the proceeds of that collateral is also automatically perfected. However, subsection (d) limits the operation of subsection (c) to a period of 20 days unless certain conditions are satisfied.

§ 9-315 (d) Continuation of perfection. A perfected security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds unless one of the following paragraphs applies:

- (1) The conditions set forth in all of the following subparagraphs are satisfied:
 - (i) a filed financing statement covers the original collateral;
 - (ii) The proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed.
 - (iii) The proceeds are not acquired with cash proceeds.
- (2) The proceeds are identifiable cash proceeds.
- (3) The security interest in the proceeds is perfected other than under subsection (c) when the security interest attaches to the proceeds or within 20 days thereafter.

Subsection (d) is difficult to untangle. First, recognize that the first clause of subsection (d) creates a 20-day period of automatic perfection in proceeds that will terminate on the 21st day after the security interest attaches to the proceeds. The following problem illustrates how the 20-day period of temporary automatic perfection works:

Problem 46A. Trading Flowers for a Truck

Dorchester Bank has a perfected security interest in the **inventory** of Linndale Florists. Linndale Florists supplied floral arrangements for a large wedding. Instead of paying Linndale in cash or by check on the day of the wedding the happy couple gave Linndale title to a new **panel truck**. **Fifteen days later** Dorchester Bank had its security interest noted on the certificate of title. Was Dorchester's security interest in the truck continuously perfected or was there a gap in the perfection?

The word “unless” in subsection (d) introduces three conditions under which the security interest in proceeds will be continuously perfected after the 20-day period of automatic perfection. These conditions – subparagraphs (d)(1), (d)(2), and (d)(3) – are considered in reverse order below.

Subparagraph (d)(3) provides that if the security interest in proceeds is **not** perfected under Section 9-315(c) – that is, if the security in the proceeds is perfected in some manner **other than** the automatic perfection in proceeds that arises under Section 9-315(c) – then the security interest in proceeds will be continuously perfected past the initial 20-day period. What might that be? How could the secured party have a perfected security interest in proceeds other than by automatic perfection? Three other methods of perfection spring to mind. The secured party may have filed a **financing statement** expressly covering the proceeds. If the proceeds are tangible property then the secured party may have taken **possession** of the proceeds. Or if the proceeds are intangible the secured party may have taken **control** of the

proceeds. Note how the two changes in the facts of the problem below change the reasoning but not the result:

Problem 46B. Trading Flowers for a Truck (2)

Dorchester Bank has a perfected security interest in the inventory of Linndale Florists. Linndale Florists supplied floral arrangements for a large wedding. Instead of paying Linndale in cash or by check on the day of the wedding the happy couple gave Linndale **1000 pounds of fertilizer. Twenty-five days later** Dorchester Bank amended the financing statement to include “fertilizer.” Was Dorchester’s security interest in the fertilizer continuously perfected or was there a gap in the perfection?

Subparagraph (d)(2) is a bit simpler. If the proceeds are “identifiable cash proceeds” then the security interest will be continuously perfected past the 20-day period of automatic perfection. However, there are two problems with cash proceeds. First, to be identifiable they must be “traced” to the original collateral; that is, if they are commingled with other funds they may no longer be “identifiable” cash proceeds. Second, the security interest in cash proceeds is easily lost. If the funds are paid to other parties who acted in good faith then the other parties may take those assets free of the security interests. Later in this chapter we shall study how security interests in cash proceeds are often cut off. For now, though, it is sufficient to know that security interests automatically attach to identifiable cash proceeds and that the security interest in identifiable cash proceeds is automatically perfected.

Problem 47. Five \$100 Bills

Northern Bank has a perfected security interest in the equipment of Smithtown Bakery. Two years ago Smithtown sold one of its stoves to Rider Academy. Rider paid Smithtown \$500 in cash (five \$100 bills) for the stove. Jo, the owner of Smithtown, placed the five \$100 bills in a desk drawer and left the money there. The money is still in the desk drawer; there is no other money in the drawer. Does Northern Bank have a perfected security interest in the money?

Subparagraph (d)(1) is the most difficult portion of the law of proceeds to understand and master. It is the “same office rule.” Under this rule **if** the original collateral is perfected by the filing of a financing statement; **and if** the proceeds are a type of collateral that can be perfected by filing a financing statement in the same office as the original collateral; **and if** the proceeds were not purchased with cash proceeds; **then** the security interest in the proceeds is automatically and continuously perfected beyond the initial 20-day period.

The “**same office rule**” is demonstrated by the following problem.

Problem 48. The After-Acquired Server

In this problem the debtor owned office furniture that served as collateral for a debt owed to the secured party. The debtor disposed of the office furniture and acquired a new computer server. Assume that the new computer server is “identifiable proceeds” of the original office furniture; that is, assume that at every step we can trace the acquisition of the new computer server to the disposition of the original office furniture. In each case, is the security interest in the computer server only temporarily perfected for 20 days after it attaches to the server or is it continuously perfected beyond the 20-day period?

- a. The original financing statement covered “all equipment, now owned or hereafter acquired.”

The original collateral was office furniture.

The office furniture was traded for a new computer server.

Is the security interest in the computer server only temporarily perfected for 20 days after it attaches to the server or is it continuously perfected beyond the 20-day period?

- b. The original financing statement covered “all equipment, now owned or hereafter acquired.”

The original collateral was office furniture.

The office furniture was sold for \$15,000 and a new computer server was purchased with those funds.

Is the security interest in the computer server only temporarily perfected for 20 days after it attaches to the server or is it continuously perfected beyond the 20-day period?

- c. The original financing statement covered “all office furniture, now owned or hereafter acquired.”

The original collateral was office furniture.

The office furniture was traded for a new computer server.

Is the security interest in the computer server only temporarily perfected for 20 days after it attaches to the server or is it continuously perfected beyond the 20-day period?

- d. The original financing statement covered “all office furniture, now owned or hereafter acquired.”

The original collateral was office furniture.

The office furniture was sold for \$15,000 and a new computer server was purchased with those funds.

Is the security interest in the computer server only temporarily perfected for 20 days after it attaches to the server or is it continuously perfected beyond the 20-day period?

Practice Pointers.

1. It makes a difference whether the original financing statement described the collateral as “equipment” or “office furniture.” From the perspective of the secured party the broader the description of the collateral in the financing statement the better because it will apply to a potentially broader variety of proceeds. Of course, the debtor will prefer for the financing statement to include a narrower description of the collateral so that the debtor has more unencumbered property that it can use to obtain additional financing.
2. If there is a particularly valuable item of collateral then the financing statement can use both general and specific language; for example, “All equipment now-owned or hereafter acquired, including but not limited to the Chagall painting ‘Anniversaire.’”
3. On behalf of the secured party draft the description of the collateral in a financing statement strategically not only to cover existing property but also to cover after-acquired property and proceeds.

The final subsection of Section 9-315 dealing with perfection of a security interest in proceeds is [Section 9-315\(e\)](#). It provides that if a security interest in proceeds is perfected under the “same office rule” then the security interest lapses when the original financing statement lapses or on the 21st day after the security interest attached to the proceeds, whichever is later.

Several different provisions of Article 9 bear upon priority over proceeds. The next several portions of this textbook cover various aspects of priority over proceeds.

G. The Time of Filing or Perfection as to Proceeds.

In Chapter 6 we studied a basic rule of priority under the law of Secured Transactions. When there is a priority dispute between two secured parties neither of whom has a purchase-money security interest the party who was the **first to file or perfect** takes priority. [Section 9-322\(a\)](#).

When the collateral has been converted into proceeds the rule is no different. Under [Section 9-332\(b\)](#), the time of filing or perfection for a security interest in proceeds is the same as the time of filing or perfection for the original collateral.

Problem 49. Proceeds of Tioga’s Inventory

In September of 2018 Tioga Dry Goods entered into negotiations with Somerset Bank to secure financing. Skyler, the Treasurer of Tioga Dry Goods, signed an authorization letter allowing Somerset Bank to file a financing statement covering Tioga's inventory, and Somerset filed the financing statement, but the parties did not yet finalize a loan agreement. In October 2018 Skyler signed a loan and security agreement with Fisher Financing granting Fisher a security interest in Tioga's inventory in return for a loan of \$1 million. Fisher immediately filed a financing statement covering Tioga's inventory. In November Tioga concluded the loan and security agreement with Somerset Bank granting Somerset a security interest in Tioga's inventory and pursuant to which Somerset loaned Tioga \$1.5 million. Neither transaction was a purchase-money loan. In February of 2020 Tioga ceased operations having made only interest payments on each loan; the principal amounts were still outstanding. The inventory was all sold. A safe at Tioga's office contains \$200,000 in cash money and \$300,000 in checks. Tioga has a checking account at Federal Bank in the amount of \$500,000. The money and checks in the safe and the funds in the checking account can all be traced to the sale of Tioga's inventory. Finally, customers who purchased inventory on credit owe Tioga \$1 million. These are Tioga's only assets, and Somerset Bank and Fisher Financing are Tioga's only creditors.

1. Are the cash money, checks, funds in the checking account, and amounts owed by customers all proceeds of Tioga's inventory?
2. What category of collateral do each of these types of proceeds belong to?
3. Which secured party had priority in the original collateral, Tioga's inventory?
4. Which secured party has priority in the proceeds?

As between two secured parties with non-purchase-money security interests the priority is the same as to proceeds as it is as to the original collateral. The priority dispute is governed by [Section 9-322\(a\)](#) and the secured party who was the first to file or perfect as to the original collateral takes priority both as to the original collateral and as to proceeds.

In general if one of the parties has a purchase-money security interest in collateral and the other party has a non-purchase-money security interest in the same collateral the priority is also the same as to proceeds as it is as to the original collateral. The priority dispute is governed by [Section 9-324](#) and the party with the purchase-money security interest prevails both as to the original collateral and as to proceeds.

However there are two situations where the priority rule as to proceeds is different from the priority rule as to the original collateral. The law imposes a **disadvantage** on a party with a purchase-money security interest in inventory as to proceeds that are **accounts**, but grants an

advantage to a party with a purchase-money security interest as to proceeds that are **chattel paper**.

The following portion of this chapter discusses priority over proceeds that are accounts, and a later portion of this chapter covers priority over proceeds that are chattel paper.

H. Priority as to Proceeds That are Accounts

As between two secured parties with a security interest in the accounts of a debtor the usual “first to file or perfect” rule of [Section 9-322](#) determines priority over the accounts.

As between two secured parties with a security interest in inventory the result is the same. “Accounts” are proceeds of “inventory,” and the party who has priority over the inventory will also have priority over the accounts.

The same is true if one secured party has a security interest in accounts and the other has a security interest in the inventory. Whichever party was the first to file or perfect will take priority over the accounts.

But what if one party previously perfected a security interest in the debtor’s accounts and the other party subsequently perfected a purchase-money security interest in the debtor’s inventory? [Section 9-324\(b\)](#) governs priority disputes between secured parties with non-purchase-money security interests and secured parties with purchase-money security interests in inventory. In Chapter 6 we learned that if a secured party with a PMSI in inventory files a financing statement and gives proper notification of its security interest before the debtor receives delivery of the goods then the party with the PMSI has “super-priority” and takes priority over secured parties who filed and perfected earlier. We shall now learn an exception to that rule.

Consider the bolded language of [Section 9-324\(b\)](#). Subsection (b) grants a party with a PMSI in inventory super-priority as to the original collateral. However, a party with a PMSI in inventory is granted super-priority only as to **certain** categories of proceeds! Other categories of proceeds are omitted from the super-priority advantage. Here is Section 9-324(b); what’s missing from the list of proceeds that a party with a PMSI in inventory has super-priority over?

§ 9-324 (b) Inventory purchase-money priority. Subject to subsection (c) and except as otherwise provided in subsection (g), a perfected purchase-money security interest in **inventory** has priority over a conflicting security interest in the same inventory; **has priority over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper if so provided in section 9330 (relating to priority of purchaser of chattel paper or instrument); and, except as otherwise provided in section 9-327, also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer**, if:

- (1) the purchase-money security interest is perfected when the debtor receives possession of the inventory;
- (2) the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;
- (3) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and
- (4) the notification states that the person sending the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.

A party with a PMSI in inventory has super-priority as to proceeds that are chattel paper, instruments, and identifiable cash proceeds that are received by the debtor before the delivery of the inventory to a buyer. What's missing from this list is **accounts**. A party with a PMSI in inventory does not have super-priority as to accounts or the proceeds of accounts, that is, identifiable cash proceeds received by the debtor **after** the inventory was delivered to the debtor's buyer. The following problem illustrates this rule.

Problem 50. Yellowknife's Inventory, Accounts and Proceeds

Yellowknife Distributors brokers clothing material to clothing manufacturers. Yellowknife has large quantities of cotton, wool, and other materials stored in a warehouse near Lincoln, Nebraska; this material is worth \$10 million. Yellowknife is owed a large amount of money for material that has already been delivered; clothing manufacturers owe Yellowknife \$8 million. Yellowknife has possession of a cashier's check in the amount of \$1 million; a customer sent Yellowknife the check as payment in advance for an upcoming order. The following banks have security interests in Yellowknife's inventory and accounts:

Bank A has a non-purchase-money security interest in Yellowknife's inventory. Bank A filed a financing statement and perfected its security interest in 2017.

Bank B has a security interest in Yellowknife's accounts. Bank B filed a financing statement and perfected its security interest in 2018.

Bank C has a purchase-money security interest in Yellowknife's inventory. Bank C filed a financing statement and gave proper notification to other secured parties before the goods were delivered to Yellowknife in 2019.

What is the order of priority among these three banks as to:

- a. The \$10 million worth of inventory in the warehouse?
- b. The \$8 million worth of accounts receivable?

c. The \$1 million cashier's check?

Practice Pointer. Why does the law carve out this disadvantage for secured parties with a PMSI in inventory? Why are such parties denied "super-priority" with respect to accounts?

The reason for imposing this disadvantage is that historically many lenders specialized as either inventory financers or accounts financers. When Article 9 was being drafted accounts financers had no objection to granting a party with a PMSI super-priority as to the inventory; accounts financers viewed the debtor's accounts receivable, not the debtor's inventory, as security for their loans. However, if a party with a PMSI in inventory could also claim super-priority over the debtor's accounts as proceeds of inventory that would undermine the security of an accounts financer. As a result Section 9-324(b) carves out an exception for accounts and leaves priority as to accounts subject to the usual "first to file or perfect" rule of Section 9-322.

I. Priority as to Proceeds That Are Funds in Deposit Accounts

We have previously studied the topics of perfection of and priority over deposit accounts. In [Part E.1.a. of Chapter 5](#) we learned that it is not possible to perfect a security interest in a deposit account by filing a financing statement. Instead, the only way to perfect a security interest in a deposit account is to take control over the account. Under Section 9-104 control can be established in three ways:

1. The deposit account may be placed in the name of the secured party, thus removing the ability of the debtor to withdraw funds from the account and preventing the bank from setting off funds in the account to pay debts that the debtor owes to the bank.
2. The bank where the account is located has a security interest in the account. (The bank has a right of recoupment or set-off against a customer's account under Section 9-340 or the bank-customer deposit agreement may expressly reserve a security agreement in the customer's account in favor of the bank.)
3. A secured party may enter into a three-way agreement with the debtor and the bank requiring the bank to follow the instructions of the secured party without further consent of the debtor.

In [Part G.1. of Chapter 6](#) we learned that under [Section 9-327](#) priority over deposit accounts is arranged in the same hierarchy as above: ownership of the account takes priority over a security interest or set-off right of the bank, and the security interest or set-off right of the bank takes priority over a security interest that is perfected by a three-way agreement governing the account.

In Chapter 8, however, we have learned that there is a fourth way to perfect a security interest in a deposit account. The funds in a deposit account may be **proceeds** of collateral if they were acquired by the debtor from the sale, lease, royalty, interest, dividend, etc. of the original collateral and if those funds remain in the account using the tracing rule of the lowest intermediate balance test.

We have already learned the priority rule that **control defeats other methods of perfection**. That rule is illustrated by the following problem.

Problem 51. The Second Checking Account

In 2017 Hegstrom Construction Co. owed \$1 million to Plain Valley Bank. The bank demanded security for the loan, so Hegstrom granted the bank a security interest in Hegstrom's inventory, equipment, accounts receivable, and deposit accounts. At that time Hegstrom had only one deposit account, a checking account at Plain Valley Bank. The Plain Valley Bank filed a financing statement indicating all that property as collateral. In 2018 Hegstrom needed more working capital so it borrowed \$500,000 from Continental Bank. Continental took a security interest in and filed a financing statement covering the same collateral. However, as a condition to the loan Continental Bank demanded for Hegstrom to open a checking account at Continental and Continental reserved a security interest in the checking account as to all debts that Hegstrom owed to Continental. All of the proceeds from the Hegstrom's construction business were thereafter deposited into Hegstrom's account at Continental Bank. In 2020 Hegstrom ceased operations and stopped making payments to both the Plain Valley Bank and Continental Bank. Plain Valley Bank takes priority over Hegstrom's inventory, equipment, accounts receivable, and the deposit account at Plain Valley Bank.

Under [Section 9-327](#), which bank takes priority as to the funds in the deposit account at Continental Bank?

Practice Pointers.

1. It is not sufficient to make sure that your client's security interest takes priority over the security interests of previous parties. It is also necessary to monitor the actions of the debtor so that your client can respond quickly if the debtor enters into transactions or contractual relationships that threaten your client's priority in the collateral. These include situations where the debtor changes its name; the debtor sells the collateral, particularly if the collateral is sold to a buyer located out of state; the debtor impairs the value of the collateral; the debtor grants another lender a purchase-money security interest in the same collateral; or where the debtor opens a deposit account at another bank where proceeds of the collateral will be deposited.

2. There is a way to avoid a party like Continental Bank from taking priority over the funds in the deposit account. If your client can trace proceeds of collateral into a deposit account and the debtor and another party “collude” against your client to withdraw those proceeds from the account then your client can recover those proceeds. That is the subject of the following portion of this chapter.

J. Priority as to Identifiable Cash Proceeds

As we saw above, cash proceeds consist of money, checks, and funds in deposit accounts that a debtor has received on account of collateral. A security interest automatically attaches to identifiable cash proceeds as it does to all proceeds. A security interest in identifiable cash proceeds is continuously perfected even after the 20-day period of automatic perfection in proceeds. Cash proceeds are a common type of proceeds, and it is to the advantage of the secured party that a security interest in this type of proceeds is automatically perfected.

However, the advantages of identifiable cash proceeds are offset by the fact that if the debtor transfers identifiable cash proceeds to a third party who acted in good faith, then the third party is likely to take the proceeds free of the secured party's security interest in the proceeds.

This topic is governed by [Section 9-332\(a\)](#) as to money, [Section 9-332\(b\)](#) as to funds in deposit accounts, and [Section 9-330\(d\)](#) as to instruments such as checks.

Under Section 9-332(a) and (b) if a debtor transfers money or funds from a deposit account to a third party then the third party takes free of a security interest in the money or funds unless the third party colluded with the debtor to deprive the secured party of their rights. Section 9-332 provides:

§ 9332. Transfer of money; transfer of funds from deposit account.

(a) Transferee of money. A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(b) Transferee of funds from deposit account. A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

The following problem presents a common situation illustrating this rule.

Problem 52. The Airplane Seats

AirSeats Unlimited, Inc., manufactured airplane seats until June 1 of 2019 when it went out of business. American Investors financed AirSeats' operations and had a security interest in all of AirSeats' inventory, equipment, and accounts. At the beginning of the day on June 1 there was \$2 million in AirSeats' checking account at Integrity Bank, all of

which was identifiable cash proceeds of the collateral securing the loan of American Investors. On June 1 the following withdrawals were made from the account:

1. On June 1 the ten members of the Board of Directors of AirSeats Unlimited met in emergency session and voted themselves a bonus in the amount of \$100,000 apiece, a total of \$1 million. The money was transferred to their personal accounts the same day.
2. PillowTop, Inc., a corporation wholly owned by Brown, the CEO of AirSeats, was owed \$800,000 for material previously delivered to AirSeats. The contract between PillowTop and AirSeats required AirSeats to pay \$75,000 per month to PillowTop. On June 1 AirSeats paid PillowTop the entire outstanding amount.
3. Second Energy, Inc., provided electricity to AirSeats' factory. In the past the bill for electricity used during the previous month was paid on the first of every month. The bill was usually about \$50,000 per month. On June 1 AirSeats paid Second Energy \$50,000 for electricity provided during the month of May.

Is it "collusion" to take advantage of the rights that are conferred by Article 9? Let's reconsider the facts of a previous problem in light of the rule against collusion.

Problem 53. The Second Checking Account, reprised

In 2017 Hegstrom Construction Co. owed \$1 million to Plain Valley Bank. The bank demanded security for the loan, so Hegstrom granted the bank a security interest in Hegstrom's inventory, equipment, accounts receivable, and deposit accounts. At that time Hegstrom had only one deposit account, a checking account at Plain Valley Bank. The Plain Valley Bank filed a financing statement indicating all that property as collateral. In 2018 Hegstrom needed more working capital so it borrowed \$500,000 from Continental Bank. Continental took a security interest in and filed a financing statement covering the same collateral. However, as a condition to the loan Continental Bank demanded for Hegstrom to open a checking account at Continental and Continental reserved a security interest in the checking account as to all debts that Hegstrom owed to Continental. All of the proceeds from the Hegstrom's construction business were thereafter deposited into Hegstrom's account at Continental Bank. In 2020 Hegstrom ceased operations and stopped making payments to both the Plain Valley Bank and Continental Bank. Plain Valley Bank takes priority over Hegstrom's inventory, equipment, accounts receivable, and the deposit account at Plain Valley Bank.

In Problem 51 we concluded that under Section 9-327 Continental Bank prevails over Plain Valley Bank as to the debtor's funds on deposit at Continental Bank because a

bank where a deposit account is located has “control” over the deposit account and takes priority over a secured party who claims a security interest in the funds in the account merely as proceeds.

The facts of this problem are loosely based upon the facts of *Platte Valley Bank v. Tetra Financial Group, LLC*, 682 F.3d 1078 (8th Cir. 2012). In that case the court concluded that “Continental Bank” did not act in violation of Article 9; that its actions were not “underhanded” or “wrongful” towards “Plain Valley Bank.” In the actual case the “Continental Bank” before making the loan the “Continental Bank” negotiated with “Plain Valley Bank” seeking for Plain Valley to subordinate its security interest in return for an infusion of new capital for the debtor; when Plain Valley Bank refused to subordinate the Continental Bank simply took the steps permitted under the Code that would enable it to take priority, by having the debtor begin placing all proceeds from inventory in a deposit account at Continental Bank.

Practice Pointers.

1. Another court might not reach the same conclusion as the court did in *Platt Valley Bank v. Tetra Financial Group*. The court was influenced by the fact that the second bank negotiated with the first bank to secure a subordination agreement, and only when that failed did the second bank have the debtor open a new deposit account. The court specifically found that the second bank did not act in an “under-handed” manner.
2. The case demonstrates that more than one provision of Article 9 must be considered in resolving priority disputes. A secured party may be entitled to priority over a deposit account under one provision of Article 9; but that party could be stripped of priority if it was guilty of collusion with the debtor to violate the rights of another party. It is not enough for a secured party to gain priority under a provision of Article 9; it is also necessary to achieve priority by acting in good faith.
2. Security interests in identifiable cash proceeds are easily cut off by other parties who act in good faith, particularly if those parties give new value to acquire an interest in the proceeds.

The third type of identifiable cash proceeds is checks. The rule governing the rights of secured parties to proceeds in the form of checks is governed by Section 9-330(d), which provides:

§ 9-330 (d) Instrument purchaser's priority. Except as otherwise provided in section 9-331(a) (relating to rights under Divisions 3, 7 and 8 not limited), a purchaser of an instrument has priority over a security interest in the instrument perfected by a method other than possession if the purchaser gives value and takes possession of the

instrument in good faith and without knowledge that the purchase violates the rights of the secured party.

The answer to the following problem turns on this provision of Article 9.

Problem 54. Negotiation of a Check

Queen's Bank has a security interest in the inventory and accounts of Hilltop Lighting and it perfected this security interest by filing a financing statement covering the same collateral. On April 1 Hilltop Lighting sold 400 lighting fixtures to Home Away from Home, a company that is building a new hotel nearby. Home Away from Home paid for the fixtures with a check for \$20,000. The check was postdated to July 1, and Hilltop promised not to deposit the check until July 1. Hilltop then sold the check to Erie Factors for \$19,500 and used the funds to pay salaries and back taxes. On June 15 Queen's Bank discovered the sale of the check and sued Erie Factors for return of the check or payment of the face amount.

1. Did Erie Factors take the check free of the security interest of Queen's Bank? See [Section 9-330\(d\)](#).

2. What result if the check had been stamped with a legend, "This instrument has been assigned to Queen's Bank"? See [Section 9-330\(f\)](#).

K. Priority as to Proceeds That Are Chattel Paper

Priority over chattel paper is governed by [Section 9-330](#).

Chattel paper is a hybrid type of property. It is a writing or electronic record of a promise to pay coupled with a right to specific goods. Chattel paper takes a variety of forms, including a loan agreement with a security clause, a promissory note attached to a contract containing a security agreement, a conditional sales contract, or a lease agreement. Chattel paper is more valuable than other types of property such as accounts or payment intangibles or promissory notes because it entails both a right to payment and a right to goods.

Chattel paper is also a common type of proceeds. When goods are leased or sold on credit the customer usually signs a contract to pay for the goods and grants the lessor or the credit seller the right to repossess the goods if payment is not made. The written or electronic record of this contract is a valuable asset that can be sold or that can serve as collateral for a loan.

A security interest in chattel paper can be perfected either by filing a financing statement or by obtaining possession or control over the chattel paper. A secured party can take possession of tangible chattel paper or obtain control over electronic chattel paper.

In the alternative to taking possession or obtaining control over chattel paper, a secured party can prevent subsequent purchasers of the chattel paper from gaining priority over the chattel paper by including a statement on all of the debtor's chattel paper stating that the chattel paper has been assigned to the secured party. Under [Section 9-330\(f\)](#), if the chattel paper bears such a statement then any other "purchaser" of the chattel paper is deemed to have knowledge that assignment of the chattel paper to any other party is a violation of the rights of the original secured party. (Recall that "purchasers" includes both buyers and secured parties.)

A security interest in chattel paper can also arise as a consequence of the fact that chattel paper is a common type of proceeds from the sale and lease of goods. If a secured party has a security interest in inventory, when the inventory is sold to a buyer the proceeds are often in the form of chattel paper. The security interest of the secured party automatically attaches to the chattel paper. Chattel paper is not "cash proceeds," but financing statements covering chattel paper are filed in the same office as financing statements covering inventory and chattel paper is not purchased with cash proceeds so under the "same office rule" the security interest in chattel paper as proceeds is continuously perfected past the 20-day period of automatic perfection.

As a result priority disputes often arise among the following types of parties:

1. A secured party who has a security interest over the chattel paper of the debtor and who has perfected by filing a financing statement covering the chattel paper;
2. A secured party or a buyer of the chattel paper who has taken possession of or control over chattel paper; and
3. A secured party with a security interest over the inventory of the debtor who has an automatically perfected security interest over the chattel paper as the proceeds of inventory.

Priority disputes among these different types of parties is governed by [Section 9-330\(a\)](#) and [\(b\)](#), which provide:

§ 9-330. Priority of purchaser of chattel paper or instrument.

(a) Purchaser's priority: security interest claimed merely as proceeds. A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory subject to a security interest if:

- (1) in good faith and in the ordinary course of the purchaser's business, the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under section 9105 (relating to control of electronic chattel paper); and
- (2) the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

(b) Purchaser's priority: other security interests. A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed other than merely as proceeds of inventory subject to a security interest if the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under section 9-105 in good faith, in the ordinary course of the purchaser's business and without knowledge that the purchase violates the rights of the secured party.

Subsection 9-330(a) applies to priority disputes between secured parties claiming a security interest in the chattel paper "merely as proceeds" and other purchasers. Subsection 9-330(b) applies to priority disputes between other purchasers and secured parties with a security interest in chattel paper that does **not** arise "merely as proceeds." Notice that in either case a competing purchaser cannot take priority over the secured party unless the purchaser satisfies three elements. The purchaser must:

1. Give new value;
2. Take possession or control of the chattel paper;
3. In good faith and in the ordinary course of the purchaser's business.

Subsection (a) adds the requirement that for the purchaser to take priority the chattel paper must not bear a legend stating that the chattel paper has been assigned to another secured party. Subsection (b) adds the requirement that the purchaser must not have knowledge that the purchase violates the rights of the secured party. As mentioned above, under Section 9-330(f) if the chattel paper bears a legend that it has been assigned to an identified secured party then other parties are deemed to have knowledge that their purchase of the chattel paper would violate the rights of the secured party.

The "new value" requirement is analogous to the rules favoring parties with a prior purchase-money security interest. If a party buys the chattel paper of a debtor and pays for it, a party with a security interest in the chattel paper could still claim the amount that was paid as proceeds of the chattel paper. Similarly, if a subsequent secured party advances funds to the debtor and takes a security interest in the chattel paper those funds provide additional working capital for the debtor.

It was noted earlier that a party with a purchase-money security interest in inventory holds an advantage in priority disputes over chattel paper as proceeds. It is this: the law considers that a party with a purchase-money security interest in chattel paper has given "new value" for the chattel paper. Subsection 9-330(e) provides:

§ 9-330 (e) Holder of purchase-money security interest gives new value. For purposes of subsections (a) and (b), the holder of a purchase-money security interest in inventory gives new value for chattel paper constituting proceeds of the inventory.

Finally, [Section 9-330\(c\)](#) provides that priority over the proceeds of chattel paper (including cash proceeds or returned goods) is the same as priority over the chattel paper itself.

The following problem illustrates some of the typical priority disputes over chattel paper that arise between secured parties and buyers.

Problem 55. Chattel Paper for Toasters

Humboldt Industries distributes countertop appliances like toasters, can openers, and mixers. Humboldt purchases these items from manufacturers and sells them to retail outlets, generating chattel paper. Three creditors claim an interest in Humboldt's chattel paper.

1. In 2017 Star Bank loaned \$10 million to Humboldt and took a security interest in all of Humboldt's chattel paper, now-owned and hereafter acquired. Star Bank perfected its security interest by filing a financing statement covering the chattel paper.
2. In 2018 Humboldt borrowed \$6 million from National Investors and used the funds to purchase inventory. The security agreement between Humboldt and National Investors included a cross-collateralization clause. National Investors filed a financing statement covering the inventory and gave Star Bank proper notification of its purchase-money security interest before the goods were delivered to Humboldt.
3. In 2019 Sandcrab Finance, which is in the business of purchasing and collecting on chattel paper, purchased all of Humboldt's chattel paper for \$6 million and took possession of it. The chattel paper did not contain a legend stating that it had been assigned to anyone.

What is the order of priority over the chattel paper among Star Bank, National Investors, and Sandcrab Finance?

Practice Pointers.

1. If your client takes a security interest in the debtor's chattel paper then advise your client to take possession of the debtor's tangible chattel paper or take control of the debtor's electronic chattel paper. This will prevent subsequent secured parties from gaining priority or subsequent buyers from taking free of your client's security interest.
2. If your client takes a security interest in chattel paper have a legend placed on the chattel paper stating that it has been assigned to your client. This will give any other purchaser knowledge that the assignment is in violation of the rights of your client and will prevent

subsequent purchasers from gaining priority over or taking free of your client's security interest.

3. If your client buys chattel paper make sure that the chattel paper does not bear a legend stating that it has been assigned to another party. Make sure that your client gives new value and buys the chattel paper in good faith in the regular course of your client's business. And make sure that your client takes possession or control of the chattel paper.

L. Lecture 28. Future Advances

In [Chapter 3 Part F](#) we learned what future advance clauses, after-acquired property clauses, and cross-collateralization clauses are and how important it is for a secured party to include those provisions in a security agreement. Without a future advance clause or an after-acquired property clause a security agreement may not be effective for a security interest to **attach** to after-acquired property or **secure** a future advance.

In contrast, **perfection** is easily achieved. It is not necessary to include a future advance clause or an after-acquired property clause in a financing agreement. Financing statements automatically perfect security interests in after-acquired property and in collateral that secures future advances. Official Comment 2 to Section 9-502 states:

“[A] financing statement is effective to cover after-acquired property of the type indicated and to perfect with respect to future advances under security agreements, regardless of whether after-acquired property or future advances are mentioned in the financing statement and even if not in the contemplation of the parties at the time the financing statement was authorized to be filed.”

Including a future advance clause or an after-acquired property clause in a financing statement isn't necessary, but some attorneys consider it to be good practice.

Priority in collateral secured by a future advance is governed by [Section 9-323](#). The time of filing or perfection for a future advance is the same as the time of filing or perfection of the original extension of credit. As between **two Article 9 secured parties** with a security interest in the same collateral, the resolution of a priority dispute is the same regardless of whether the indebtedness was incurred at the time that the parties entered into the security agreement or at a later time.

This creates a trap for the unwary, as the following problem demonstrates.

Problem 56. The Disappearing Security Cushion

Rice Providers brokers rice, buying rice from farmers and selling it to companies that process or package rice. In January of 2020 Alpha Bank loaned Rice Providers \$5,000 and

took a security interest in “all of the debtor’s inventory and accounts, now-owned and hereafter-acquired,” and the security agreement also expressly provided that the collateral secured “all debts owed by the debtor to the secured party, from any source whatsoever, in existence or arising at future time.” The financing statement described the collateral as “all inventory and accounts.” In February of 2020 Beta Bank loaned Rice Providers \$500,000. The security agreement and the financing statement between Beta Bank and Rice providers contained the same language as the security agreement with Alpha Bank and the financing statement filed by Alpha Bank. In March of 2020 Alpha Bank loaned Rice Providers another \$1 million. At the present time Rice Providers has \$800,000 in inventory, accounts, and identifiable proceeds of inventory and accounts. As between Alpha Bank and Beta Bank, which bank takes priority to the collateral?

Practice Pointers.

1. If another secured party has previously filed or perfected a security interest in the same collateral, and if there is a future advance clause in the security agreement between the debtor and the other secured party, the other secured party can vacuum up all of the value of the collateral by advancing additional funds to the debtor.
2. What can a subsequent secured party do to protect itself from a future advance made by a party who has previously perfected its security interest in collateral?

A secured party must be even more careful about making future advances after a buyer has purchased the collateral from a debtor or after a lien creditor has attached the collateral. Under [Section 9-323\(d\)](#), as against a **buyer** who has purchased the collateral, a future advance that is made by the secured party without knowledge of the purchase **and** within 45 days of the purchase is effective against the buyer. Under [Section 9-323\(b\)](#), as against a **lien creditor**, a future advance that is made within 45 days of the attachment of the lien **or** without knowledge of the lien is effective against the lien creditor.

Problem 57. The Super Computer and the Future Advance

In 2018 Maple Bank loaned \$1,000 to Olvine Industries and took a security interest in Olvine’s equipment. The security agreement contained both a future advance clause and an after-acquired property clause. The security agreement also provided that Olvine Industries did not have authority to sell any equipment subject to the security agreement without express prior written authorization of Maple Bank. On September 1, 2019, Olvine purchased a Mac Pro Desktop from Apple for \$50,000. On November 1 without the knowledge or consent of Maple Bank Olvine sold the Mac Pro Desktop to Island Destinations, a national travel agency, for \$45,000; Olvine quickly spent the money trying to stay in business. On December 20 Maple Bank loaned Olvine another

\$60,000. On December 22 Maple Bank discovered two things: that Olvine had sold the computer to Island Destinations without permission, and that Olvine was insolvent. Maple Bank declares Olvine to be in default and seeks to repossess the Mac Pro Desktop from Island Destinations.

1. Maple Bank contends that Island Destinations did not acquire any title whatsoever to the computer because Olvine did not have authority to sell the equipment without express prior written permission from Maple Bank. Is Maple Bank correct? [See Section 9-401\(b\).](#)
2. Did Island Destinations acquire the computer free of or subject to Maple Bank's security interest to the extent of the original loan in the amount of \$1,000? [See Section 9-320.](#)
3. Did Island Destinations acquire the computer free of or subject to Maple Bank's security interest to the extent of the future advance in the amount of \$60,000? [See Section 9-323\(d\).](#)

Practice Pointer. In representing a secured party it is important to make sure that the debtor has not sold collateral that is equipment; the security agreement should identify that as an act of default. It is particularly important to make sure that the collateral has not been sold more than 45 days before the secured party makes another advance to the debtor.

End of Chapter 8

Chapter 9. Federal Debts and Taxes; Bankruptcy; Subrogation Powers of Bankruptcy Trustee

Chapters 9 and 10, like Chapters 6, 7, and 8, deal with **priority** of security interests. In Chapters 9 and 10, however, in addition to Article 9 of the U.C.C. and other state laws like the law of fraudulent conveyances, we must also take into account certain **federal laws**. The most important topic in this Chapter is the last one, Part E. – the subrogation powers of the bankruptcy trustee.

We have already encountered federal laws that govern the **perfection** of security interests in certain goods such as ships and airplanes and in certain general intangibles such as intellectual property. In [Chapter 1 Part M](#) it was mentioned that security interests in ships over a certain size must be registered with the Coast Guard. The Federal Aviation Administration maintains a system for recording ownership of and liens attaching to airplanes. The Office of Copyrights operates an exclusive recording system for interests in registered copyrights. Security interests in trademarks and unregistered copyrights are perfected by filing a financing statement with the office of the state Secretary of State. It is wise to record security interests in patents with both the federal Patent Office and the state Secretary of State.

In [Chapter 7 Part B.5](#), we studied how the federal **Food Security Act** supplements and preempts the rules of Article 9. The Food Security Act protects **farm lenders** by requiring the buyers of farm products to pay those lenders when they buy farm products. In this Chapter we will study the **Perishable Agricultural Commodities Act**, which protects the interests of **farmers** against the creditors of their buyers.

What if a debtor owes money to the federal government? If the debtor is insolvent and owes a debt to the federal government then under the **Federal Priority Statute** the federal government takes priority over other debtors, at least as to inchoate liens. If the debtor owes taxes to the federal government then another federal statute applies: the federal **Tax Lien Act**.

Finally, what if the debtor declares bankruptcy but some or all of the debtor's property is subject to a security interest? Is the security interest still valid? Can the secured party still enforce its security interest? Can the bankruptcy trustee **avoid** the security interest? The priority of Article 9 security interests in bankruptcy is determined by the subrogation powers and avoidance powers of the Bankruptcy Trustee as established by the federal **Bankruptcy Code**.

All of these federal laws that affect the priority of security interests in the property of the debtor – the Perishable Agricultural Commodities Act, the Federal Priority Statute, the Tax Lien Act, and the Bankruptcy Code – are covered in Chapters 9 and 10.

A. Learning Objectives

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Resolve disputes between farmers and parties with security interests in the accounts receivable of buyers of farm products.
2. Resolve disputes between secured parties and the federal government over the property of insolvent debtors under the Federal Priority Statute.
3. Resolve disputes between secured parties and the Internal Revenue Service over the property of persons who owe taxes.
4. Apply introductory concepts in bankruptcy procedure to problems in Secured Transactions, including filing for bankruptcy, the automatic stay in bankruptcy, and the role of the bankruptcy trustee.
5. Resolve disputes between secured parties and bankruptcy trustees when the trustees exercise their subrogation powers under Bankruptcy Code Sections 544(a), 544(b), and 558.
6. Identify the elements of an actual fraudulent conveyance and a constructive fraudulent conveyance under the Pennsylvania Uniform Voidable Transactions Act (PUVTA).
7. Determine whether a transaction can be avoided as a fraudulent conveyance under PUVTA.

B. Priority Under the Perishable Agricultural Commodities Act

The federal Perishable Agricultural Commodities Act (PACA) protects the nation's farmers. When farmers sell their products to buyers, and those buyers resell the products to other persons, the proceeds are impressed with a trust so that the farmers will be guaranteed payment from the proceeds. Even if a lender has a perfected security interest in the buyer's accounts receivable, the farmer who sold the products to the buyer will take priority over the secured party as to the accounts.

Practice Pointer.

The purpose of PACA is to protect farmers from the creditors of distributors or processors who do not pay for the products they purchase. This policy is enforced by subordinating security

interests in the accounts of the distributors or processors to the interests of the farmers. Is this fair? Is it good policy?

We now turn to the Federal Priority Statute and the Federal Tax Lien Act and their effect on priority disputes between secured parties and the federal government.

C. **Lecture 29. Federal Debts and Taxes** – The Federal Priority Statute and the Federal Tax Lien Act

The Federal Priority Statute is 31 USC § 3713. On its face this law gives absolute priority to debts owed to the federal government when the debtor is insolvent. There is a great deal of confusion about the precise effect of the Federal Priority Statute on Article 9 security interests. There are however two important doctrines that limit the extent of federal priority as applied to Article 9 security interests.

1. “Choate” interests in the debtor’s property. The Federal Priority Statute is triggered when the debtor becomes **insolvent**. The purpose of the statute is to make sure that when the debtor no longer has enough property to pay its debts then the federal government should be paid first. However, if the debtor has already conveyed its property to another creditor before it became insolvent then the claim of the federal government is subject to the interest of the other creditor.

If the debtor has sold and delivered its property to another person before the debtor becomes insolvent then it is clear that the federal government does not have priority as to that property. But what if the conveyance to the other creditor is only partial? If the interest of a creditor to the insolvent debtor’s property became “**choate**” before the debtor became insolvent then the courts have given the creditor priority over the federal government on the theory that the debtor’s interest in the property has been diminished or eliminated before the interest of the federal government attached. The word “choate” is a centuries-old term that means “completed” or “perfected.” In contrast the term “inchoate” means “incomplete” or “unperfected.” In general, a previously-perfected security interest in specific property belonging to a debtor takes priority over a claim of the federal government. However, there are two exceptions. The courts have ruled that a security interest in “after-acquired property” and a security interest that secures repayment of a “future advance” are **inchoate**. If a debtor commits an act of insolvency before the debtor acquires the property or before the secured party made the future advance then the federal government takes priority as to the after-acquired party and as to any collateral secured by the future advance.

2. Tax claims. If the federal government’s claim against the debtor is based upon nonpayment of taxes, then the Federal Priority Statute does not apply at all. Instead the Federal Tax Lien Act, 20 U.S.C. Sections 6321 and 6323, applies. Under the Federal Tax Lien Act the government is required to **file** the tax lien. A secured party with a previously-perfected security interest in the debtor’s property takes priority over the government. In *U.S. v. Romani*, 523 U.S. 517 (1998),

the United States Supreme Court ruled that the Tax Lien Act, not the Federal Priority Statute, is the governing statute when the government asserts a tax deficiency against a taxpayer. Furthermore, under the Federal Tax Lien Act secured creditors are accorded a grace period for future advances and after-acquired property. If the future advance was made or the property was acquired by the debtor within 45 days **after** the filing of the tax lien and without knowledge of the tax lien then the secured party still takes priority over the federal government.

The following case explores the relation between the Federal Priority Statute and the Tax Lien Act.

United States v. Krasicky, 2016 WL 1242387 (E.D. Mich. 2016)

National City Bank loaned \$12 million to Page Distribution, Inc., taking a security interest in all of Page's existing and after-acquired assets, including inventory. Page went into receivership and failed to pay a federal tax on tobacco products. The federal government demanded payment of the tax but did not file a tax lien. Instead the government relied upon the Federal Priority Statute to claim priority over the perfected security interest of National City Bank. The bank and the receiver (Krasicky) filed a motion to dismiss the government's claim to priority.

The court followed *Romani* and ruled that because the government's lien arises from non-payment of a tax this priority dispute is governed by the Tax Lien Act and not the Federal Priority Statute. Under the Tax Lien Act the government is required to file a tax lien to establish priority, and in any event a previous perfected security interest takes priority over a subsequently-filed tax lien. National City Bank prevailed over the government.

Practice pointers.

1. This case demonstrates one more reason to make sure that your client's security interest is perfected: to take priority over federal debts and taxes.
2. This case also gives us one more reason to monitor the debtor's finances. If the security interest covers the debtor's after-acquired property or if it secures future advances to the debtor make sure that the federal government has not filed a tax lien against the debtor and that the debtor has not otherwise incurred debts to the federal government and become insolvent. If one of those events occurs the security interest in after-acquired property or any debt secured by a future advance can become subordinate to the claim of the federal government to the debtor's property.

In the next case the court addresses the **choateness doctrine**; the rule that the federal government takes priority over **inchoate** liens. In cases involving tax liens this means that the federal government takes priority as to property that the debtor acquires more than 45 days after a tax lien is filed and that the federal government takes priority over property that secures indebtedness from future advances made more than 45 days after the tax lien was filed.

We studied another portion of the following case in Chapter 3 on attachment of a security interest. In the following portion of the case the court addressed a priority dispute between a party with a perfected security interest in the after-acquired property of the debtor and the I.R.S. claiming under a filed tax lien on the debtor's property.

SE Property Holdings, LLC v. Unified Recovery Group, LLC (Priority of Tax Lien), 357 F.Supp3d 537 (E.D. La 2018)

URG performed cleanup work for some Louisiana parishes (counties) after Hurricane Katrina and one of the parishes owed URG money for those services; the money that was owed was an **account**. SEPH had a security interest in URG's accounts, and SEPH filed a financing statement covering URG's accounts before the IRS filed its tax lien in 2013. However, the account was **after-acquired property**. Therefore the security interest did not become **choate** until the debtor URG earned the account. If URG completed its work under the contract within 45 days after the IRS filed its tax lien then SEPH would take priority over the government as to the accounts. However, if URG completed its work under the contracts more than 45 days after the IRS filed its tax lien then the government has an interest in the accounts that is superior to that of the secured creditor SEPH.

The court found that the contract between URG and the parish not only required URG to complete the cleanup work but also required URG to obtain approval from the parish for its invoices certifying that the work was completed.

Ultimately the court had to remand the case because it wasn't clear from the evidence when the Parish approved all of the documentation that URG submitted to the Parish.

Practice Pointers.

1. The IRS also argued in this case that the security agreement between SEPH and URG expressly granted priority to the IRS over the security interest of SEPH. Section 2.01 of the security agreement stated:

Section 2.01. Grant of Security Interest. [URG] hereby grants and confirms that it has granted to [SEPH] a security interest, subject only to Permitted Liens (as defined in the Agreement) in, a general lien upon, and a right of set-off against the following described property: (a) all of [URG's] accounts of any kind (including all leases) whether now existing or here after arising.

Although this provision of the contract referred to “Permitted Liens (as defined in the Agreement)” the term was nowhere defined in the security agreement. The court ultimately found that this provision was ambiguous and that the parties did not intend to subordinate the security interest of SEPH to the IRS tax lien or any other lien. But the court spent several pages of the opinion discussing this matter, and the attorneys for the parties spent countless hours researching, discussing, conferring, arguing, drafting and re-drafting the briefs on this topic, all because of a poorly-drafted phrase in the boilerplate of the security agreement.

2. The dispute with the IRS could have been avoided if the contract between URG and the parish had been drafted differently. If the contract had stated that URG was entitled to be paid as soon as it completed its clean-up work then the parish would have owed URG for its work at that time and the account would have become “choate” at that same moment, establishing the priority of SEPH over the receivables from the contract.

We now turn to the topic of Bankruptcy. The ultimate test of a security interest is whether it withstands the claims of a trustee in bankruptcy, that is, whether the bankruptcy trustee can **avoid** the security interest. Part D below contains an introduction to the field of Bankruptcy law and procedure. In Part E we commence our study of the avoidance powers of a bankruptcy trustee, beginning with the three subrogation powers of the trustee.

D. The Bankruptcy Code and Bankruptcy Procedure

Presented below is a brief introduction to the Bankruptcy Code and bankruptcy procedure. This material is intended to provide background for our study of the avoidance powers of the Bankruptcy Trustee. It will at most be lightly tested on the final examination.

1. The Constitutional Basis for a Federal Law of Bankruptcy

Article I, Section 8 of the Constitution of the United States grants Congress the power to enact “uniform laws on the subject of bankruptcies throughout the United States.” The drafters of the Constitution were drawn mainly from the merchant class, and they were suspicious that the states would enact debt forgiveness statutes, so they concentrated this power in Congress.

2. The Bankruptcy Code

The Bankruptcy Code is in Title 11 of the United States Code. Six chapters of the Bankruptcy Code permit the filing of a petition for bankruptcy.

Chapter 7. Liquidation.

When an individual or a company enters Chapter 7 the bankruptcy trustee will liquidate the assets. The trustee assembles the unencumbered and non-exempt assets of the debtor, sells them, and after paying administrative fees, taxes, and other priorities divides the remaining proceeds among the unsecured creditors proportionately to the debt that each creditor is owed. If an asset is so encumbered by a security interest that its sale would yield little or nothing for the unsecured creditors the asset will be released to the secured party. Typically the unsecured creditors receive little or nothing in Chapter 7.

Chapter 9. Reorganization for Municipalities.

Under Chapter 9 the debts of cities and counties can be restructured. In recent decades this occurred to Detroit, Michigan, and Orange County, California.

Chapter 11. Reorganization for a Company.

Companies that wish to restructure their debts and emerge from bankruptcy choose Chapter 11 over Chapter 7. A reorganization plan may extend as long as five years.

Chapter 12. Reorganization for Family Farmers and Family Fishermen.

Chapter 12 reorganization is more generous to the debtor than Chapter 11.

Chapter 13. Reorganization for Individuals.

Most individual bankruptcies are liquidations under Chapter 7. A small percentage of individual bankruptcies involve restructuring of debts under Chapter 13.

Chapter 15. Cross-Border Insolvency.

Chapter 15 is for insolvent foreign companies that are in debt to persons or entities in the United States. It allows the United States courts to coordinate with foreign courts conducting insolvency proceedings against foreign companies.

3. The Bankruptcy Courts

Bankruptcy Courts are units of the federal district courts. Bankruptcy judges are appointed for a period of 14 years by the Circuit Courts. Decisions of the Bankruptcy Courts are appealed to District Courts and then to the Circuit Courts of Appeals. In the First, Sixth, Eighth, Ninth, and Tenth Circuits appeals from Bankruptcy Courts are heard by a Bankruptcy Appellate Panel (BAP), which is composed of a panel of three bankruptcy judges. Appeals from the BAP's are heard by the Circuit Courts of Appeal.

4. Filing for Bankruptcy

A bankruptcy case is started by filing a petition in Bankruptcy Court. The debtor can file for bankruptcy protection (voluntary bankruptcy) or a creditor can file a bankruptcy petition against a debtor (involuntary bankruptcy) to force the debtor into bankruptcy. The vast majority of filings in bankruptcy are voluntary.

5. The First Meeting of Creditors

The first meeting of creditors is called a “341 hearing.” The debtor is required to appear, provide financial information including pay stubs, tax returns, and bank statements, and answer under oath the questions of the bankruptcy trustee and other creditors who may attend.

6. The Automatic Stay in Bankruptcy

When the petition for bankruptcy is filed all creditors, including secured creditors, are subject to an automatic stay under [Section 362](#) of the Bankruptcy Code. Creditors are prohibited from taking **any** action to collect a debt. The automatic stay prevents a secured party from repossessing or reselling collateral without the permission of the Bankruptcy Court. A secured party who violates the automatic stay could face serious legal consequences, as in the case of [In re Lewis](#) in Chapter 12 of this textbook.

The Bankruptcy Court may release the collateral subject to the security interest to the secured party or in the alternative the Bankruptcy Court might elect instead to give the secured party “adequate protection” within the meaning of [Section 361](#) of the Bankruptcy Code. If the collateral is being used up or is depreciating in value then the court-awarded “adequate protection” might consist of periodic payments or substitute collateral.

7. The Avoidance Powers of the Bankruptcy Trustee

As noted above the bankruptcy trustee has the duty to assemble the assets of the debtor and liquidate those assets for the benefit of all of the unsecured creditors. Most of the time there are no assets to assemble; because of Article 9 all of the debtor’s assets are encumbered. Sometimes, however, the bankruptcy trustee is able to take assets free of creditors’ security interests. The common term for this is that the bankruptcy trustee can **avoid** the security interest of a secured party. There are five principal avoidance powers. The avoidance powers are **cumulative**. The bankruptcy trustee prevails against the secured creditor if any one of the five avoidance powers gives the trustee the power to avoid the security interest. Three of these powers are **subrogation powers**. The Bankruptcy Trustee has the power to step into the shoes of and exercise the legal rights of the debtor ([B.C. § 558](#)), a hypothetical lien creditor ([B.C. § 544\(a\)](#)), or an actual unsecured creditor ([B.C. § 544\(b\)](#)). The trustee’s subrogation powers are discussed below in this chapter. The two other avoidance powers are the power to avoid preferences under [Section 547](#) of the Bankruptcy Code and the power to avoid fraudulent conveyances under [Section 548](#). Those two avoidance powers are the subject of Chapter 10.

E. [Lecture 30: The Subrogation Powers of the Bankruptcy Trustee](#)

Despite its brevity in this textbook, this topic is critically important to the law of Secured Transactions and it will certainly be tested on the final examination. This portion of Chapter 9 incorporates by reference several of the cases we have already studied concerning the subrogation power of the bankruptcy trustee under Section 544(a) of the Bankruptcy Code as well as the power of a creditor to avoid fraudulent conveyances under state law.

When the petition in bankruptcy is filed, the trustee steps into the shoes of three different types of parties:

- 1. The debtor.** Under [Section 558](#), the bankruptcy trustee may assert any rights that the debtor could have asserted against the secured party.
- 2. A lien creditor.** Under [Section 544\(a\)](#), the bankruptcy trustee may assert the rights of a judgment creditor who has filed a lien against the property of the debtor. This means that under 9-317, a bankruptcy trustee defeats an unperfected secured party, but loses to a perfected secured party.
- 3. An unsecured creditor.** Under [Section 544\(b\)](#), the bankruptcy trustee steps into the shoes of an actual unsecured creditor.

1. The Rights of the Debtor – B.C. § 558

Section 558 of the Bankruptcy Code provides:

The estate shall have the benefit of any defense available to the debtor as against any entity other than the estate, including statutes of limitation, statutes of frauds, usury, and other personal defenses. A waiver of any such defense by the debtor after the commencement of the case does not bind the estate.

The following problem illustrates some of the defenses against a secured party that the bankruptcy trustee might inherit from the debtor.

Problem 58. The Trailers

GTI, Inc., sells and services small trailers for boats or for moving goods. Andover Bank promised to loan GTI \$100,000 and took a security interest in all of GTI's "inventory, equipment, and accounts, now-owned or hereafter acquired." The bank perfected its security interest by promptly filing a financing statement covering all of this collateral. GTI filed for bankruptcy and the bank sought to repossess the inventory and equipment and collect on the accounts. Can the bankruptcy trustee assert the following defenses against the bank?

- a. The security agreement is oral and the collateral is in the possession of the debtor.

- b. The bank fraudulently induced GTI to enter into the loan and security agreement.
- c. The bank violated the federal Truth-in-Lending Act (TILA) because it provided GTI with a misleading disclosure statement. See *In re Beach*, 447 B.R. 313 (Bankr. Ct. D. Idaho 2011).

2. The Rights of a Lien Creditor -- B.C. § 544(a)

Under Bankruptcy Code Section 544(a) a bankruptcy trustee succeeds to the rights of a hypothetical lien creditor. This is commonly referred to as the “strong arm” power of the bankruptcy trustee. Section 544(a)(1) provides:

- (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by
 - (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists

The priority between a secured party and a lien creditor is governed by [Section 9-317\(a\)\(2\)](#) of the U.C.C. That provision states:

- (a) Conflicting security interests and rights of lien creditors.** A security interest or agricultural lien is subordinate to the rights of all of the following:
 - ...
 - (2) Except as otherwise provided in subsection (e), a person that becomes a lien creditor before the earlier of the time:
 - (i) the security interest or agricultural lien is perfected; or
 - (ii) one of the conditions specified in [section 9203\(b\)\(3\)](#) (relating to enforceability) is met and a financing statement covering the collateral is filed.

Notice that there are **two** ways for a secured party to take priority over a bankruptcy trustee:

1. If the security interest is perfected before the petition in bankruptcy is filed; or

2. If before the petition in bankruptcy is filed the secured party has: (1) Filed a financing statement covering the collateral; and (2) the secured party and the debtor have entered into an enforceable security agreement.

Priority disputes under [Section 544\(a\)\(1\)](#) of the Bankruptcy Code are usually straightforward. If the security interest was perfected even one second before the petition for bankruptcy was filed then the bankruptcy trustee cannot avoid the security interest under the strong arm power. Many of the cases we have already studied arose in this context and turned upon whether the secured party had properly perfected its security interest before the filing for bankruptcy.

1. [*In re ProvidRx of Grapevine, LLC*](#) (Was the description of the collateral in the financing statement sufficient?)
2. [*In re 180 Equipment*](#) (same)
3. [*In re Wastetech*](#) (Did the financing statement contain the correct name of the debtor?)
4. [*In re B & M Hospitality, LLC*](#) (Was the description of the collateral in the financing statement sufficient?)
5. [*In re Palmer*](#) (Were the goods that were sold on credit “consumer goods” and was the seller’s purchase-money security interest therefore automatically perfected?)
6. [*In re Meridian Reserve*](#) (Did Article 9 apply to the assignment of accounts making it necessary for the purchaser to file a financing statement?)

Here is another case analyzing and applying the strong arm power of the bankruptcy trustee.

In re Jaghab
584 B. R. 472 (Bankr. Ct. E.D.N.Y. 2018)

Robert E. Grossman, United States Bankruptcy Judge

...

Having concluded that Flores and the Debtor each owned 50% of the shares of GJ & JF as of the Petition Date, the Court turns to whether Flores had a perfected lien on the shares owned by the Debtor. The Trustee recognizes that Flores was granted a security interest in the shares owned by the Debtor as of the Petition Date. However, the Trustee asserts that Flores never perfected his interest in the shares under New York law, which governs this dispute. See *In re Kors, Inc.*, 819 F.2d 19, 22–23 (2d Cir. 1987). If the Trustee is correct, then the Trustee, who assumes the status of a hypothetical lien creditor under 11 U.S.C. § 544(a)(1), can avoid Flores’s unperfected security interest for the benefit of the Debtor’s estate.

Flores was granted a security interest in the Debtor's shares of GJ & JF pursuant to the Security Agreement but because the stock certificates were never prepared, Flores never obtained possession of the shares pledged to him. Under Article 9 of the New York Uniform Commercial Code ("NY U.C.C."), both certificated and uncertificated securities are considered "investment property." NY U.C.C. § 9–102 (a)(49). NY U.C.C. § 8–102(4) defines a certificated security as "a security that is represented by a certificate." NY U.C.C. § 8–102(18) defines an uncertificated security as "a security that is not represented by a certificate." A secured party may perfect its interest in investment property by either (i) filing pursuant to Article 9 or (ii) obtaining control of the investment property. NY U.C.C. § 9–312 (a), (b); N.Y. UCC § 9–106. In this case a U.C.C. financing statement was never filed with the New York Department of State in connection with the Debtor's pledge of his shares to Flores as collateral for the 2013 Note. Therefore, Flores never perfected his security interest by filing in accordance with Article 9.

Under NY U.C.C. § 9–106, perfection of investment property is made via control over the investment property as provided in § 8–106. In turn, § 8–106 provides that a secured party has control of an uncertificated security if "(1) the uncertificated security is delivered to the purchaser; or (2) the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner." Flores did not perfect his interest in the stock by delivery because there was no stock ledger for GJ & JF. GJ & JF had no method of recording stock ownership, so there is no basis to find that a person other than the Debtor held the stock. There are also no facts showing that GJ & JF agreed to comply with the instructions of Flores without further consent by the registered owner. Without such evidence, the Court cannot find that Flores had a perfected lien on the Debtor's stock in GJ & JF. Therefore, as of the Petition Date, the Trustee, as the hypothetical lien creditor, owned 50% of the shares of GJ & JG, free of any perfected lien or claim asserted by Flores.

Practice Pointers.

1. Be sure to perfect your client's security interest before the debtor files for bankruptcy!
2. Keep in mind that even if the claim of the bankruptcy trustee under Section 544(a) fails, it is still possible that the trustee could use one of the **other** avoidance powers to take priority over the secured party and avoid the security interest.

3. The Rights of an Unsecured Creditor -- B.C. § 544(b)

The third subrogation power of the bankruptcy trustee is that the trustee succeeds to the rights of any **actual** unsecured creditor to avoid a transfer of property that the debtor made to a third party. The principal reason that an unsecured creditor would have the right to avoid a debtor's

transfer of property is that the transfer is a **fraudulent conveyance**, also known as a **fraudulent transfer** or **voidable transaction**.

There are two categories of fraudulent conveyance. A transfer by the debtor to another person may be an **actual** fraudulent conveyance or it may be a **constructive** fraudulent conveyance. An actual fraudulent conveyance is one that is made with the actual intent to hinder, delay, or defraud creditors. A constructive fraudulent conveyance is one that may be innocently made but which was made for less than “reasonably equivalent value” and that occurred when the debtor was insolvent or that rendered the debtor insolvent. Here is a simple example of a transfer that is both an actual fraudulent conveyance and a constructive fraudulent conveyance.

Problem 59. The China Shop

T.J. Halifax owned a china shop in Windsor, Massachusetts. Halifax borrowed \$20,000 from Erin Murtaugh. Murtaugh did not take a security interest in any of Halifax’s property. Halifax did not have enough money to pay personal bills or the bills for the store as they became due. Halifax then “sold” the store and all of its contents for \$1 to a favorite cousin, Worthy Halifax. Murtaugh seeks to avoid the conveyance from T.J. to Worthy as a fraudulent conveyance.

- a. Why is this transfer from T.J. to Worthy an actual fraudulent conveyance?
- b. Why is this transfer from T.J. to Worthy a constructive fraudulent conveyance?
- c. How many of the “badges of fraud” are present in this transaction? (You will have to peek ahead to [12 Pa. C. S. 5104\(b\)](#) to see the 11 “badges of fraud” in the law of fraudulent conveyances.)

The trustee’s avoidance power under Section 544(b) of the Bankruptcy Code has several characteristics.

1. Like the other avoidance powers based on **subrogation** that we have studied in this chapter this power is derivative; the trustee derives its right to avoid a transfer from the right of another person, an unsecured creditor to whom the debtor is indebted.
2. Unlike the strong arm power under Section 544(a) of the Bankruptcy Code in which the trustee is automatically vested with the power of a **hypothetical** lien creditor even though no actual lien creditor exists, under Section 544(b) there must be an **actual** unsecured creditor with the power to avoid the transfer. To exercise this power the bankruptcy trustee must look for and find an unsecured creditor of the debtor who was the victim of the debtor’s fraudulent transfer of property to another debtor.

3. Under Section 544(b) the avoidance power of the bankruptcy trustee is **absolute**. The trustee is not limited by the amount of money that the debtor owed to the actual unsecured creditor. If the debtor owed the unsecured creditor \$100 and fraudulently transferred worth \$1 million to a third party, the bankruptcy trustee could avoid the entire transaction and have the court return the entire \$1 million worth of property to the bankruptcy estate. (This is the doctrine of *Moore v. Bay*, 284 U.S. 4 (1931).)

4. As with the other subrogation powers, under Section 544(b) the powers of the bankruptcy trustee are rights that arise under **state law**, not federal law. The **state** fraudulent conveyance statute determines whether the bankruptcy trustee can invalidate a transfer under Section 544(b).

5. Under state law the normal **statute of limitations** to undo a fraudulent transfer is four years. However there are special rules that apply in certain situations that can allow the bankruptcy trustee to avoid fraudulent transfers over a longer period of time. The Internal Revenue Service, for example, can invalidate fraudulent transfers going back ten years. If the debtor owed taxes when a fraudulent transfer was made then under Section 544(b) a bankruptcy trustee could invalidate a fraudulent transfer made at any time over the ten-year period prior to the filing for bankruptcy.

Three sections of the current Pennsylvania fraudulent conveyance statute are presented below. Section 5101 is the title of the act. Section 5104 governs the avoidance powers of present or future creditors. And Section 5105 contains an avoidance power that is available only to present creditors.

12 Pa. C.S. § 5101.

(a) **Short title of chapter.** This chapter, that was formerly cited as the Pennsylvania Uniform Fraudulent Transfer Act [Ed.- PUFTA], shall be known and may be cited as the Pennsylvania Uniform Voidable Transactions Act [Ed.- PUVTA].

12 Pa. C.S. § 5104. Transfer or obligation voidable as to present or future creditor

(a) **General rule.** A transfer made or obligation incurred by a debtor is voidable as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

- (1) with actual intent to hinder, delay or defraud any creditor of the debtor; or
- (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
 - (i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

(ii) intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due.

(b) **Certain factors.** In determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether:

- (1) the transfer or obligation was to an insider;
- (2) the debtor retained possession or control of the property transferred after the transfer;
- (3) the transfer or obligation was disclosed or concealed;
- (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
- (5) the transfer was of substantially all the debtor's assets;
- (6) the debtor absconded;
- (7) the debtor removed or concealed assets;
- (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
- (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
- (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and
- (11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

(c) **Burden of proof.** A creditor making a claim for relief under subsection (a) has the burden of proving the elements of the claim for relief by a preponderance of the evidence.

12 Pa. C.S. § 5105. Transfer or obligation voidable as to present creditor

(a) **General rule.** A transfer made or obligation incurred by a debtor is voidable as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

(b) **Burden of proof.** Subject to section 5102(b) (relating to insolvency), a creditor making a claim for relief under subsection (a) has the burden of proving the elements of the claim for relief by a preponderance of the evidence.

Questions.

1. What is the difference between Section 5104(a)(1) and Section 5104(a)(2)?

2. What is the difference between Section 5104 and Section 5105?

Problem 60. Perfecting Just Before a Judgment Lien

Aman Calim sold Precision Swage, Inc. (PST), to Daniel Comer. Daniel Comer was also the trustee of the Comer Family Trust. The Comer Family Trust loaned \$800,000 to PST and took a security interest covering PST's assets but the Trust did not perfect its security interest. On August 14, 1995 Calim won a lawsuit against Comer in a dispute growing out of the sale of the business to Comer. On August 24 the Comer Family Trust, under the direction of Daniel Comer, perfected its security interest in the assets of PST. Was the perfection of the security interest in PST's assets by the Comer Family Trust a "transfer" within the meaning of the Ohio Fraudulent Transfer Act? Was the perfection a "fraudulent transfer?" See *Comer v. Calim*, 128 Ohio App. 3d 599 (1st Dist. Ct. App. Ohio 1998).

In Lesson 10 we shall discuss the history of the law of fraudulent conveyances and we shall study the independent power of a bankruptcy trustee to avoid fraudulent conveyances under Section 548 of the Bankruptcy Code.

End of Chapter 9

Chapter 10. Bankruptcy, continued. Power of the Bankruptcy Trustee to Avoid Preferences and Voidable Transactions

The most important test for a security interest is whether it will be valid in bankruptcy. In Lesson 9 we studied the subrogation powers of a bankruptcy trustee as a lien creditor ([B.C. Section 544\(a\)](#)); as an unsecured creditor ([B.C. Section 544\(b\)](#)); and as the debtor ([B.C. Section 558](#)). In Lesson 10 we will study the power of a bankruptcy trustee to avoid preferential transfers ([B.C. Section 547](#)) and fraudulent transfers ([B.C. Section 548](#)).

A bankruptcy trustee represents the interests of the unsecured creditors of the debtor. The trustee is empowered to avoid preferences and fraudulent conveyances because both of these types of transfers are unfair to the other creditors of the debtor. Because of the subject matter of this course this chapter primarily concentrates on the types of transfers from a debtor to a secured party that a bankruptcy trustee may avoid as either a preference or a fraudulent conveyance.

A. Learning Objectives

After watching the recorded lecture, taking the quiz, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Identify the five elements of a preferential transfer established by § B.C. 547(b).
2. Determine whether a transfer by a debtor who is now in bankruptcy was a preferential transfer within the meaning of § B.C. 547(b).
3. Identify the nine exceptions to the rule against preferential transfers under § B.C. 547(c).
4. Determine whether a preferential transfer by a debtor who is now in bankruptcy was covered by any of the exceptions under B.C. 547(c).
5. Analyze whether a transfer by the debtor is avoidable by a bankruptcy trustee as a preference.
...
6. Identify the elements of an actual fraudulent transfer.

7. Identify the badges of fraud and the legal consequence if one or several of the badges of fraud are present.
8. Describe the import and the legal effect of the “legitimate supervening purpose” test.
9. Identify the elements of a constructive fraudulent transfer.
10. Analyze whether a transfer by a debtor is avoidable by a bankruptcy trustee as an actual or constructive fraudulent transfer.

B. Lecture 31. The Avoidance Powers of the Bankruptcy Trustee

Lecture 31 and the accompanying quiz provide a general introduction to the power of a bankruptcy trustee to avoid preferential transfers and fraudulent transfers.

Preferences are transfers in the period before bankruptcy that favor one creditor over others. In general terms, if a debtor is insolvent and owes money to two creditors and chooses to pay one creditor rather than the other before filing for bankruptcy, the payment is a “preference,” and the bankruptcy trustee can recover the amount of the payment from the creditor who received it.

In Chapter 9 we studied fraudulent transfers and we return to that topic in Chapter 10. For centuries the law has recognized that a person who owes money may seek to avoid paying the debt by transferring their assets to someone else, and if a creditor objects the courts will declare the transfer void and return the property to the debtor so that the creditor can reach it. Such a transfer has traditionally been called a “fraudulent conveyance;” more modern terms are “fraudulent transfer” or “voidable transaction.” As we saw in Chapter 9 there are two kinds of fraudulent conveyances: actual fraudulent conveyances and constructive fraudulent conveyances. In Chapter 9 we focused on the subrogation power of the bankruptcy trustee to assert the rights of an actual unsecured creditor to avoid a transfer that was fraudulent as to that creditor. In Chapter 9 we learn that a bankruptcy trustee is granted an independent power to avoid fraudulent transfers.

The Bankruptcy Code grants bankruptcy trustees the power to avoid **both** preferences and fraudulent transfers. Each of those avoidance powers is explored in more depth below.

C. The Power of the Bankruptcy Trustee to Avoid Preferential Transfers Under B.C. Section 547

Preferential transfers are analyzed by asking two questions:

1. Is the transfer a preference under Section 547(b) of the Bankruptcy Code?

2. If so, does one of the exceptions to the rule against preferences under Section 547(c) of the Bankruptcy Code apply?

If a transfer qualifies as a preference under Section 547(b) and does not fall into any of the exceptions under Section 547(c) then the bankruptcy trustee has the right to avoid the transfer and have the assets returned to the bankruptcy estate.

1. Definition of a Preference Under B.C. § 547(b)

“Preferences” are transfers of property by the debtor to a creditor that unfairly “prefer” that creditor over the other creditors of the debtor.

Preferences are defined in [Section 547\(b\)](#) of the Bankruptcy Code. A preferential transfer is:

1. A transfer from a debtor to or for the benefit of a creditor;
2. Made while the debtor was insolvent;
3. On account of an antecedent debt;
4. Within 90 days of the filing of the bankruptcy petition (or within 1 year if the creditor is an insider);
5. That enables the creditor to receive more than it otherwise would have received under Chapter 7 in bankruptcy.

Each of the required elements of a preferential transfer are described in more detail below. A preference is:

1. A transfer from a debtor to or for the benefit of a creditor.

Statutory Language

§ 547(b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any **transfer** of an interest of the debtor in property –

- (1) to or **for the benefit** of a creditor

Explanation

“**Transfer.**” Some actions are obviously “transfers” such as a payment of money or a transfer of a deed of real property to a favored creditor. The granting of a security interest is also a “transfer.” The definition of a “transfer” under the Bankruptcy Code includes the creation of a

“lien” and a “lien” clearly includes an Article 9 security interest. See [Section 101\(54\)](#) of the Bankruptcy Code (defining “transfer”) and [Section 101\(37\)](#) (defining “lien”).

“To or for the benefit of a creditor.” A payment that is made directly to a creditor may qualify as a preference. But what if the payment is made to someone else? A payment that is made “for the benefit” of a creditor may also qualify as a preference, as the following problem illustrates:

Problem 61. For Whose Benefit?

Carter Corporation owed \$8,000 to Markup, LLC, which owed \$10,000 to Second Street Bank. Two weeks before filing for bankruptcy Carter paid \$5,000 to Second Street Bank, and the bank canceled \$5,000 of the debt that Markup owed the bank. The bankruptcy trustee sent Second Street Bank a letter demanding that bank turn over the \$5,000 that the bank received from Carter Corporation as a preference. The bank responded that the \$5,000 payment was not a preference because the bank was not a “creditor” of Carter Corporation. Is the bank correct?

2. Made while the debtor was insolvent

Statutory Language

§ 547(b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(2) made while the debtor was insolvent ...

§ 101(32). The term “insolvent” means –

(A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity’s debts is greater than all of such entity’s property, at a fair valuation, exclusive of—

(i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity’s creditors; and

(ii) property that may be exempted from property of the estate under section 522 of this title

§ 547(f). For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

§ 547(e)(3) For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

Explanation

"Insolvent." Under [B.C. Section 101\(32\)](#) a debtor is "insolvent" when their liabilities exceed their assets. This is referred to as "balance sheet" insolvency and that is the definition of insolvency that applies in determining whether a transfer was a "preference." (As we shall see below in determining whether a transfer was a "constructive fraudulent transfer" under B.C. Section 548 a broader definition of "insolvency" applies.)

Under [B.C. Section 547\(f\)](#), for purposes of determining whether a transfer was an avoidable preference, the Bankruptcy Code presumes that the debtor was insolvent during the 90-day preference period. This is a rebuttable presumption. A creditor who has been paid during this period is permitted to introduce evidence that the debtor was solvent when the transfer was made. If the creditor can prove that the debtor was solvent when the transfer was made then the transfer cannot be avoided as a preference.

Problem 62. Insolvent?

Portland Plumbers owned the building where it did business, the building was not mortgaged, and the building was worth \$500,000. However business was bad and Portland was unable to pay all its bills. On August 1 Portland paid Midland, a secured creditor, \$15,000. Midland had a security interest in Portland's inventory, equipment, and accounts. After receiving the payment from Portland Midland was still owed \$20,000, which was also the value of the inventory, equipment, and accounts. On September 1 a fire burned down Portland's building, which was uninsured. Portland declared bankruptcy on October 1 with total unsecured debts of \$200,000. The bankruptcy trustee wrote a letter to Midland demanding the return of the \$15,000 payment as a preference. Was it a preference? Who has the burden of proof on this issue?

"Made." In general under [B.C. Section 547\(e\)](#) the transfer of a security interest is "made" when it is "perfected." Accordingly if a security interest is **perfected** before the start of the 90-day period before bankruptcy then the security interest is not a preferential transfer because the transfer did not occur during the 90-day period before bankruptcy.

However, a security interest in after-acquired property presents a special problem. Normally under Article 9 the time of perfection for after-acquired property is the time when the security interest was originally perfected. In contrast under [Section 547\(e\)\(3\)](#) of the Bankruptcy Code a security interest in property is not "perfected" until the debtor acquires "rights in the collateral." This means that even though the security interest was originally perfected before the start of the 90-day preference period, if the debtor acquires property that becomes subject to the security interest during the 90-day preference period then the security interest in the after-acquired property is deemed to have been perfected **at the moment when the debtor acquired the property**. This means that the transfer was made during the preference period on

account of an antecedent debt. If the other three elements of Section 547(b) are also satisfied and none of the exceptions of Section 547(c) apply then the bankruptcy trustee may avoid a security interest in after-acquired property as a preferential transfer.

Problem 63. Time of the Transfer?

In 2016 Carnegie Investors loaned \$100,000 to Munhall Video, a start-up company that designed video games. Carnegie took a security interest in all of Munhall's equipment and properly perfected the security interest by filing a financing statement. On April 15, 2020 Munhall purchased an expensive computer server using its own funds. On June 1, unfortunately, after struggling for months, Munhall filed for bankruptcy. The bankruptcy trustee has written to Carnegie Investors demanding the release of the security interest in the server claiming that there has been a preferential transfer. Is the trustee correct?

3. On account of an antecedent debt.

Statutory Language

§ 547(b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(3) for or on account of an antecedent debt owed by the debtor before such transfer was made....

Explanation

"Antecedent debt." If a transfer is made to a creditor **contemporaneously** with the assumption of a debt then the transfer is not a preferential transfer. Only transfers to a creditor on account of an **antecedent debt** can be preferences. If a transfer was made to a person who is **not a creditor** – a person to whom **no debt is owing** – then the transfer is not a preference. Such a transfer might be a well-intentioned gift or an action undertaken to defraud creditors. Even though such a transfer would not be a preference it might be avoidable as an actual or constructive **fraudulent conveyance**.

Problem 64. On Account of an Antecedent Debt?

Kyrie, a physical therapist, made transfers to three different persons on November 10.

- a. Kyrie entered into a security agreement with Upsilon Finance granting Upsilon a security interest in Kyrie's accounts receivables. Upsilon filed a financing statement covering the accounts the same day. Kyrie had borrowed \$12,000 from Upsilon a year ago and still owed the entire principal amount.

- b. Kyrie paid Septuagint Medical Equipment \$2,500 in return for a new exam table worth the same amount.
- c. Kyrie gave their mother Mary Elizabeth \$5,000 in cash. Kyrie did not owe their mother anything. (Except the gift of life, of course!)

Kyrie filed for bankruptcy on December 20. The bankruptcy trustee wrote to Upsilon, Septuagint, and Mary Elizabeth and demanded return of the payments and release of the security interest as preferential transfers. Is the trustee correct?

4. Within 90 days of the filing of the bankruptcy petition (or within 1 year if the creditor is an insider).

Statutory Language

§ 547(b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(4) made—

- (A) on or within 90 days before the date of the filing of the petition; or
- (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider

Explanation

“Insider.” Transfers that were made before the 90-day preference period are not avoidable as preferences unless the transfer was to an insider, in which case a one-year preference period applies. [Section 101\(31\)](#) of the Bankruptcy Code defines an “insider” as including a relative, a general partner, or a director, officer, or other person in control of a corporation.

Problem 65. Insider?

Eleven months ago Baseline Corporation transferred all of its valuable patents to VBG Inc., a corporation which is owned by T. Summers, the CFO of Baseline. Today Baseline declared bankruptcy.

- a. Assume that in return for the patents VBG canceled \$2 million in indebtedness that Baseline owed to VBG. Would the transfer of the patents potentially be a preference?
- b. In the alternative assume that in return for the patents VBG paid Baseline \$1. Would the transfer of the patents potentially be a preference?

5. That enables the creditor to receive more than it otherwise would have received under Chapter 7 in bankruptcy.

Statutory Language

§ 547(b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(5) that enables such creditor to receive more than such creditor would receive if—

- (A) the case were a case under chapter 7 of this title;
- (B) the transfer had not been made; and
- (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Explanation

“Receive more.” The fifth and final element of a preferential transfer is that as a result of the transfer the creditor receives more than it would have in a proceeding under Chapter 7 of the Bankruptcy Code. If a secured party was **oversecured** at all times during the preference period then transfers to the secured party during the preference period would not result in the secured party receiving more than it would have under Chapter 7. Only transfers made to a secured party who is **undersecured** have the potential to be preferential transfers.

Problem 66. Oversecured?

Forest Bank was owed \$150,000 by Severance Company and had a security interest in collateral worth \$250,000. One day before bankruptcy Severance paid Forest Bank \$25,000. Was this a preference?

There are four common types of transactions between debtors and secured parties that constitute preferential transfers. A preference may occur if during the 90-day period before bankruptcy: (1) the debtor grants the secured party a security interest in collateral to secure a preexisting debt; (2) the debtor makes a payment to the secured party; (3) the secured party perfects its security interest; or (4) the debtor acquires property that becomes subject to an existing perfected security interest. These last three of these common situations are illustrated in the following problem.

Problem 67. Different Types of Preferences?

Sunrise Leasing owns a fleet of automobiles as well as a repair facility to keep the cars in sound mechanical condition. In 2016 Andreas Bank loaned Sunrise \$12 million and took a security interest in “all of the inventory and equipment, now-owned and hereafter acquired” belonging to Sunrise. However, the financing statement that the bank filed against Sunrise only covered “equipment.” The inventory belonging to Sunrise was worth no more than \$2 million at all times during the year 2020 and the equipment was worth about \$1 million during the same time period. Sunrise filed for bankruptcy on March 31, 2020. Earlier that year the following transactions occurred:

- a. On January 15 the bank filed an amendment to the financing statement covering “inventory.”
 - b. On March 1 Sunrise paid the bank \$8 million. This was unusual; under the security agreement Sunrise was only required to make interest payments of \$50,000 to the bank on the first of every month.
 - c. On March 10 Sunrise purchased six new hydraulic lifts for \$200,000.
1. Were each of these transactions a preference? Do these transactions satisfy all five elements of a preferential transfer under B.C. § 547(b)?
 2. What is the policy behind the rule against preferences? Why should the bankruptcy trustee have the right to avoid each of these transfers?

The bankruptcy trustee has the burden of proving that a preferential transfer has occurred within the meaning of [B.C. Section 547\(b\)](#). The trustee must prove to the court that all five elements of Section 547(b) have been satisfied.

But that is not the end of the inquiry. Once the court has determined that a transaction between the debtor and the secured party was a preferential transfer under Section 547(b) then the secured party is given the opportunity to prove that one of the exceptions to the rule against preferences under [Section 547\(c\)](#) applies. If one of the exceptions contained in B.C. Section 547(c) applies then the bankruptcy trustee is **not** entitled to avoid the transfer.

Consider the following variations on the previous problem.

Problem 68. Different Types of Preferences?, reprised

As in the previous problem Andreas Bank loaned \$12 million and took a security interest in the existing and after-acquired inventory and equipment of Sunrise Leasing. However, this time assume that one of the following alternatives occurred:

- a. The inventory belonging to the debtor was at all times during 2020 worth more than \$15 million and the equipment was at all times worth more than \$14 million; or
- b. On January 15 the bank did not file an amendment to its financing statement because the original financing statement that the bank filed in 2016 covered the debtor's inventory as well as equipment; or
- c. On March 1 Sunrise made its regular monthly payment of interest to the bank in the amount of \$50,000 as required by the security agreement; or
- d. On March 10 instead of acquiring six new hydraulic lifts Sunrise acquired six new automobiles for its fleet.

In a and b there was not an avoidable preference within the meaning of B.C. Section 547(b). In c there was not an avoidable preference because one of the exceptions in Section 547(c) applies; the exception for a "payment of a debt in the ordinary course of business" exception under B.C. Section 547(c)(2). In d it is possible that this was also not an avoidable preference because of another exception contained in Section 547(c); the "floating lien" rule of Section 547(c)(5). In class we will discuss these and other exceptions to the rule against preferences.

What **policies** make the results in this problem different from the results of the previous problem? **Why** would the bankruptcy trustee have the right to avoid the transfers in the previous problem but not the transfers in this problem?

We shall now turn our attention to the nine exceptions to the rule against preferential transfers.

2. Exceptions to the Rule Against Preferences

Just because a transfer meets all five elements of a preferential transfer under Section 547(b) does not mean that the transfer is avoidable as a preference. It is also necessary that none of the exceptions of Section 547(c) to the rule against preferences applies.

Presented below are the nine exceptions to the rule against preferential transfers. The number of the paragraphs below correspond to the numbering of the paragraphs of Section 547(c) of the bankruptcy code. Each of the paragraphs below name the exception; set forth the statutory

language of the exception; contain a brief description of the exception; and pose a problem illustrating the exception.

Just because **one** of the following exceptions does not apply to a transfer does not mean that the transfer is a preference. Instead, if **any one** of the following exceptions applies to a transfer of property then the transfer is **not avoidable as a preference**.

1. Substantially contemporaneous exchange

Statutory Language

Section 547(c). The trustee may not avoid under this section a transfer –

- (1) to the extent that such transfer was--
 - (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
 - (B) in fact a substantially contemporaneous exchange

Explanation

“Substantially contemporaneous.” If the secured party gives the debtor “new value” at about the same time as the debtor made a transfer to the secured party then the transfer is not a preference.

Problem 69. Substantially Contemporaneous?

On Day 60 prior to bankruptcy secured party loaned the debtor \$60,000. On that same date the secured party took a security interest in collateral belonging to the debtor worth the same amount and the secured party also perfected the security interest on the same day.

- a. Is the security interest avoidable as a preference?
- b. If the secured party perfected the security interest two days later would the security interest be avoidable as a preference?
- c. If the secured party perfected the security interest on Day 20 prior to bankruptcy would the security interest be avoidable as a preference?
- d. If the secured party had failed to perfect the security interest would the security interest be avoidable under any of the trustee’s avoidance powers?

2. Payment of a Debt in the Ordinary Course

Statutory Language

Section 547(c). The trustee may not avoid under this section a transfer –

- (2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was--
 - (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
 - (B) made according to ordinary business terms

Explanation

“Payment in the ordinary course.” If the debtor incurred a debt to the secured party in the ordinary course of business and the debtor made a payment to the secured party in the ordinary course of business or made the payment according to ordinary business terms (that is, terms that are standard in the industry) then the transfer is not avoidable as a preferential transfer.

This exception to the rule against preferences was the subject of two previous problems in which the debtor Sunrise Leasing made payments to the secured party Andreas Bank on a \$12 million debt. In one problem the debtor paid \$8 million all at once during the preference period, and in the other problem the debtor only made the usual monthly interest payments of \$50,000 called for in the loan agreement. The payment of \$8 million is an avoidable preference, but the monthly interest payments are not avoidable transfers.

It can be difficult to determine whether a payment was made “in the ordinary course.” Two points are important to remember about this exception to the rule against preferences.

1. Either the payment must be in the ordinary course of business for **both** the debtor and the creditor who received payment;
2. Or the payment must be in the ordinary course of other parties in the same trade or industry. See *In re Turner Grain Merchandising, Inc.*, 595 B.R. 295 (Bankr. Ct. E.D. Ark. 2018).

3. Purchase-Money Security Interest

Statutory Language

Section 547(c). The trustee may not avoid under this section a transfer –

- (3) that creates a security interest in property acquired by the debtor--
 - (A) to the extent such security interest secures new value that was--
 - (i) given at or after the signing of a security agreement that contains a description of such property as collateral;

- (ii) given by or on behalf of the secured party under such agreement;
 - (iii) given to enable the debtor to acquire such property; and
 - (iv) in fact used by the debtor to acquire such property; and
- (B) that is perfected on or before 30 days after the debtor receives possession of such property

Explanation

"Purchase-money security interest." If a purchase-money security interest is perfected within 30 days after the debtor receives possession of the property then the perfection of the security interest is not an avoidable preference.

Problem 70. PMSI?

NewStar Productions borrowed \$200,000 from Omega Bank for the express purpose of using the funds to purchase equipment for the production of documentaries. NewStar used the funds to purchase cameras, microphones, and editing software and workstations. The equipment arrived at NewStar's studio on June 1. Omega Bank properly filed a financing statement covering the equipment on June 25.

Was the perfection of the security interest by the bank an avoidable preference?

4. To the Extent of New Value Given Not Secured by an Unavoidable Security Interest

Statutory Language

Section 547(c). The trustee may not avoid under this section a transfer –

- (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor--
 - (A) not secured by an otherwise unavoidable security interest; and
 - (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor

Explanation

"New Value." This exception to the rule against preferences has three elements: (1) If the secured party gives new value to the debtor that is **not** secured by collateral; (2) If the new value was given **after** the secured party received an avoidable preference; and (3) If the secured party has not been compensated for the new value that was given, then the avoidable preference is reduced by the amount of new value that the secured party gave to the debtor.

Problem 71. New Value?

In 2017 Palmetto Industries LLC (an ice-cream store) borrowed \$50,000 from First Avenue Bank; the bank took a security interest in the store's delivery truck which was worth only \$12,000. On July 1, 2020 the bank demanded that the debtor pay off half of the loan, and Palmetto paid the bank \$25,000. On August 1 Palmetto asked the bank for an emergency loan of \$5,000 to purchase supplies. The bank granted the loan the same day. The initial security agreement for the \$50,000 loan did not include a future advance clause, and the loan agreement for the \$5,000 loan did not include a security agreement. The debtor did not repay any portion of the \$5,000 loan. On August 15 the debtor filed for bankruptcy.

To what extent has there been an avoidable preference?

5. To the Extent That There Has Been No Increase in the Equity of a Floating Lien (the "Improvement of Position" Test)

Statutory Language

Section 547(c). The trustee may not avoid under this section a transfer –

(5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of --

(A)

(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or

(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

(B) the date on which new value was first given under the security agreement creating such security interest

Explanation

The "improvement of position" test for floating liens. A longstanding problem in the law of preferences was how to treat security interests in "after-acquired property." Formerly the United States Supreme Court had ruled that the time of transfer for after-acquired property was the time of perfection. This meant that in most cases the time of transfer would be the time that the financing statement was filed, and that the debtor's acquisition of property that was collateral could "feed" the security interest and would not constitute a preference. Congress reversed this holding by enacting Section 547(e)(3) of the Bankruptcy Code, which provides:

“For purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.”

The effect of this provision is to potentially make any acquisition of property that becomes collateral under an after-acquired property clause during the 90-day period before bankruptcy an avoidable preference. This would be devastating to creditors who have a security interest in inventory or accounts, because these types of collateral are constantly being acquired by the debtor and become subject to the creditor’s security interest, replacing the inventory that is sold and the accounts that are paid off. Without some protection for such creditors the law of preferences would give the bankruptcy trustee priority in all of the inventory and accounts acquired by the debtor during the 90-day period as well as the proceeds of that collateral. Accordingly Congress also adopted Section 547(c)(5) of the Bankruptcy Code to provide a “safe harbor” for creditors with a security interest in inventory and accounts. This section provides that the bankruptcy trustee may not avoid a security interest in “inventory or a receivable or the proceeds of either except to the extent that the aggregate of all such transfers to the transferee caused a reduction” of the secured party’s unsecured debt during the 90-day preference period. The following problem explores some of the nuances of the “improvement of position” test under Section 547(c)(5).

Problem 72. The “Big Box” Floating Lien

World Discount, Inc., operates “big box” stores in the State of Georgia. Peach Bank loaned World Discount \$11 million and took a security interest in World’s inventory on March 31, 2018. World Discount declared bankruptcy precisely one year later on March 31, 2019. During the 90-day preference period World made payments in the ordinary course to Peach Bank in the amount of \$333,333.33 per month just like it had every month in accordance with the security agreement. The payments from World during the 90-day preference period, a total of \$1 million, reduced World’s indebtedness to Peach Bank from \$9 million to \$8 million. Here is the value of World’s inventory, accounts, cash on hand, and cash proceeds in deposit accounts that are traceable to the sale of inventory on January 1 and March 31.

January 1:

Inventory	\$2.5 million
Accounts	\$1.7 million
Cash proceeds of inventory in deposit accounts	\$0.8 million
TOTAL	\$5 million

March 31

Inventory	\$5.5 million
Accounts	\$1.0 million
Cash proceeds of inventory in deposit accounts	\$0.5 million
TOTAL	\$7 million

- a. To what extent has Peach Bank received a preferential transfer from World Discount?
- b. Explain the **policy** behind this result. **Why** under these circumstances should the bankruptcy trustee have the right to recover this amount from Peach Bank?
- c. Assume that **all** of the inventory and accounts that existed on January 1 had been replaced by new inventory and accounts by March 31. All of these assets would be “after-acquired” collateral which were perfected during the preference period. **Why** shouldn’t **all** of it be recoverable by the bankruptcy trustee as a preferential transfer?
- d. Questions b and c in this problem are asking you what the policy is behind the **improvement of position test** that applies to inventory, accounts, and the proceeds of inventory and accounts that are acquired during the preference period. In your opinion is the improvement of position test an appropriate compromise between the interests of secured creditors and the interests of other creditors represented by the bankruptcy trustee?

Finally, keep in mind that if the secured party is **oversecured** during the preference period then an improvement of position in the amount of collateral is **not** a preferential transfer because such an improvement does not allow the secured creditor to recover more than it would have received in Chapter 7. See *In re Smith’s Home Furnishings, Inc.*, 265 F.3d 959 (9th Cir. 2001).

6. The Fixing of a Statutory Lien Not Avoidable Under B.C. Section 545

Statutory Language

Section 547(c). The trustee may not avoid under this section a transfer—
(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title

Explanation

This exception to the rule against preferences has no application to security interests because security interests are **consensual** liens created by contract, not statutory liens. The exception does apply, however, to agricultural liens and to liens arising automatically under Article 2, such as a lien arising under U.C.C. Section 2-711(3) in favor of a buyer who has rightfully rejected goods. Agricultural liens and security interests arising under U.C.C. Section 2-711(3) are not avoidable preferences even though they arise during the 90-day period before filing for bankruptcy.

7. Payment of domestic support obligations

Statutory Language

Section 547(c). The trustee may not avoid under this section a transfer –
(7) to the extent such transfer was a bona fide payment of a debt for a domestic support obligation

Explanation

Payments on a debt for the support of a spouse or children are not avoidable preferences.

8. Transfers of less than \$600 in consumer debt cases

Statutory Language

Section 547(c). The trustee may not avoid under this section a transfer –
(8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than \$600

Explanation

This is a *de minimis* exception for preferences that total less than \$600 in consumer bankruptcy cases.

9. Transfers of less than \$5,000 in commercial debt cases

Statutory Language

Section 547(c). The trustee may not avoid under this section a transfer –
(9) if, in a case filed by a debtor whose debts are not primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than \$5,000.

Explanation

This is a *de minimis* exception for preferences that total less than \$5,000 in commercial bankruptcy cases.

The following case illustrates the legal consequence of filing a financing statement in the wrong state.

In re Qualia Clinical Service, Inc., 652 F3d 933 (8th Cir. 2011)

Inova Capital Funding loaned money to Qualia Clinical Service, Inc., in 2007 and took a security interest in Qualia's accounts. Inova filed a financing statement in Nebraska, where the clinic was located, instead of Nevada, where the clinic was incorporated. Inova did not discover its mistake and file a financing statement in Nevada until February 19, 2009. Qualia filed for bankruptcy one month later on March 18, 2009.

The court ruled that the late filing constituted a preference under Section 547(b) of the Bankruptcy Code, and the court found that none of the exceptions of Section 547(c) that Inova argued for were applicable. Accordingly the bankruptcy trustee had the right to avoid Inova's security interest and was entitled to take Qualia's accounts for the benefit of the bankruptcy estate.

Practice Pointer.

1. Inova's first mistake was to file the financing statement in the wrong state leading eventually to the loss of the collateral when the debtor declared bankruptcy. Inova's lawyers scrambled to recover from this error but were unable to. Legal mistakes tend to have a cascade effect.
2. In its brief to the appellate court Inova attempted to argue that several of the exceptions of Section 547(c) were applicable, but then it abandoned some of these arguments at oral argument. Lawyers face a difficult choice on appeal just as they do in presenting a claim or defense at trial. Which legal theories should we pursue on behalf of our clients? Should we try the "kitchen sink" approach or should we narrowly focus on our strongest argument? We don't like to concede a secondary argument that might persuade a court or a jury, but we also don't want to seem unsure of our principal argument. The Court of Appeals summarily dismissed Inova's claims that were abandoned at oral argument.

We now turn from the study of **preferential transfers** to the subject of **fraudulent transfers**.

D. The Power of the Bankruptcy Trustee to Avoid Fraudulent Transfers Under B.C. Section 548

In Chapter 9 we learned that fraudulent conveyances consist of two types of transfers: transfers that are **actually fraudulent** and transfers that are **constructively fraudulent**. Transfers that are actually fraudulent are transfers from the debtor to another party that are made with the intent to hinder, delay, or defraud creditors. If a transfer exhibits one of the 11 "badges of fraud" then the court may place the burden of proof on the person who received the transfer to prove that the transfer was not intentionally fraudulent. Constructively fraudulent transfers are transfers that are made for less than fair equivalent value at a time when the debtor is insolvent.

Also in Chapter 9 we learned that bankruptcy trustees can use their power under [B. C. Section 544\(b\)](#) to invalidate fraudulent conveyances. Under that provision of the Bankruptcy Code bankruptcy trustees are subrogated to the rights and powers of any actual unsecured creditor of the debtor; if a transfer was fraudulent as to that creditor under state law then the bankruptcy trustee can avoid the transfer.

In Chapter 10 we are studying the additional power that is granted to the bankruptcy trustee under [B.C. Section 548](#) to avoid fraudulent transfers. We shall first look to the history of the law: the Fraudulent Conveyances Act of 1571. We shall then examine the statutory language of Section 548 and compare it to the language of Pennsylvania's enactment of the Uniform Voidable Transactions Act (PUVTA). We shall then consider some difficult cases applying B.C. Section 548.

[1. The Fraudulent Conveyances Act of 1571 and Twyne's Case](#)

In 1571 the British Parliament enacted the Fraudulent Conveyances Act, also known as the Act of 13 Elizabeth. The law states that it was made "For the avoiding of feigned, covinous and fraudulent feoffments, gifts, grants, alienations, bonds, suits, judgments and executions" of real property as well as "goods and chattels" when those transfers were made "to the end, purpose and **intent to delay, hinder or defraud creditors.**" In 1602 the Star Chamber decided *Twyne's Case*, in which a debtor, Pierce, was sued by a creditor, "C." While the case was pending Pierce conveyed all of his property to Twyne, but still kept the property and treated it like his own. Sir Edward Coke, the Queen's Attorney General, brought this case against Twyne for violating the Act of 1571. Coke reports that the judges of the Star Chamber found that this transfer from Pierce to Twyne was in violation of the Act because it had the "signs and marks of fraud." Coke reported:

1st. That this gift had the signs and marks of fraud, because the gift is general, without exception of his apparel, or anything of necessity ; for it is commonly said, [*quod dolus veratur in generalibus.*](#)

2nd. The donor continued in possession, and used them as his own ; and by reason thereof he traded and trafficked with others, and defrauded and deceived them.

3rd. It was made in secret, [*et dona clandestine sunt semper suspiciosa.*](#)

4th. It was made pending the writ.

5th. Here was a trust between the parties, for the donor possessed all, and used them as his proper goods, and fraud is always apparelled and clad with a trust, and a trust is the cover of fraud.

6th. The deed contains, that the gift was made honestly, truly, and *bona fide; et clausulae inconsuet semper inducunt suspicionem.*

Human nature hasn't changed much in 450 years and the law prohibiting transfers that "hinder, delay or defraud creditors" has changed much either. The Uniform Fraudulent Conveyance Act of 1918, the Uniform Fraudulent Transfer Act of 1984, and the Uniform Voidable Transactions Act of 2014 all preserve the language of the Fraudulent Conveyances Act of 1571 invalidating transfers that were made with the intent to "hinder, delay, or defraud creditors."

Section 548 of the Bankruptcy Code, like Pennsylvania's PUVTA, permits bankruptcy trustees to avoid both **constructive fraudulent transfers** and **actual fraudulent transfers**. The text of the statute follows.

2. Statutory Language

B.C. § 548. Fraudulent transfers and obligations

(a)(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily--

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(B)

(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)

(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

3. Explanation of B.C. Section 548

Like PUVTA, Section 548 of the Bankruptcy Code covers both actual (intentional) fraudulent transfers as well as constructive fraudulent transfers. Section 548 adds yet another category of constructive fraudulent transfer: employment contracts with insiders that are not in the ordinary course of business and for which the debtor receives less than reasonably equivalent value. In other words unearned bonuses or “no-show” jobs for family members or other insiders are constructively fraudulent transfers and are avoidable by the bankruptcy trustee if granted within the two-year period before filing for bankruptcy. Note that an insider employment contract for less than reasonably equivalent value is a fraudulent transfer even though the debtor is not insolvent and even though the debtor did not intend to hinder, delay or defraud creditors.

4. Examples of Fraudulent Transfers and Obligations Under B.C. Section 548

Every year there are myriad cases decided under Section 548 of the Bankruptcy Code. Here are three decisions handed down in 2019. For each case decide whether the transfer was an actual fraudulent transfer, a constructive fraudulent transfer, both an actual and a constructive fraudulent transfer, or not a fraudulent transfer at all.

In re Bateman, 397 F.Supp.3d 113 (D.Mass 2019)

The Batemans owned a home in Sebago worth \$1.8 million. The Batemans owed the Town of Sebago \$56,000 in back taxes. The Batemans transferred the house to the Town in return for abatement of the tax, and the Town agreed to sell the house back to the Batemans’ son for \$300,000. The Batemans then filed for bankruptcy. The bankruptcy trustee alleged that the Batemans were insolvent when they negotiated these transactions with the Town. The court quoted this standard from another case: **“The presence of a single badge of fraud may spur mere suspicion, the confluence of several can constitute conclusive evidence of an actual intent to defraud, absent ‘significantly clear’ evidence of a legitimate supervening purpose.”** Was this set of transactions:

- An actual fraudulent transfer?
- A constructive fraudulent transfer?
- Both?
- Neither?

In re PennySaver USA Publishing, LLC, 602 B.R. 256 (Bankr. Ct. D.Del. 2019)

OpenGate is a private equity firm. OpenGate acquired Pennysaver USA, LLC in a leveraged buy-out. OpenGate raised the capital to purchase Pennysaver by presenting lenders with an optimistic business plan that it never attempted to implement. Instead, OpenGate had Pennysaver pay close to \$7 million dollars in “dividends,” “closing costs,” “tax payments,”

“management fees,” “salaries” and “bonuses” to OpenGate and OpenGate members, managers and employees, and a “consulting fee” for an OpenGate IT employee who never rendered any services to Pennysaver. OpenGate also had Pennysaver enter into a contract to purchase paper from another company that OpenGate owned that required Pennysaver to pay a huge “advance fee.” When that transaction threatened to unravel the payment was recharacterized as “rent” for subleasing two offices from the same subsidiary company and the sublease documents were backdated at the instruction of OpenGate.

Pennysaver was insolvent when OpenGate acquired it and Pennysaver quickly went bankrupt. The court dismissed the trustee’s complaint without prejudice for failing to identify the specific persons who received all of these transfers. Assuming that the trustee can cure the lack of specificity, were these transfers:

- Actual fraudulent transfers?
- Constructive fraudulent transfers?
- Both?
- Neither?

In re Direct Access Partners, LLC, 602 B.R. 495 (Bankr. Ct. S.D.N.Y. 2019)

The debtor Direct Access Partners, LLC, was a brokerage firm. The firm engaged in bribery to obtain investments from foreign sources. Before the bribery scheme was discovered the members and managers of DA Partners received salaries and bonuses from the firm. The firm declared bankruptcy shortly after criminal indictments were issued. The trustee in bankruptcy sought to recover the salaries and bonuses as fraudulent transfers.

The Bankruptcy Court found that DA Partners was solvent during the time that these salaries and bonuses were being paid and that the salaries and bonuses were not disproportionate to the work that the recipients were doing. The trustee contended that the “Ponzi Scheme Presumption” should apply in this case. The court rejected that argument on the ground that the transfers in this case were not part of the Ponzi scheme “under which every payment made to one investor is necessarily part of the scheme to defraud a new investor, and necessarily part of a scheme that ultimately will leave someone unpaid.” Instead this was simply a case where salaries were paid by a company that was engaging in illegal activity, and the court found that salaries paid to employees of a company engaged in illegal activity do not qualify as fraudulent transfers unless the payment of salaries was part of the scheme to hinder, delay, or defraud creditors.

Do you agree with the court in *Direct Access Partners*? In your opinion are the salaries and bonuses that are paid to persons engaged in a criminal enterprise avoidable as fraudulent transfers? Are these payments:

- Actual fraudulent transfers?
- Constructive fraudulent transfers?

Both?
Neither?

5. The “Legitimate Supervening Purpose” Test

In *In re Bateman* above the court mentioned the “legitimate supervening purpose” test as a defense to a claim that a transaction was an avoidable fraudulent transfer. Some courts have ruled that even if a transfer is marked by badges of fraud the transfer may be valid if the debtor can prove by clear evidence that it had a “legitimate supervening purpose” for making the transfer. The following case shows how strictly the courts interpret this defense to the rule against fraudulent conveyances.

Aptix Corp. v. Quickturn Design Systems, Inc., 148 Fed.Appx. 924. (Fed. Cir. 2005)

Amr Mohsen was the founder and majority shareholder of Aptix Corporation. Aptix owned U.S. Patent No. 5,544,069. Quickturn Design won a judgment against Aptix in the amount of \$4.2 million. Mohsen then loaned Aptix \$9,000,000 and took a security interest in the assets of the corporation, including the patent, and Mohsen perfected the security interest. The influx of cash kept Aptix running; it could pay its bills and stay in business. However, the granting of the security interest in the patent prevented Quickturn from being able to collect its judgment. The trial court ruled that the granting and perfection of the security interest was an actual fraudulent transfer from Aptix to Mohsen, made with intent to hinder, delay, or defraud creditors.

Mohsen appealed on the ground that his \$9 million loan to Aptix was made for a legitimate business reason – to keep the business running. A majority of the Court of Appeals agreed with him that the **loan** was made for a legitimate business reason, but found that there was no legitimate reason for Mohsen to take a **security interest** in the patent. The court stated:

Although Mohsen's argument may explain why Aptix entered into the loan arrangement with Mohsen, it does not explain why it was necessary for Aptix to grant Mohsen a security interest in substantially all of its assets when Mohsen had never required such an interest for his past loans.

Accordingly the Court of Appeals affirmed the finding of the trial court that Mohsen's reservation of the security interest in the patent was a fraudulent transfer, and that the bankruptcy trustee was entitled to avoid the security interest and seize the patent. The dissenting judge would have found that the granting of the security interest in the patent by Aptix to Mohsen had a “legitimate business purpose” and would have upheld it as a normal requirement incident to the loan.

Practice Pointers.

1. This transaction wasn't a constructive fraudulent conveyance because Dr. Mohsen gave new value that was reasonably equivalent in return for a perfected security interest in order to keep

his company operating. Was the transaction an actual fraudulent conveyance? Do you agree with the majority or the dissent regarding whether Dr. Mohsen acted with the intent to hinder, delay, or defraud creditors?

2. What advice would you give to the owner of a business that has suffered a ruinous judgment against it? Is it safe for the owner to make a loan to the business and to take a perfected security interest in the assets of the business to prevent the execution of the judgment against the business?

End of Chapter 10

Chapter 11. Enforcement of the Security Agreement. Pre-Default Duties; Default; Repossession; and Redemption

The fifth and final fundamental topic in the law of Secured Transactions is “Enforcement of the Security Agreement.” A **security agreement** is a contract between the secured party and the debtor. Some of the contractual responsibilities of the parties are expressly set forth in the agreement, but many of the contractual obligations on both parties are imposed by Article 9. The obligations that secured parties and debtors owe to each other are covered in Chapters 11 and 12.

A. Learning Objectives

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Identify the pre-default duties of the secured party and the debtor;
2. Identify contractual provisions, including an “insecurity clause,” that can be included in a security agreement to define the actions or circumstances that would constitute a default by the debtor;
3. Determine whether a secured party is justified in “deeming itself insecure” under an insecurity clause and therefore entitled to do declare that the debtor is in default;
3. Identify the rights of the secured party upon the debtor’s default;
4. Determine whether a secured party has lawfully repossessed collateral belonging to the debtor;
5. Determine whether the debtor has the right to redeem the collateral from the secured party and what the debtor must do to redeem it.

B. Lecture 32. Pre-Default Duties of the Secured Party and the Debtor

Whether or not the debtor defaults the secured party and the debtor owe each other a number of duties under the security agreement. The first portion of this chapter covers:

1. Responsibility for care and maintenance of the collateral;
2. Requests for accounting and a list of the collateral;

3. Demands for filing of a termination statement or relinquishment of control; and
4. Liability of the secured party for violation of its obligations under Article 9.

1. Responsibility for Maintenance of the Collateral

Responsibility for maintaining the collateral is governed by [Section 9-207](#). Whichever party has possession of the collateral is obligated to take reasonable care of the collateral. The debtor is responsible for paying for custody and preservation of the collateral even if the secured party has possession of the collateral.

Problem 73

North Star Bank loaned Stanton Trucking \$500,000 and has a security interest in Stanton's fleet of trucks. When not in use the trucks are stored at Pemberton Garage, which has agreed to hold the trucks for North Star Bank. North Star Bank has had Pemberton perform both routine maintenance on the trucks and perform repairs when needed. Under [Section 9-207](#), which party is obligated to pay for the maintenance and repairs?

2. Reasonable Care and Accidental Loss

Under [Section 9-207\(a\)](#) if the collateral is in the possession of the secured party the **secured party** is liable for damage or destruction of the collateral if it fails to exercise reasonable care; that is, the secured party is liable for its own negligence. But under [Section 9-207\(b\)](#) the **debtor** is liable for any "accidental loss." How do you reconcile those two rules? This issue is illustrated in the following problem.

Problem 74

Midwest Minerals has mined 200 metric tons of salt worth \$4 million. The salt is stored on the premises of Lapland Lenders, a company that specializes in storing minerals and making loans to the owners with the minerals serving as collateral. Lapland loaned Midwest \$5 million with the salt as collateral for the loan. No portion of the loan has yet been paid.

1. A flood occurred and the salt was destroyed through no fault of either party. Neither Lapland nor Midwest purchased any insurance to protect against

damage or destruction of the stored salt. Which party had the duty to procure and pay for insuring the collateral?

2. A flood occurred and the salt was destroyed because Lapland negligently failed to protect against the flood. Neither Lapland nor Midwest purchased any insurance to protect against damage or destruction of the stored salt. What result?

Practice Pointers.

1. The second part of this problem involves the secured party's negligent failure to protect against a flood. In other circumstances the secured party's liability for impairment of collateral might arise from negligently failing to prevent **any** type of loss including theft, vandalism, or a failure to keep the collateral in repair.

2. Can a debtor waive its right to hold the secured party liable for impairment of collateral?

Section 9-602 does not prohibit the debtor from waiving this right. In *Hartley v. Hynes*, 97 U.C.C. Rep. Serv.2d 27 (Pa. Super. Ct. 2018) the court ruled that a guarantor had waived any claim against the secured party for impairment of collateral and that the waiver was enforceable under Section 3-605. The court stated:

[A]ssuming that section 9602 applies, whether in addition to or independently of section 3605, section 9602 lists the rights that may not be waived. See 13 Pa.C.S. § 9602.

Section 9207(a), which imposes a duty of care upon a secured party in possession of collateral, is not among the rights listed in section 9602.

3. Requests for Accounting and a List of Collateral

Under Section 9-210 a secured party must within 14 days honor a request for an accounting or respond to a request to approve or correct a list of collateral or a statement of account. The debtor must "reasonably identify" the transaction that the debtor is inquiring about. Under Section 9-625(f) if the secured party fails to respond to the request without reasonable cause the secured party is liable to the debtor for \$500 plus any actual damages. A debtor is entitled to one response to a request at no charge within a six-month period; for additional requests there can be a charge of \$25. Under Section 9-602 the debtor's right to request an accounting or a list of collateral cannot be waived.

The debtor must, of course, make the request in good faith.

In re Dixon, 97 U.C.C. Rep. Serv.2d 588 (2018)

The debtor requested the secured party to confirm that “\$0.00” was owed, at a time when the secured party was demanding a significant amount. The court found that the debtor’s request for accounting was not made in good faith, and therefore the secured party had no duty to respond to the request.

Practice Pointers.

1. A request for accounting under [Section 9-210](#) can be a useful tool in protecting a debtor’s interests. A careful attorney representing the debtor should take advantage of this cheap and easy method of obtaining information about the transaction.
2. Under [Section 9-210](#) the secured party is only obligated to respond to requests from the **debtor**. Potential lenders or buyers of the collateral may ask the debtor to submit a request to the secured party in order to determine the extent of the debtor’s indebtedness or the extent to which the debtor’s property is encumbered.
3. Unlike *In re Dixon* in the usual case the secured party should promptly and accurately respond to a request for accounting or list of collateral. Article 9 imposes potentially devastating liability on a secured party who fails to comply with [Section 9-210](#). Under [Section 9-625\(g\)](#) if the secured party fails to respond to the request the secured party may be precluded from asserting its security interest against any party who is reasonably misled by the omission. In addition if the secured party responds inaccurately to the request under the common law doctrine of estoppel the secured party may be precluded from correcting the error. ([Section 1-103](#) permits the U.C.C. to be supplemented by common law rules that are not displaced by the Code.) Secured parties should be aware of their responsibility to promptly and accurately respond to requests from debtors for an accounting or list of collateral.

4. Demand for Filing of a Termination Statement or Relinquishment of Control

If there is no outstanding indebtedness under a security agreement and if there is no commitment to make an advance or otherwise give value to the debtor, then Article 9 authorizes the debtor to demand that the secured party release the collateral:

1. If a financing statement has been filed, then the secured party must file a termination statement within one month or (if earlier) within 20 days of receiving an authenticated demand from the debtor. ([Section 9-513](#))
2. If the secured party has control over collateral such as a deposit account, electronic chattel paper, investment property, letter of credit rights, or electronic documents, then

within 10 days after receiving an authenticated demand the secured party must relinquish control. ([Section 9-208](#))

Problem 75

Friendly Finance Co. loaned \$100,000 to Piper Paper Incorporated and took a security interest in Piper's inventory and accounts. Piper paid off the loan in full. Under the security agreement the finance company did not have a commitment to loan Piper any more money. Piper wanted to borrow more funds for operating costs and applied for a loan at Bank of Athens County. The bank refused to grant the loan because of the financing statement that had been filed by the finance company. Piper sent an email message to Friendly Finance demanding for the finance company to file a termination statement.

1. Is this demand covered by [Section 9-513\(a\)](#) and [\(b\)](#) or [Section 9-513\(c\)](#)?
2. Is Friendly Finance liable to Piper if it fails to file a termination statement? See [Section 9-625\(b\)](#) and [\(e\)](#).
3. If Friendly Finance fails to file a termination statement in response to Piper's request can Piper file a termination statement? See [Section 9-509\(d\)\(2\)](#).

5. Liability of the Secured Party for Noncompliance with Article 9

We have already seen how [Section 9-625](#) is applied in several of the previous cases and problems.

Statutory damages. Under [Section 9-625\(e\)](#) a secured party may be liable for statutory damages of \$500 for failing to release control of collateral on demand, failing to file a termination statement on demand, or failing to respond to a request for an accounting or a list of collateral.

Money damages. Damages under [Section 9-625\(b\)](#) are recoverable for violation of any duty under Article 9, including but not limited to liability for harm to the debtor's ability to obtain alternative financing.

Court orders. Equitable relief such as a court order to enforce or restrain collection or resale is available under [Section 9-625\(a\)](#).

Penalty in cases involving consumer goods. Under [Section 9-625\(c\)\(2\)](#) if the collateral is consumer goods debtors and obligors may recover a minimum award equal to 10% of the credit service charge or time price differential plus 10% of the principal amount of the obligation or cash price.

C. Lecture 33. Default

1. Defining Default

In broad terms a debtor's "default" can be any breach of a security agreement. Acts of default can be grouped into the following categories:

a. Breach of payment obligations:

1. Nonpayment;
2. Incomplete payment;
3. Late payment;

b. Interruption of the debtor's business:

3. Death of the debtor or dissolution of the business entity of the debtor;
4. Termination or cessation of the debtor's business;
5. Insolvency of the debtor, or the institution of bankruptcy or insolvency proceedings;
6. The debtor loses their employment;
7. The debtor's business falters (losing market share, lower earnings, a key employee leaves, etc.);
8. Cross-default (the debtor is in default to other creditors);

c. Impairment of collateral:

9. The collateral is lost, stolen, damaged or destroyed;
10. The debtor granted a security interest in the collateral to another creditor;
11. The debtor failed to maintain the collateral in good repair and condition;
12. The debtor failed to maintain insurance coverage on the collateral;
13. The collateral has been attached through judicial process;
14. The government has filed a tax lien against the property of the debtor;

d. Concealment, misrepresentation or fraud:

15. The debtor made false or misleading statements in the application for credit;
16. Breach of a financial covenant (breach of promises about the debtor's financial condition);
17. The debtor failed to make available to the secured party for inspection its books and records or the collateral itself;

e. General acts of default:

18. Any breach of the security agreement;
19. Any event or state of affairs that calls the ability of any surety or guarantor to perform into doubt;
20. Any other event or state of affairs which in the good faith opinion of the secured party imperils either the value of the collateral or the prospect of repayment or otherwise causes the secured party to "deem itself insecure" ("insecurity clause" governed by [Section 1-309](#)).

The most difficult default provision to apply is the last one in the list where the debtor may be in default if the secured party “deems itself insecure.” The vagueness and subjectivity of this contractual provision (called an “insecurity clause”) is counterbalanced by the doctrine of good faith. [Section 1-309](#) governs this type of contractual provision, and it provides:

A term providing that one party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral “at will” or when the party “deems itself insecure,” or words of similar import, means that the party has power to do so only if that party in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against which the power has been exercised.

The following problem illustrates the nuances of an “insecurity clause.”

Problem 76

Cullen Property Management, Inc., manages office buildings in the suburbs of Indianapolis. Enterprise Bank loaned Cullen \$800,000. Cullen signed a promissory note in that amount that is due two years from now; however the note contains an “insecurity clause.” The parties also signed a security agreement giving the bank a security interest in Cullen’s accounts. Are the following events sufficient for the bank to hold Cullen in default and to foreclose on Cullen’s accounts?

- a. A fire burned down the offices of Enterprise Bank and the bank desperately needs operating capital.
- b. The bank hears a rumor, unconfirmed, that a competitor of Cullen will be taking over managing the office buildings of Cullen’s biggest client. See Section 251 of the Restatement (Second) of Contracts.
- c. Due to a recession there is an economic contraction in the Indianapolis area and many office buildings in the region have fallen below 50% occupancy.
- d. Assume that the note that Cullen signed is not due on a date certain but rather is “due on demand.”

Practice Pointers.

1. Under Article 9 the only act that automatically constitutes a default is nonpayment of the debt. In representing a secured party it is critically important to include a comprehensive list of acts and events constituting “default” in the security agreement, and to that end the above list is instructive. It is particularly advisable to include an “insecurity clause.” If there are other

conditions that the secured party wants the debtor to observe, such as a specific financial covenant that the debt/equity ratio of the debtor must not exceed 2:1 or a provision prohibiting the debtor from selling collateral without express written authorization of the secured party, then those conditions must as well be included in the security agreement.

2. A “demand for adequate assurance of due performance” is one of the most useful items in a transactional lawyer’s toolbox. Consider the dangers of forging ahead and declaring the debtor to be in default on the basis of insufficient information. This type of demand letter can clear the waters and prevent your client from prematurely canceling a contract and committing a material breach. If the debtor fails to adequately respond to the request then it constitutes a repudiation of the contract, and the debtor is clearly in breach. Note, however, that a party is entitled to send such a demand only if there are “reasonable grounds” to believe that the other party will commit a total breach by nonperformance.

The following decision of the Alaska Supreme Court involves the enforcement of security interests in three airplanes. The opinion touches on several different aspects of enforcement of a security interest including default, repossession, notice of disposition , resale, and explanation of any deficiency or surplus.

Crowley v. Northern Aviation, LLC, 441 P.3d 407 (Alaska Supreme Court, 2019)

Crowley borrowed money from Helmericks and gave Helmericks a security interest in three airplanes: two Cessnas and a Mooney aircraft. The following events occurred:

1. Crowley failed to insure the Cessnas. The court found that this was an act of default.
2. Crowley damaged the Mooney by landing with the landing gear up. This was an act of default.
3. Crowley purchased a new propeller for the Mooney but failed to install it. This too was an act of default.
4. Helmericks sold the Cessnas without giving written notice to Crowley about the resale. This was a violation of Article 9.
5. Helmericks did not send Crowley an explanation of the application of the proceeds of the sale of the Cessnas. If there was a surplus then this was a violation of Article 9.
6. Helmericks repossessed the Mooney by removing the engine and the plane’s radio. A self-help repossession must be accomplished without a breach of the peace. If Helmericks broke a lock to remove the radio then it may have been a breach of the peace, and if it was a breach of the peace then the repossession was invalid.

The case was remanded to determine whether Helmericks failed to account for any surplus and whether he committed a breach of the peace.

Practice Pointer.

Notice all of the ways in which the action of a secured party can be challenged. A secured party must be careful to ensure that the debtor actually committed an act of default; must repossess the debtor's property without committing a breach of the peace; must give the debtor adequate notice of disposition of the collateral; must respect the debtor's right to redeem the collateral; must conduct the resale in a manner that is commercially reasonable in every respect; and must give the debtor an adequate explanation of any deficiency or surplus. The following cases and problems explore the rights and duties of the secured party after the debtor defaults.

D. The Rights of the Secured Party Upon Default

1. Acceleration of the Entire Indebtedness

The most immediate consequence of a debtor's default is that the secured party is free to accelerate the entire indebtedness. After defining all of the events constituting a default a well-drafted security agreement will expressly grant this power to the secured party. For example:

In the event of default the entire unpaid balance, including expenses and fees, shall at the sole option of the secured party and without notice to the debtor become due.

2. No Election of Remedies Necessary

The common law doctrine of "election of remedies" often forced plaintiffs into making a hard choice. If a plaintiff elected to pursue one remedy or theory of recovery it had to give up another. Article 9 rejects the doctrine of election of remedies. Under [Section 9-601](#) a secured party does not have to "elect" one particular remedy to the exclusion of others.

The language of Section 9-601(a) and (c) is expansive. Under Section 9-601 of the Code a secured party may exercise the rights granted by Article 9 as well as any rights arising under the security agreement. The secured party may choose to go to court to obtain a court order ordering law enforcement to seize the collateral from the debtor and conduct an official foreclosure sale. In the alternative the secured party may resort to self-help remedies by repossessing and reselling the collateral. The secured party's decision to pursue or forego one remedy does not prevent the secured party from electing a different remedy. In the proper circumstances neither *res judicata* nor the doctrine of election of remedies would bar the

secured party from pursuing multiple alternative remedies until the debt has been satisfied, as the following cases demonstrate.

Sysinformation Healthcare, Services, LLC v. Pauls Valley Hospital Authority, 99 U.C.C. Rep Serv 2d 622 (United States District Court, W.D. Oklahoma 2019)

In 2013 Sysinformation Healthcare, Services, LLC entered into a contract with Pauls Valley Hospital Authority to perform billing and bookkeeping services for the hospital. The contractual relationship broke down and in 2017 the parties entered into a termination agreement. Under the termination agreement the hospital signed a promissory note for \$336,000 and granted Sysinformation a security interest in certain property. In this lawsuit the plaintiff, Sysinformation, sued the hospital for breach of the termination agreement and nonpayment of the note. Sysinformation did **not** seek to enforce the security agreement. The defendant Pauls Valley Hospital Authority filed a motion seeking a “determination of security interest” alleging that because Sysinformation failed to seek enforcement of the security interest that Sysinformation had therefore waived its right to enforce the security interest.

The court found that a secured party may elect to pursue its contractual remedies for payment or may choose to enforce a security agreement, at its discretion, and that pursuit of one remedy does not foreclose pursuit of another. The court stated:

Under [Section 9-601 of] the Oklahoma Uniform Commercial Code, a secured party “may reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure” and these remedies “are cumulative and may be exercised simultaneously.”

State Bank of Piper City v. A-Way, Inc. 402 N.E.2d 282 (Illinois Supreme Court, 1987)

A-Way, Inc. was holding 5,141.20 bushels of grain for William C. Brenner. The grain was collateral for a loan that was owed to State Bank of Piper City. The bank repossessed the collateral and mistakenly demanded A-Way to pay the bank \$5,141.20. A-Way sold the grain for \$11,310.64, and then paid the bank \$5,141.20, taking advantage of the bank’s mistake. Upon discovering its error the bank sued A-Way for the remainder of the proceeds of the collateral. A-Way defended on the ground of *res judicata*.

The court found that A-Way knew that State Bank had made a mistake and that the invocation of *res judicata* “borders on effrontery.” The court then warned A-Way, “If we were to conclude that fraud had been present, which under our analysis we need not do, *res judicata*, of course, would not be applicable.”

Practice pointers.

1. Even though the courts in these cases uphold the implicit right of a secured party to pursue multiple alternative and cumulative remedies, in representing the secured party in court and out of court it would be wise to expressly acknowledge to the debtor and other parties that the secured party reserves the right to pursue any and all other remedies until the debt is paid in full.
2. In *State Bank of Piper City* the court states that the defendant's argument "appears to border on effrontery." Why did the court say this? What did the court mean when it said, "If we were to conclude that fraud had been present,"? What lesson would you draw from the judicial reprimand?

The following portion of this chapter deals with repossession of the collateral.

E. Lecture 34. Repossession

Article 9 expressly allows the secured party to resort to "self-help" remedies including repossession of the collateral. Section 9-609 states:

§ 9609. Secured party's right to take possession after default.

(a) Possession; rendering equipment unusable; disposition on debtor's premises. After default, a secured party:

(1) may take possession of the collateral; and

(2) without removal, may render equipment unusable and dispose of collateral on a debtor's premises under section 9610 (relating to disposition of collateral after default).

(b) Judicial and nonjudicial process. A secured party may proceed under subsection (a):

(1) pursuant to judicial process; or

(2) without judicial process if it proceeds without breach of the peace.

(c) Assembly of collateral. If so agreed, and in any event after default, a secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties.

On the topic of repossession we will discuss the following issues:

1. Is the secured party required to give the debtor **notice** that the collateral will be repossessed?
2. Is the secured party entitled to **ex parte** judicial proceedings to repossess the collateral?
3. Is the secured party **liable** for the acts of the repossession **agent**?
4. What actions during repossession might constitute **conversion**?
5. What is a “**breach of the peace**” that would render a repossession invalid?
6. **Other federal and state laws** governing repossession.

1. Is the secured party required to give the debtor notice that the collateral will be repossessed?

The following New York case exemplifies the general rule that after the debtor has defaulted a secured party may repossess the collateral **without notice** to the debtor. Here is a short passage from the opinion of the appellate court:

Abele Tractor & Equipment Co. v. Shaeffer, 167 A.D.3d 1256 (App. Div. 2018)

The court stated:

Supreme Court properly found that Trustco was entitled to repossess the equipment from Paige, without providing either notice of default or prior notice of repossession, to protect its own financial stake. In support of its summary judgment motion, Trustco submitted the 2004 and 2006 security agreements that provided it with a security interest in Paige’s goods, machinery and equipment which, notably, secured all of Paige’s obligations to Trustco. According to the security agreements, the failure to comply with any of their provisions is an event of default. Paige’s sale of the equipment to plaintiff on November 6, 2013 – an undisputed fact upon which plaintiff’s claims are entirely founded – conclusively establishes that an event of default occurred before Trustco repossessed the equipment in December 2013. Based on Paige’s default, Trustco was entitled to take possession, without notice, of all collateral in which it had a valid security interest.

Article 9 requires a secured party to give adequate notice before **reselling** the collateral, but Article 9 does not require notice before **repossession**. However, it is possible for the secured party to **waive** the right to repossess collateral without notice. There are three circumstances where a secured party may voluntarily assume the duty to give notice to the debtor before repossessing the collateral. Those circumstances are:

1. Where the secured party includes language in the agreement requiring the secured party to **demand** payment of the entire indebtedness before repossession can take place;
2. Where the secured party consistently **accepts late payments** from the debtor; and
3. Where the secured party has required the debtor to **purchase credit insurance** and the debtor subsequently dies or becomes disabled.

Each of these circumstances forcing the secured party to give the debtor notice before repossessing collateral are described below.

1. Explicit Language in the Security Agreement Requiring the Secured Party to Notify the Debtor Before Repossession.

In *Klingbiel v. Commercial Credit Corp.*, 439 F.2d 1303, 1305 n. 2 (10th Cir. 1971) the following language was included in an automobile finance security agreement:

if Seller should feel itself or Vehicle insecure, (c) the unpaid portion of the Time Balance and any expense (including taxes) shall without notice, at the option of Seller, become due forthwith. (ii) Purchaser agrees in any such case (a) to pay said amount to Seller, **upon demand**, or (b) at the election of Seller, to deliver Vehicle to Seller.

The highlighted words “upon demand” may seem innocuous but they were not. The courts held that while the entire indebtedness could be **accelerated** without notice the auto could not be **repossessed** until the secured party demanded payment from the debtor.

2. Accepting Late Payments from the Debtor

In some cases lenders try to work with a debtor who is having trouble complying with the payment schedule. A lender may allow a debtor to consistently make late payments. In that situation may a lender suddenly repossess the collateral on account of a late payment without notifying the debtor?

Hendrickson v. Fifth Third Bank, 98 U.C.C. Rep. Serv.2d 31 (D. Minn. 2019)

Forty years ago in *Cobb v. Midwest Recovery Bureau Co.*, 295 N.W.2d 232, 237 (Minn. 1980) the Minnesota Supreme Court ruled that if a creditor repeatedly accepts late payments, the creditor is required to give the debtor written notice of the creditor's intent to strictly enforce the terms of the loan agreement before repossessing collateral. This is called a "Cobb-notice."

In this case for five months in a row the Fifth Third Bank allowed Hendrickson, the debtor, to make late payments. The bank then repossessed Hendrickson's car without sending Hendrickson a *Cobb*-notice. The court ruled that the repossession was wrongful.

Practice Pointer.

Clients must be careful when their actions deviate from the letter of a written security agreement. Even if a contract contains a "time is of the essence" clause making any late payment a default and even if the contract contains language stating that acceptance of a late payment does not alter the responsibility of the debtor to make subsequent payments on time, the terms of a contract can be explicitly or implicitly modified or waived. [Section 2-209](#) of the Uniform Commercial Code and Section 89 of the Restatement (Second) of Contracts govern modification of contracts and waiver of rights under a contract, and [Section 1-303](#) of the Code and Section 202 of the Restatement govern course of performance, that is, the conduct of the parties in the performance of the contract. Contracts can be modified explicitly by agreement or implicitly by course of performance even if there is no consideration for the modification. Even if the parties' communications and conduct do not constitute a modification they may be considered to be a waiver of certain rights and duties. Once a waiver of rights has occurred a party must take affirmative steps to reinstate its rights under the contract. [Section 2-209\(e\)](#) of the Code provides:

(e) **Retraction of waiver.** A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

3. Requiring the Debtor to Purchase Credit Insurance

If the secured party had the debtor acquire credit insurance and the debtor subsequently becomes disabled some courts have held that the secured party must look first to the insurance proceeds before repossessing or declaring a default. See *Entricken v. Motor Coach Federal Credit Union*, 845 P.2d 93, 96-97 (Mont. 1992) (citing *Owens v. Walt Johnson Lincoln Mercury, Inc.*, 574 P.2d 642 (1978), for the proposition that "the right of repossession is subordinated to collection of the payments due from the insurer if the debtor is disabled within the terms of the policy. Additionally, repossession may not occur prior to allowing the debtor a fair opportunity to establish eligibility under the coverage.").

2. Ex parte judicial proceedings attaching collateral are prohibited

A secured party has the right to go to court and obtain an order of attachment that will allow either the secured party or the authorities to repossess the collateral. However, court proceedings are “state action” and are therefore subject to the requirements of the due process clause of the Fourteenth Amendment. The due process clause provides:

nor shall any state deprive any person of life, liberty, or property without due process of law

Due process requires the government to give the debtor **adequate notice** of any proceedings and an adequate opportunity to be heard before property is taken by court order. See *Fuentes v. Shevin*, 407 U.S. 67 (1972) (striking down the laws of Pennsylvania and Florida that allowed secured parties to obtain court orders of attachment without notice to the debtor).

If the secured party wrongfully enlists the assistance of the courts or the police and invades the constitutional rights of the debtor then the debtor may bring a civil rights action under 42 U.S.C. Section 1983 for any violation of rights that is committed “under color of state law.” The *Hyman* case below contains an example of a Section 1983 claim.

The due process clause applies and advance notice of repossession is required only where there is “state action;” that is, only where the government is significantly involved in the taking. See *Shelley v. Kraemer*, 344 U.S. 1, 13 (1948), where the court stated:

"Since the decision of this court in the Civil Rights Cases, 109 U.S. 3, 3 S. Ct. 18, 27 L. Ed. 835 (1883), the principle has become firmly embedded in our constitutional law that the action inhibited by the first section of the Fourteenth Amendment is only such action as may fairly be said to be that of the States. That Amendment erects no shield against merely private conduct, however, discriminatory or wrongful."

If a secured party proceeds by “self-help” remedies such as repossession and resale it is “private action” not “state action.” In that case constitutional due process is not applicable and the rights and obligations of the parties are governed by contract and by statute, not the Constitution of the United States.

3. Is the secured party liable for the acts of the repossession agent?

Yes! Comment 3 to Section 9-609 states:

In considering whether a secured party has engaged in a breach of the peace, however, courts should hold the secured party responsible for the actions of others taken on the

secured party's behalf, including independent contractors engaged by the secured party to take possession of collateral.

The normal rule under the law of torts is that a principal is not liable for physical torts committed by an agent who is an independent contractor. But that common law rule does not apply to situations where the agent was hired to conduct "inherently dangerous" activities. Under the law of Secured Transactions a secured party is liable for torts such as conversion, battery, or intentional infliction of emotional distress committed by the repossession agent even if the agent is not an employee. The following case discusses the rule that a secured party is liable for the harm caused by a repossession agent in the course of carrying out a repossession.

Sogn v. Alaska USA Federal Credit Union, 96 U.C.C. Rep. Serv.2d 971 (W.D. Wash. 2018)

Alaska USA Federal Credit Union (AUSA) had a security interest in Sogn's Lexus. AUSA hired PAR, Inc., to repossess the vehicle, and PAR hired Car Service, LLC (CS). Jeremie Kaufman, an employee of CS, knocked on Sogn's door at 2:30 a.m. and demanded the keys to the car. Kaufman entered Sogn's back yard and again yelled at Sogn to give him the keys to the car. Kaufman threatened Sogn with physical force if he attempted to prevent him from repossessing the car, and Kaufman and his partner pretended to call the police. Kaufman towed the car away. Sogn complained and CS gave Kaufman a "Breach of the Peace Violation."

AUSA defended on two grounds: (1) That Kaufman's actions did not constitute a breach of the peace; and (2) That CS was an independent contractor and therefore AUSA was not liable for his actions.

The court ruled that Kaufman's actions were a breach of the peace, and characterized AUSA's arguments on this point as "unpersuasive" and an "act of desperation."

The court also found that repossession of collateral is an "inherently dangerous activity." Under the law of tort when an independent contractor undertakes an inherently dangerous activity on behalf of the principal the principal is strictly liable for any negligent or intentional torts committed by the agent; the duty to avoid a breach of the peace in conducting a repossession is a "non-delegable duty."

Finally, in a footnote the court noted: "The Court does not address at this time whether some or all of the evidence of Kaufman's criminal history might be admissible for impeachment purposes should he appear and testify."

Practice pointer.

Secured parties are potentially liable for the acts of repossession agents in a number of ways. If a secured party instructs a repossession agent to repossess property from the debtor that is not collateral or in circumstances where the debtor is not in default then both the secured party and the repossession agent are directly liable for conversion. Where the secured party hires the repossession agent to rightfully repossess collateral from the debtor and the repossession agent commits conversion by taking property that is not collateral or otherwise commits a tort like battery or intentional infliction of emotional distress then the repossession agent is directly liable for their own actions and the secured party is strictly liable for the agent's tortious conduct. If the secured party negligently hires a repossession agent whom the secured party should have known might commit torts against debtors then in addition to strict liability for the acts of the agent the secured party is also directly liable in negligence to any debtor who suffers harm.

4. Actions during repossession constituting conversion.

Under Section 222A of the Restatement (Second) of Torts conversion is defined as follows:

- (1) Conversion is an intentional exercise of dominion or control over a chattel which so seriously interferes with the right of another to control it that the actor may justly be required to pay the other the full value of the chattel.
- (2) In determining the seriousness of the interference and the justice of requiring the actor to pay the full value, the following factors are important:
 - (a) the extent and duration of the actor's exercise of dominion or control;
 - (b) the actor's intent to assert a right in fact inconsistent with the other's right of control;
 - (c) the actor's good faith;
 - (d) the extent and duration of the resulting interference with the other's right of control;
 - (e) the harm done to the chattel;
 - (f) the inconvenience and expense caused to the other.

Conversion includes wrongfully repossessing the property where the debtor was not in default or by taking personal property that was **not** collateral (such as tools in the trunk of a car) and not returning it promptly.

If other personal property is attached to the collateral the question arises whether it has become a part of the collateral, that is, whether the property is an "accession." The following case wrestles with the distinction between accessions and non-accessions. The case also discusses the liability of the repossession agent for conversion.

Magley v. M & W Incorporated, 325 Mich.App. 307 (Mich. Ct. App. 2018)

Magley was a farmer. Kellogg Community Credit Union had a security interest in Magley's tractor as well as any accessions to the tractor. When Magley defaulted the credit union hired

M & W, Incorporated to repossess the tractor. M & W took the tractor as well as front-mounted tank and a sprayer that were lightly attached to the tractor. Magley demanded the return of the tank and the sprayer, but M & W refused to return them. Magley incurred extra costs because of the refusal, so Magley sued M & W, the asset recovery firm, to recover those costs.

M & W asserted three arguments in defense of their conduct. It contended: (1) that the tank and the sprayer were accessions; (2) that the repossession company had acted reasonably under the circumstances; and (3) that the credit union, as the principal who had hired it to repossess the tractor, was liable to Magley, and because M & W was merely the credit union's agent it was not liable to Magley.

The trial court granted summary judgment in favor of M & W. The appellate court reversed. The appellate court found that there was substantial evidence that the tank and the sprayer were too easily separated to be accessions, and that while it was understandable that the repossession agent took the tank and the sprayer when the tractor was repossessed, there was no excuse for M & W to refuse to return Magley's property upon proper demand. As to the point on agency law, the court properly reminded M & W that all persons, including agents, are liable for the torts that they commit. Accordingly the appellate court reversed the summary judgment and remanded for further proceedings.

Practice Pointer.

This case stands for the proposition that repossession agents are liable for any torts that they commit. This is a basic rule of the law of agency. Many people are under the impression that if they commit a tort while working for someone else the person who hired them is liable to the injured party but that they themselves are not liable. This misimpression arises because employers and other principals are often strictly liable for the torts of their employees and other agents. People forget that the employee or agent is **primarily liable** for any torts they commit, while their employer or principal may be **secondarily liable**, as in the [Sogn](#) case above.

5. What is a “breach of the peace” that would render a repossession invalid?

Article 9 does not define the term “breach of the peace.” It is a centuries-old term of art. In *Wallace v. Chrysler Credit Corp.*, 743 F.Supp. 1228, 1231 (W.D. Vir. 1990) Judge Glen Williams describes the origins of the term:

The origins of the self-help remedy for creditors as embodied in today's law go back to the Dark Ages. Self-help was tolerated because legal institutions were too weak to prevent it. Mikolajczyk, Breach of Peace and Section 9–503 of the Uniform Commercial Code, 82 Dick.L.Rev. 351, 351 (1977–78) (citing 2 F. Pollock & F. Maitland, *The History of*

English Law, 547 (2d. ed. 1909)). The remedy had been totally abolished by the time of the Norman Conquest, but the practical considerations involved in creditors' needs to protect their property caused its revival; as Blackstone put it: “[I]t may frequently happen that the owner may have this only opportunity of doing himself justice: his goods may be afterwards conveyed away or destroyed ... if he had no speedier remedy than the ordinary process of law.” Id. at 353, n. 13 (quoting 3 W. Blackstone, *Commentaries of the Laws of England* 4.) Then as now the creditor had to exercise restraint, according to Blackstone, because “public peace is a superior consideration of any man's private property; and ... this natural right of recaution shall never be exerted where such exertion must occasion strife and bodily contention, or endanger the peace of society.” Id.

Exactly what constitutes a “breach of the peace” is not clear. In *Crowley* the court accurately stated that there are many cases on this subject and that they are not all in agreement. White & Summers suggest that there are two principal categories of breach of the peace:

- (1) whether there was entry by the creditor upon the debtor's premises; and (2) whether the debtor or someone acting on his behalf consented (or objected) to the entry and repossession.

Three cases are presented below each of which turns on the question whether the repossession was conducted “without a breach of the peace.” In each of the following cases, would you find that there was a breach of the peace or would you find that the repossession was lawfully conducted?

Hyman v. Capital One Auto Finance, 306 F. Supp.3d 756 (W.D. Penn. 2018)

Capital One hired a repossession agent to repossess the debtor Hyman's car. The car was on the driveway on Hyman's property. Hyman and her partner, Shyree, repeatedly told the repossession agents to leave, and Shyree entered the car and closed the door. The repossession agents called the Pennsylvania State Police. Multiple state troopers arrived and assisted the repossession agents by repeatedly ordering Shyree to exit the car and threatening Shyree with arrest for disorderly conduct. The troopers also repeatedly ordered Hyman to allow the repossession agents to take the car.

The court ruled that the repossession was unlawful, and that Hyman had valid claims against Capital One for conversion and trespass and that punitive damages were warranted. The court also found that the actions of the state troopers constituted state action, and that the troopers were subject to liability under 42 U.S.C. 1983 for violating Hyman's constitutional rights under the Fourth and Fourteenth Amendments; the actions of the troopers were not protected by the doctrine of qualified immunity because it was “clearly established” that the police may not assist in carrying out a repossession in the absence of a court order.

Cooper v. Fulton Bank, N.A., 94 U.C.C. Rep. Serv.2d 179 (Dist. Ct. D. Md. 2017)

In this case the debtor, Cooper, confronted two repossession agents on his property and held them at gunpoint. In attempting to leave the repossession agents claimed to be law enforcement officers and showed Cooper fake badges. Cooper claimed that the repossession agents committed a breach of the peace because they were trespassing and because they pretended to be police.

The court found that mere trespass is not a breach of the peace. Repossession agents may not enter locked dwellings but they may enter property to effect a repossession.

The court also ruled that the repossession agents did not impersonate police in order to carry out the repossession but only to escape from Cooper, who was holding them at gunpoint. The court found that this, also, was not a breach of the peace.

Carter v. First National Bank of Crossett, 552 S.W.3d 40 (Ark. App. 2018)

In this case the repossession agents broke a lock on a gate to enter the debtor's property in order to repossess logging equipment that was collateral for a loan, and the debtor claimed that the cutting of the lock constituted a breach of the peace.

However, in this case the secured party had obtained a court order granting the right to repossess the equipment. The court explained, "breach of the peace only becomes an issue if a secured party takes possession of the collateral without judicial process."

6. Other Federal and State Laws Governing Repossession

Other federal and state laws protect debtors against unfair or abusive conduct by creditors. The text of the Federal Fair Debt Collection Practices Act appears on the website of the Federal Trade Commission [here](#). The provisions of the Pennsylvania Fair Credit Extension Uniformity Act are described on the website of the Pennsylvania Attorney General [here](#).

F. Lecture 35. Redemption

Redemption is governed by [Section 9-623](#). After repossession a debtor is entitled to redeem collateral if the debtor pays the secured party before the secured party has resold the collateral, collected on accounts that were collateral, or exercised the right of strict foreclosure. A debtor may not redeem collateral simply by paying the secured party the amount of any

payment that was missed. Normally upon default the secured party **accelerates the debt**. Default is a breach of contract by the debtor, and under standard contract law the secured party may cancel the entire contract and hold the debtor liable for breach. To redeem the collateral after default and repossession the debtor is required to pay the secured party **the entire amount of the outstanding indebtedness**, including reasonable expenses and attorney fees.

In bankruptcy, however, there are different rules favoring the debtor. Under Bankruptcy Code Section 722 if the property is exempt (such as household goods and cars up to a certain value) then rather than paying off the entire loan the debtor may redeem the collateral by paying the secured party the **retail market value** of the collateral. The remainder of the indebtedness is discharged. Moreover if a debtor files for bankruptcy under Chapter 13 after the secured party has repossessed the collateral but before the secured party has resold it then the right of redemption automatically belongs to the bankruptcy estate and the repayment terms of the underlying obligation can be extended over a period of time or otherwise restructured to allow the debtor to redeem the collateral. *See Tidewater Finance Company v. Moffett*, 356 F.3d 518 (4th Cir. 2004).

Section 9-624 governs “waiver” of the debtor’s rights. Subsections 9-624(a) and (b) allow debtors to waive notice of resale or of strict foreclosure by means of a written agreement that is entered into **after default**. In other words, any waiver of these rights that is contained in a security agreement is void. Subsection 9-624(c) dealing with redemption goes further in protection of consumer debtors. Section 9-624 also provides that a debtor can waive the right to redemption in a post-default written agreement **except in a consumer-goods transaction**. Any agreement by a consumer to waive the right of redemption is void.

The following problem illustrates some of the legal issues surrounding redemption of collateral.

Problem 77

Bryce Perkins purchased a used pick-up truck for personal use on credit from Tidewater Auto Sales for \$6,000, and Tidewater’s security interest was noted on the certificate of title. The monthly payments were \$300. Perkins missed the first two payments so Tidewater declared Perkins to be in default, accelerated the entire indebtedness, and repossessed the truck. It cost Tidewater \$60 to repossess the vehicle. Perkins came to Tidewater and offered Tidewater \$600 cash to return the truck. Tidewater refused. Instead, Tidewater persuaded Perkins to orally agree to waive the right to redeem the truck.

1. Was Tidewater obligated to allow Perkins to redeem the truck for \$600? What if Perkins had offered \$660?
2. Was Perkins’ waiver of the right of redemption valid?

Practice Pointers.

1. Repossession is not only hard on debtors; it also represents a failure for the secured party. Moreover as we shall see in Chapter 12 resale of the goods entails more substantial risks for the secured party because resale must be conducted in a manner that is commercially reasonable **in every respect.**
2. The best time to renegotiate a price or payment schedule on behalf of a debtor is before default. But even after default secured parties may be open to restructuring debt to avoid the hassles and risks of finding another reliable buyer of the collateral.
3. The debtor's right of redemption under Section 722 of the Bankruptcy Code is useful but only in certain circumstances. It makes sense for the debtor to redeem collateral under Section 722 only where the collateral's retail value is significantly less than the outstanding debt on the collateral.

End of Chapter 11

Chapter 12. Enforcement, continued. Resale, Strict Foreclosure

After default if the collateral is not redeemed then the secured party is entitled to **dispose** of the collateral (resell it, lease it, or license it). In the alternative the secured party may have the option of entering into an agreement with the debtor that will allow the secured party to keep the collateral in full or partial satisfaction of the debt, a process called **strict foreclosure**. This chapter covers both disposition of the collateral and strict foreclosure.

A. Learning Objectives

After watching the recorded lectures, taking the quizzes, reading this chapter, briefing the cases, answering the problems, completing all of the other assignments and participating in class students will be able to:

1. Identify who a secured party must notify before disposing of collateral.
2. Identify what a secured party must do to notify a debtor and other parties of a disposition of collateral.
3. Analyze whether the secured party gave sufficient notice of the disposition of collateral.
4. Identify the standard for determining whether a disposition of collateral by the secured party was in accordance with Article 9.
5. Analyze whether a disposition of collateral by a secured party was commercially reasonable in every respect.
6. Analyze whether a secured party has after disposition of the collateral given a consumer debtor or obligor a sufficient explanation of any remaining deficiency or surplus.
7. Determine the penalty for a secured party who has failed to give sufficient notice of disposition, failed to conduct a disposition of the collateral that was commercially reasonable, or failed to give a sufficient explanation of deficiency or surplus.
...
8. Identify what a secured party must do to retain collateral in partial or complete satisfaction of a debt, that is, to conduct a strict foreclosure.

9. Analyze whether there has been valid consent to strict foreclosure.

B. Lecture 36. Resale

After default the secured party must dispose of the collateral in a manner that is commercially reasonable in every respect. After disposition if the proceeds of the sale are less than what the debtor owes then the secured party can sue the debtor for a deficiency. If the sale of the collateral earns more than the debtor owes then the secured party must remit the surplus to the debtor. The secured party is obligated to send a notice to the debtor **before** the sale so that the debtor can take steps to repurchase the collateral or find another buyer. If the transaction was a consumer transaction then the secured party is also obligated to send an explanation to the debtor **after** the sale informing the debtor how much of a deficiency that the debtor owes or how much of a surplus that the debtor is entitled to.

The heading for the recorded lecture and this subsection of the textbook is titled “Resale” because the most common type of disposition is for the secured party to resell the collateral; however a secured party has some discretion in deciding how to generate funds from the collateral. [Section 9-610\(a\)](#) states:

Disposition after default. After default, a secured party may sell, lease, license or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.

Regardless of the type of disposition of collateral that the secured party chooses to undertake Article 9 creates several substantial responsibilities that a secured party must conform to and imposes significant liability if the secured party fails to live up to those responsibilities. A secured party must **give notice** of the disposition to the debtor and other parties, conduct the disposition in a **commercially reasonable manner**, and in a consumer transaction the secured party must **send the debtor an explanation** informing the debtor and other parties of the results of the disposition and whether the debtor owes a deficiency or is entitled to a surplus. If the secured party fails in any of these duties the secured party may be deprived of the right to sue for a deficiency and may also be liable for other damages. The ensuing subsections of the textbook address the following questions.

1. Who is entitled to receive a notice of disposition?
2. What information must be included in a pre-sale notice of disposition?
3. How must a secured party conduct a disposition of collateral?
4. How are the proceeds of the disposition to be applied and in consumer transactions what information must be included in the post-sale explanation of deficiency or surplus?

5. What are the legal consequences for a secured party's failure to give proper notice or failure to conduct a resale in a manner that is commercially reasonable in every respect?

1. Who Is Entitled to Receive a Notice of Disposition?

Before disposing of the collateral the secured party is required to send a **notice of disposition**. This is governed by [Section 9-611](#). The notice must be sent to the debtor, any secondary obligor (such as a guarantor or co-signer), and any secured party who filed a financing statement covering the collateral or whose lien was properly noted on a certificate of title.

Section 9-611 contains two exceptions to these rules. Under subsection [9-611\(c\)\(3\)](#) If the collateral is **consumer goods** then the secured party is obligated to give notice of disposition to the debtor but is not obligated to give notice to other secured parties. And under subsection [9-611\(d\)](#) if the collateral is **perishable goods** (such as a truckload of ice cream) or is a type of goods that is **customarily sold on a recognized market** (like shares of stock traded on the New York Stock Exchange) then the pre-sale notice of disposition does not have to be given.

Here is a recent case that turns in part upon whether an unsecured creditor (Opacmare) was entitled to pre-sale notice of disposition. The court also considered the circumstances under which a foreclosure sale can be invalidated.

Opacmare USA, LLC v. Lazzara Custom Yachts, LLC, 314 F.Supp.3d 1276 (M.D. Fla. 2018)

Lazzara Yacht Corporation defaulted on its loan and the collateral, the LAZZARA trademark, was sold at a private sale, ultimately ending up in the hands of a good faith purchaser for value, Lazzara Custom Yachts. Opacmare, an unsecured creditor, sued Lazzara Yacht Corporation and obtained judgment and a court order ordering the company to turn over the trademark to Opacmare. Opacmare contended that the sale of the trademark in foreclosure was invalid because Opacmare did not receive notice of the disposition.

The court ruled that Opacmare was not entitled to notice of disposition because it was an unsecured creditor. Moreover, the court ruled that so long as the buyer gave value and purchased the collateral in good faith a foreclosure sale may not be overturned. If a foreclosure sale is not conducted in a commercially reasonable manner the usual remedy is not to invalidate the sale but rather to deny the secured party the opportunity to collect any deficiency that may be owed.

Practice Pointers.

1. As an unsecured creditor it was very difficult for Opacmare to prevent the sale of the LAZZARA trademark to another company. Because Opacmare was an unsecured creditor it was not entitled to notice of disposition. It would have had to have discovered that the trademark was being sold and it would have had to bid more than other potential buyers.

2. If a party who is **not** a secured party purports to foreclose, is the sale valid? No, if the seller had no right to foreclose on the collateral then any attempted resale is a nullity.

3. As the court notes, Article 9 shields a person who in good faith purchased the collateral in an Article 9 foreclosure sale. [Section 9-617](#). If the buyer at a foreclosure sale did **not** act in good faith then the foreclosure sale is likely avoidable as a fraudulent conveyance.

4. Was Opacmare's claim "frivolous?" Should Opacmare have been held liable under Rule 11? In this case the court ruled that Opacmare had at least a "colorable" claim to the trademark and therefore it was not liable to pay the other side's attorney fees.

The required content of the pre-sale notice of disposition is the subject of the next section.

2. What Information Must Be Included in a Pre-Sale Notice of Disposition?

The notice of resale that is sent to debtors, secondary obligors, and other secured parties who have filed a financing statement must contain certain information.

[Section 9-613](#) governs the contents of a pre-sale notice of disposition. Section 9-613 states that the notice is sufficient if it:

- (i) describes the debtor and the secured party;
- (ii) describes the collateral which is the subject of the intended disposition;
- (iii) states the method of intended disposition;
- (iv) states that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting; and
- (v) states the time and place of a public disposition or the time after which any other disposition is to be made.

Minor errors that are not seriously misleading do not affect the sufficiency of the notice. Section 9-613 contains a form that can be used to give notice. It is wise for a secured party to adopt the notice form provided in Section 9-613.

[Section 9-614](#) governs the contents of pre-sale notification in consumer transactions. In addition to the foregoing information in consumer transactions Section 9-614 requires the notification to contain:

- (ii) a description of any liability for a deficiency of the person to which the notification is sent;
- (iii) a telephone number from which the amount which must be paid to the secured party to redeem the collateral under section 9623 (relating to right to redeem collateral) is available; and
- (iv) a telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

As with Section 9-613, Section 9-614 contains a form which if followed as a matter of law provides sufficient information.

The sufficiency of a pre-sale notification is one of the most common issues that is litigated under Article 9. Here are five cases on this subject that were decided in recent years.

[Hamilton v. Muncy, 93 U.C.C. Rep. Serv.2d 1382 \(Ky. Ct. App. 2017\) \(unpublished\)](#)

The court concluded:

In this case, Muncy received a “Notice of Sale” from Hamilton before he sold the vehicle. The Notice of Sale, however, plainly failed to include all the information mandated by KRS 355.9–615. As a consequence, the Notice of Sale was insufficient as a matter of law and violated the terms of KRS 355.9–615. Because Hamilton failed to comply with the notification requirements of KRS 355.9–615, we conclude, as did the circuit court, that he is precluded from recovering a deficiency judgment against Muncy.

[Manshadi v. Bleggi, 134 N.E.3d 695 \(Ohio Ct. App. 2019\)](#)

The Court ruled:

The notices clearly state that the sale of the assets by private sale would occur “after August 3, 2014.” It is also undisputed that the Article 9 sale of the assets to Appellees was executed on July 23, 2014, as written on the first page of the VRSA. As this sale predates the notification of sale date by nearly two weeks, on its face the notification does not provide reasonable notice of the disposition of Appellants’ collateral and violates the mandates of the UCC.

[Autovest, L.L.C. v. Weatherly, 98 U.C.C. Rep. Serv. 431 \(Del. Com. Pls. 2019\)](#)

After repossessing and reselling an automobile the plaintiff sued the defendant Weatherly for a deficiency judgment. The court reached the following conclusion:

Here, the Defendant was sent a letter advising her that her vehicle was repossessed on

July 28, 2015 and that Pelican will sell the vehicle at a public sale “sometime after August 13, 2015.” This notice is insufficient as it fails to specify the date, time and place of the sale.

...

Based on the forgoing, Plaintiff has failed to establish the right to collect on the debt against the Defendant. Accordingly, judgment is entered for Defendant. All parties are to pay their own costs.

Show-Me Credit Union v. Mosely, 541 S.W.3d 28 (2018)

The pre-sale notice stated that the secured party intended to dispose of the collateral “at a private or public sale.” The court found that this notice was inadequate because it failed to specify whether the foreclosure sale would be private or public. The court quoted the California Court of Appeal explaining why it was necessary to state whether the sale would be private or public:

“If a public sale is intended, notice of the time and place informs the debtor of the deadline for curing the default and, in the alternative, permits the debtor to arrange for someone to be present at the auction, either himself or another, to bid up the price. If a private sale is intended, notice of the date after which it will occur provides a minimum deadline for curing the default. The debtor may thereafter continue curative efforts until the collateral is sold and monitor the creditor’s attempts to sell the collateral to assure commercial reasonableness.” *Union Safe Deposit Bank v. Floyd*, 76 Cal. App. 4th 25, 40-41, 90 Cal.Rptr.2d 36 (1999),

Sun Trust Bank v. Howard, 173 A.D.3d 1101 (N.Y. App. Div. 2019)

The debtor Howard changed his address to Cross Bay Boulevard and the secured party Sun Trust Bank was made aware of the change. After Howard defaulted the bank sent the pre-disposition notice to Howard’s home address listed on the original loan application, instead of the Cross Bay Boulevard address that Howard had provided to the bank, and Howard did not learn of the foreclosure sale. The collateral, a yacht, was sold at foreclosure for \$975,000, leaving a deficiency of \$565,000. The court found that the notice of disposition was not commercially reasonable. This created a rebuttable presumption that the value of the collateral was equal to the amount of the outstanding indebtedness, meaning that the bank was not permitted to sue Howard for any deficiency unless the bank could produce evidence proving that the lack of notice to the debtor did not affect the price that was obtained at foreclosure.

Practice pointers.

1. An early passage in the appellate opinion foreshadows the outcome on appeal: "The [trial] court determined that the conduct of the plaintiff was not considerate or prudent, but all that was required of the plaintiff was commercially reasonable conduct. The defendant appeals." Would you advise a secured party that under the law their conduct does not have to be "considerate or prudent?"
2. Note again the penalty for failing to give the debtor adequate pre-sale notice of disposition: a rebuttable presumption arises that if the secured party had complied with the law then the collateral would have been sold for the full amount of the outstanding indebtedness. If the secured party cannot overcome that presumption then the secured party loses any right to recover a deficiency from the debtor. In this case that amounted to a loss of over \$565,000.

3. How Must the Secured Party Conduct a Disposition of Collateral?

Section 9-610(b) provides that "every aspect" of a disposition of collateral must be "commercially reasonable." The statute states:

Commercially reasonable disposition. Every aspect of a disposition of collateral, including the method, manner, time, place and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels and at any time and place and on any terms.

Commercial reasonableness is defined and described in several different provisions of the Code. Section 9-610(c) states that the secured party is entitled to purchase the collateral at a public sale but that the secured party may purchase at a private sale only under certain conditions:

Purchase by secured party. A secured party may purchase collateral:

- (1) at a public disposition; or
- (2) at a private disposition only if the collateral is of a kind which is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

Section 9-627(a) proclaims that price is not the sole determinate of whether a sale was commercially reasonable:

(a) Greater amount obtainable under other circumstances; no preclusion of commercial reasonableness. The fact that a greater amount could have been obtained

by a collection, enforcement, disposition or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition or acceptance was made in a commercially reasonable manner.

And [Section 9-627\(b\)](#) creates three “safe harbors.” If a secured party follows one of these guidelines then the disposition is commercially reasonable as a matter of law:

Dispositions which are commercially reasonable. A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

- (1) in the usual manner on any recognized market;
- (2) at the price current in any recognized market at the time of the disposition; or
- (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property which was the subject of the disposition.

As with **notice of disposition** there are myriad cases analyzing whether the **manner of disposition** was commercially reasonable. The courts have identified a wide range of factors to take into account in determining whether a resale was “commercially reasonable.” Many of these factors were discussed in the following case from Tennessee.

R & J of Tennessee, Inc. v. Blankenship-Melton Real Estate, Inc., 166 S.W.3d 195 (Tenn. Ct. App. 2005)

This is a “textbook case” illustrating the meaning of the term “commercially unreasonable.”

In the year 2000 the Bank of Henderson County made a loan in the amount of \$40,000 to Blankenship-Melton Real Estate, Inc. The bank was granted a security interest in a Ford truck, a tractor, and a double-wide trailer owned by the debtor. When the loan was made the bank estimated the value of the collateral to be \$40,000. Walden Blankenship, the President of Blankenship-Melton Real Estate, co-signed the note for the loan. Larry Melton and his son Steve Melton, the Secretary of Blankenship-Melton also co-signed the loan. The real estate company defaulted on the note. The bank then sold the note and the security interest to R & J of Tennessee. The majority owner of R & J was Johnny Melton.

Johnny Melton had his company purchase the note at the request of Larry and Steve Melton. When R & J purchased the promissory note Steve Melton was living in the trailer and did not pay rent to Blankenship-Melton. Larry Melton had possession of the Ford truck and the tractor. R & J did not sell the collateral until 7 ½ months later. The Meltons continued to use the truck, and the trailer that entire time.

R & J placed only two advertisements of the sale; a notice of the sale was posted in the courthouse building and another on the collateral itself. R & J did not seek an independent appraisal of the collateral. R & J was the only bidder on the collateral. R & J purchased the collateral for \$20,000. R & J then sued Walden Blankenship, one of the guarantors, for the deficiency.

The trial court found that the disposition of the collateral was commercially reasonable. The appellate court reversed, finding the circumstances of the sale were commercially unreasonable in several respects, including: (1) the continued use of the collateral after default by the relatives of the secured party; (2) the 7 ½ month delay in the sale of the collateral; (3) the lack of an independent appraisal which would have informed the secured party of the value of the collateral; (4) the utterly inadequate advertising of the foreclosure sale; and (5) the absence of any competitive bids and the low purchase price paid by the secured party. While a low purchase price and the lack of competitive bids by third parties do not automatically make a foreclosure sale commercially unreasonable, the cumulative effect of all of these factors gave rise to a presumption that the collateral should have been sold for an amount equal to the outstanding indebtedness, meaning that the guarantor Walden Blankenship was not liable for any deficiency unless R & J could prove that these defects did not affect how much the collateral sold for in foreclosure.

Practice Pointers.

1. Just as a secured party must be careful in how it repossesses the collateral, a secured party must be careful in how it disposes of the collateral. Sound legal advice and careful planning make the process more efficient and more fair.
2. As a “secondary obligor” Blankenship was entitled to receive notice of disposition. Why are guarantors entitled to pre-sale notice?
3. Blankenship also contended that the notice of the foreclosure sale was commercially unreasonable because Larry Melton sent it to Blankenship’s old address. After the initial trial Blankenship’s attorneys presented an additional piece of evidence in their motion for a new trial. On the same day that Larry Melton conducted the foreclosure sale of the collateral he sued Blankenship in federal court and he served the complaint at Blankenship’s correct address. Neither the trial court nor the appellate court considered this evidence because Blankenship failed to offer it at trial.

4. Application of Proceeds and the Post-Sale Explanation of Deficiency or Surplus

Section 9-615 sets forth the **order** in which the proceeds of the disposition are to be applied. Proceeds are applied in this order:

1. Reasonable expenses in repossessing and reselling the collateral;
2. Satisfaction of the indebtedness owed to the secured party;
3. Satisfaction of any subordinate security interests or liens.

Under [Section 9-615](#) if there is any indebtedness remaining after the proceeds of the disposition have been distributed then the secured party is entitled to claim the amount of the **deficiency** from an obligor. If there are any proceeds remaining after the liens on the collateral have been satisfied then the secured party must remit the **surplus** to the debtor.

If the obligor or the debtor is a **consumer** then the secured party must send an **explanation** of the deficiency or surplus. Under [Section 9-616](#) if a consumer debtor is entitled to a surplus or if a consumer obligor is liable for a deficiency then the secured party must give the debtor or obligor an explanation which:

- (1) states the amount of the surplus or deficiency;
- (2) provides an explanation ... of how the secured party calculated the surplus or deficiency;
- (3) states, if applicable, that future debits, credits, charges, including additional credit service charges or interest, rebates and expenses may affect the amount of the surplus or deficiency; and
- (4) provides a telephone number or mailing address from which additional information concerning the transaction is available.

The following case illustrates what can go wrong with the consumer's post-sale explanation.

Missouri Credit Union v. Diaz, 545 S.W.3d 856 (Mo. Ct. App. 2018)

The secured party (the Missouri Credit Union) foreclosed on the automobile owned by the borrowers (Diaz and Weir). The sale price of the car was less than the outstanding indebtedness, so there was a deficiency. The collateral was consumer goods, so following the sale the credit union sent the borrowers an explanation of the deficiency. However, the explanation failed to mention thousands of dollars of rebates and extra fees that altered the amount of the deficiency. This was in defiance of a provision of Section 9-616 that requires the explanation to contain a statement of any other debits or credits that might affect the amount of the deficiency.

A post-sale explanation need not be precisely accurate but rather must "substantially comply" with the requirements of Section 9-616. The trial court ruled in favor of the Credit Union but

the court of appeals reversed, finding that the credit union's explanation of deficiency did not substantially comply with the requirements of Section 9-616.

5. Legal Consequences for a Secured Party's Failure to Give Proper Notice or Failure to Conduct a Resale in a Manner that Is Commercially Reasonable in All Respects

When a secured party violates Article 9 by wrongfully repossessing the collateral, failing to give proper notice of disposition, or reselling the collateral in commercially unreasonable manner, then the secured party is liable to the debtor, secondary obligor, or other secured party whose rights were violated.

The remedies that are available for violation of Article 9 are set forth in Sections 9-625, 9-626, 9-627, and 9-628. Here are the principal remedies that are obtainable as well as some limitations on the remedies:

1. Court order. When a secured party violates Article 9, [Section 9-625\(a\)](#) authorizes the courts to "order or restrain collection, enforcement or disposition of collateral on appropriate terms and conditions."

2. Actual damages. When a person violates Article 9, [Section 9-625\(b\)](#) provides that the person is liable for damages "for any loss," including "loss resulting from the debtor's inability to obtain or increased costs of alternative financing." A variety of actual and punitive damages were recovered in *In re Lewis*, below.

3. Consumer goods penalty: interest plus 10% of principal. If the collateral was consumer goods and the secured party is a **lender** who violated Article 9 then under [Section 9-625\(c\)\(2\)](#) the secured party is liable for the credit service charge plus 10% of the principal amount of the loan. If the collateral was consumer goods and the secured party is a **credit seller** who violated Article 9 then under Section 9-625(c)(2) the secured party is liable for the time-price differential plus 10% of the cash price.

4. Statutory damages penalty of \$500. In addition to any actual damages, under [Section 9-625\(e\)](#) and [\(f\)](#) a debtor or consumer obligor is entitled to recover \$500 from a secured party for certain specific violations of Article 9, including failing to maintain the collateral, failing to file a termination statement, or failing to comply with a request for a statement of account or a list of collateral.

5. Loss of right to deficiency judgment in non-consumer cases. Where the collateral is **not** consumer goods if the secured party fails to prove that the enforcement of the security agreement was commercially reasonable in every respect then [Section 9-626\(a\)](#) creates a **rebuttable presumption** that the amount collected by the secured party was the amount of the entire outstanding indebtedness. In other words, the secured party is

presumptively denied the right to collect a deficiency judgment, and the secured party has the burden of proving how much would have been collected if the sale had been conducted in a commercially reasonable manner.

6. Loss of right to deficiency judgment in consumer cases. [Section 9-626](#) expressly states that it does not apply to consumer transactions. It even states that the courts should draw “no inference” from this omission about “the nature of the proper rule in consumer transactions.” The courts in many states have adopted the rule that in consumer cases if the secured party violates Article 9 then the secured party is not entitled to recover any deficiency.

7. Right to recover a surplus. Under [Section 9-615](#) if the secured party disposed of the collateral and realized a surplus or should have realized a surplus then the debtor is entitled to recover the amount of the surplus. What if the secured party **lied** about recovering a surplus? Is the secured party liable to the debtor for the phantom surplus? See the *Lewis* case below.

8. Limit on recovery of both actual damages and elimination of a deficiency in non-consumer cases. [Section 9-625\(d\)](#) provides that if a debtor’s deficiency is eliminated under [Section 9-626](#) then the debtor is **not** entitled to recover actual damages under [Section 9-625\(b\)](#). However, as the *Castillo* case below illustrates, this limitation does not apply to consumer transactions.

9. No liability if the disposition was approved by a court or by an assignee for the benefit of creditors. Under [Section 9-627\(c\)](#) if a disposition was approved by a court or by an assignee for the benefit of creditors then it is automatically considered to be “commercially reasonable.”

The following case reveals a number of gross violations of Article 9 and the Bankruptcy Code.

In re Lewis, 98 UCC Rep. Serv.2d 1022 (Bankr. Ct. W.D. Louisiana 2019)

Money Mayday Loans lent Kerry Lewis \$400 against a car worth over \$3,000. This is called a “car title loan.” Lewis defaulted and declared bankruptcy. After repossessing the car Money Payday Loans committed a number of serious violations of both Article 9 and the Bankruptcy Code.

The secured party ended up claiming \$800 for an outstanding indebtedness of \$125; it did not send Lewis a notice of the repossession; it pretended to have sold the car within hours of the repossession in order to avoid the automatic stay of bankruptcy and to deprive the debtor of the opportunity to redeem the car; it lied when it said that the sale price was \$700, which was

one-third of the value of the car; it did not send a pre-disposition notice to the debtor; and it forged the sale documents.

The court found that the secured party had violated not only the U.C.C. in several respects but also the Bankruptcy Code. The court awarded Lewis more than \$20,000 in damages for loss of the vehicle; lost wages; transportation costs; emotional distress; attorney fees; and punitive damages. The court also found that Tracy Cullum, the owner of Money Payday Loans, was guilty of fraud and was personally liable in damages to Lewis.

Practice Pointers.

1. This case illustrates that there are serious consequences for violating the automatic stay that goes into effect when a person files for bankruptcy.
2. This case also illustrates the broad range of actual and punitive damages that are recoverable from a secured party who has sought to enforce a security interest in violation of Section 362 establishing the automatic stay in bankruptcy.

As noted above, the *Castillo* case involves the types of damages that can be recovered in consumer transactions.

Castillo v. United Federal Credit Union, 409 P.3d 54 (Nevada Supreme Court 2018)

The technical issue in this case was jurisdictional. For a Nevada district court to have jurisdiction the amount in controversy must be \$10,000 or more. The debtor, Castillo, sued the secured party, the United Federal Credit Union, for both statutory damages in the amount of \$6,000 and to eliminate a deficiency in the amount of \$6,000. In commercial cases the debtor must choose between an award of statutory damages or elimination of a deficiency, but in consumer cases a debtor may be entitled to both remedies. Castillo was a consumer debtor. Accordingly, the jurisdictional amount was satisfied in the case.

C. Lecture 37. Strict Foreclosure

Strict foreclosure is governed by [Sections 9-620, 9-621, and 9-622](#).

Strict foreclosure occurs when the parties agree that the secured party will accept the collateral in full or partial satisfaction of the debt. The parties may not agree to strict foreclosure in the original security agreement. Instead **after default** the secured party must send a written proposal to the debtor and others unconditionally offering to accept the collateral in full or

partial satisfaction of the debt. The proposal must state whether the offer is for full or partial satisfaction. If the debtor and other parties **fail to respond** to a proposal for **full satisfaction** of the debt within 20 days then the secured party may retain the collateral in full satisfaction of the debt. For **partial satisfaction** to be effective the debtor must **expressly agree** in writing both to allowing the secured party to retain the collateral and to the terms of the partial satisfaction.

There are additional limitations on the use of strict foreclosure in consumer transactions.

Three questions about strict foreclosure are addressed below:

1. When is strict foreclosure available to the secured party?
2. Was there a valid post-default consent from all parties to strict foreclosure?
3. Can a strict foreclosure be a fraudulent transfer?

1. When Is Strict Foreclosure Available to the Secured Party?

Under [Section 9-620](#) strict foreclosure is not available to a secured party unless the secured party obtains the consent of other parties **after default**.

Moreover because of the danger of abuse, in certain circumstances involving **consumers** [Section 9-620](#) prohibits strict foreclosure.

1. If the collateral is **consumer goods** the debtor **must not be in possession** of the collateral when the proposal is made. If the debtor still has possession of the collateral then secured party may not propose to retain the goods in full or partial satisfaction of the indebtedness.
2. If the collateral is **consumer goods** the consumer **must not have paid more than 60% of the cash price or principal amount**. If a consumer has paid 60% of the price of the goods or repaid 60% of the loan secured by the goods then strict foreclosure is not available.
3. If the transaction is a **consumer transaction** then strict foreclosure is not permitted in partial satisfaction of the indebtedness. In a consumer transaction a secured party may propose strict foreclosure **only in full satisfaction** of any indebtedness.

Another rule protecting consumers was judicially forged. Forty years ago in *Reeves v. Foutz & Tanner, Inc.*, 617 P.2d 149 (N.M. Sup. Ct. 1980) the New Mexico Supreme Court was faced with a pawnshop that had exercised strict foreclosure over jewelry belonging to two Native Americans. The jewelry was far more valuable than the amount of the debt that the jewelry secured. After default the pawnshop sent the notice proposing strict foreclosure to the debtors.

The debtors did not respond so the pawnshop kept the jewelry in satisfaction of the debt and then sold the jewelry for much more than the original debt. The court reasoned that because the pawnshop resold the jewelry that the transaction was not a strict foreclosure but rather a disposition of the collateral and the pawnshop was therefore liable to the uneducated debtors for the surplus that the pawnshop realized. If the court's explanation is taken literally then it would call into doubt nearly every act of strict foreclosure; rarely does a secured party retain collateral for its personal use! In the alternative the court could have reasoned that this particular exercise of strict foreclosure was unconscionable.

2. Was There Valid Consent to Strict Foreclosure?

Strict foreclosure is not allowed unless all parties consent to it.

Under [Section 9-621](#) a secured party must send a proposal for strict foreclosure to the debtor, any secured party of record, and any other person who has in writing notified the secured party of a claim of an interest in the collateral. If the proposal is for strict foreclosure in partial satisfaction of the debt then the secured party must also send the proposal to any secondary obligor.

To prevent strict foreclosure the debtor or other party must object to the proposal in writing (an "authenticated record"). The following case illustrates that requirement.

[Bennett v. Bascom, 788 Fed.Appx. 318 \(6th Cir. 2019\)](#)

The secured party sent the debtor a proposal to retain the collateral in satisfaction of the debt. The debtor's attorney responded by email, stating that the proposal was "premature and beyond [the secured party's] abilities as a purported creditor," but that the attorney would "send ... a more detailed response on behalf of the Estate in a few days." The attorney did not follow up with a more detailed response.

The secured party contended that the attorney's response did not constitute a rejection of the proposal to retain the collateral in satisfaction of the debt, and that therefore the strict foreclosure was valid. The Sixth Circuit Court of Appeals disagreed, and found that the attorney's response was sufficient to constitute an objection to the proposal and that a follow-up was not necessary to prevent the secured party from strictly foreclosing on the collateral.

Practice Pointer.

The requirement of consent to strict foreclosure also protects the secured party. Years ago debtors would frequently argue that the secured party had effected a strict foreclosure by repossessing the collateral and failing to dispose of the collateral within a reasonable time. [Section 9-620\(b\)](#) now provides:

Purported acceptance ineffective. A purported or apparent acceptance of collateral under this section is ineffective unless:

- (1) the secured party consents to the acceptance in an authenticated record or sends a proposal to the debtor; and
- (2) the conditions of subsection (a) are met.

If the secured party does **not** wish to effect a strict foreclosure then the secured party should be careful in its correspondence with the debtor so that its communications are not construed as a proposal to retain the collateral in satisfaction of the debt.

3. Can a Strict Foreclosure Be a Fraudulent Transfer?

Yes! Under Section 8(e) of the Uniform Voidable Transactions Act ([12 Pa. C.S. 5108\(e\)\(2\)](#) of PUVTA) a strict foreclosure can be voidable as a fraudulent conveyance if all of the elements of an actual or constructive fraudulent conveyance are met.

End of Chapter 12

CODEBOOK FOR SECURED TRANSACTIONS

Pennsylvania Commercial Code Divisions 1, 2, and 9 and
Selected Provisions of the Bankruptcy Code and Internal
Revenue Code



Duquesne University School of Law
Professor Wilson Huhn
Fall 2019

Preface to Codebook

This codebook is intended for the use of Professor Huhn's students in Secured Transactions, a course at Duquesne University School of Law. It includes the Divisions 1, 2, and 9 of the Pennsylvania Commercial Code (corresponding to Articles 1, 2, and 9 of the Uniform Commercial Code) as well as selected provisions of the Bankruptcy Code and the Internal Revenue Code.

You may also use the Navigation Pane to link directly to specific sections of the Pennsylvania Commercial Code and other statutes. (The Navigation Pane will appear in the left-hand margin if you click on "View" and check the box next to "Navigation Pane.") There are also links to the Westlaw webpages of the corresponding provision of the Uniform Commercial Code so that students may read the legislative history and Official Comments to those provisions.

I wish to thank research assistants Lucille Shane, Charles Ackman, Jyme Mariani, and John Unitt of the University of Akron School of law for their hard work and invaluable assistance in compiling earlier versions of this codebook.

Wilson Huhn
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Division 1, Pennsylvania Commercial Code. General Provisions

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Chapter 11. General Provisions

§ 1101. Short Titles

(a) **Title.** This title may be cited as the Uniform Commercial Code.

(b) **Division.** This division may be cited as Uniform Commercial Code-General Provisions.

[Official Comment to § 1-101.](#)

§ 1102. Scope of Division

This division applies to a transaction to the extent that it is governed by another division of this title.

[Official Comment to § 1-102.](#)

§ 1103. Construction of this Title [the Uniform Commercial Code] to Promote its Purposes and Policies: Applicability of Supplemental Principles of Law

(a) **Liberal construction.** This title must be liberally construed and applied to promote its underlying purposes and policies, which are:

- (1) to simplify, clarify, and modernize the law governing commercial transactions;
- (2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and
- (3) to make uniform the law among the various jurisdictions.

(b) **Law and equity.** Unless displaced by the particular provisions of this title, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions.

[Official Comment to § 1-103.](#)

§ 1104. Construction Against Implied Repeal

This title being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided.

[Official Comment to § 1-104.](#)

§ 1105. (Reserved)

[Official Comment to § 1-105.](#)

§ 1108. Relation to Electronic Signatures in Global and National Commerce Act

This division modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., except that nothing in this division modifies, limits, or supersedes Section 7001(c) of that Act or authorizes electronic delivery of any of the notices described in Section 7003(b) of that Act.

[Official Comment to § 1-108.](#)

§ 1106. Use of Singular and Plural; Gender (Reserved)

[Official Comment to § 1-106.](#)

§ 1107. Section Captions

Notwithstanding 1 Pa.C.S. § 1924 (relating to construction of titles, preambles, provisos, exceptions and headings), section captions are part of this title.

[Official Comment to § 1-107.](#)

§ 1109. Construction

Nothing in this title shall be construed to modify or supersede the provisions of 42 Pa.C.S. Ch. 69 (relating to particular rights and immunities).

Chapter 12. General Definitions and Principles of Interpretation

§ 1201. General Definitions

(a) Definition Provisions. Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other articles of [the Uniform Commercial Code] that apply to particular division or chapters thereof, have the meanings stated.

(b) Definitions. Subject to definitions contained in other articles of [the Uniform Commercial Code] that apply to particular divisions or chapters thereof:

(1) **"Action."** In the sense of a judicial proceeding, the term includes recoupment, counterclaim, set-off, suit in equity, and any other proceeding in which rights are determined.

(2) **"Aggrieved party."** A party entitled to pursue a remedy.

(3) **"Agreement."** As distinguished from "contract" under paragraph (12), the term means the bargain of the parties in fact, as found in their language or inferred from other

circumstances, including course of performance, course of dealing, or usage of trade as provided in section 1303 (relating to course of performance, course of dealing and usage of trade).

(4) "**Bank.**" A person engaged in the business of banking. The term includes a savings bank, savings and loan association, credit union, and trust company.

(5) "**Bearer.**" A person in control of a negotiable electronic document of title or a person in possession of a negotiable instrument, negotiable tangible document of title or certificated security, that is payable to bearer or indorsed in blank.

(6) "**Bill of lading.**" A document of title evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods. The term does not include a warehouse receipt.

(7) "**Branch.**" The term includes a separately incorporated foreign branch of a bank.

(8) "**Burden of establishing.**" As to a fact, the burden of persuading the trier of fact that the existence of the fact is more probable than its nonexistence.

(9) "**Buyer in ordinary course of business.**" A person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind.

(i) A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices.

(ii) A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind.

(iii) A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale.

(iv) Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Division 2 may be a buyer in ordinary course of business.

The term does not include a person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) "**Conspicuous.**" With reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. Whether a

term is "conspicuous" or not is a decision for the court. Conspicuous terms include the following:

(i) A heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size.

(ii) Language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language.

(11) "**Consumer.**" An individual who enters into a transaction primarily for personal, family, or household purposes.

(12) "**Contract.**" As distinguished from "agreement" in paragraph (3), the total legal obligation that results from the parties' agreement as determined by this title [the Uniform Commercial Code] as supplemented by any other applicable laws.

(13) "**Creditor.**" The term includes a general creditor, a secured creditor, a lien creditor, and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity, and an executor or administrator of an insolvent debtor's or assignor's estate.

(14) "**Defendant.**" Includes a person in the position of defendant in a counterclaim, cross-claim, or third-party claim.

(15) "**Delivery.**" With respect to an electronic document of title means voluntary transfer of control and with respect to an instrument, document of title, or chattel paper, means voluntary transfer of possession.

(16) "**Document of title.**" A record that:

(i) in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold, and dispose of the document and the goods it covers; or

(ii) purports to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

The term includes a bill of lading, transport document, dock warrant, dock receipt, warehouse receipt and order for the delivery of goods.

(16.1) "**Electronic document of title**" A document of title evidenced by a record consisting of information stored in an electronic medium.

(17) "**Fault.**" A default, breach, or wrongful act or omission.

(18) "**Fungible goods.**" As follows:

- (i) goods of which any unit, by nature or usage of trade, is the equivalent of any other like unit; or
- (ii) goods that by agreement are treated as equivalent.

(19) "**Genuine.**" Free of forgery or counterfeiting.

(20) "**Good faith.**" Except as otherwise provided in Division 5 (relating to letters of credit), means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(21) "**Holder.**" As follows:

- (i) the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession; or
- (ii) the person in possession of a document of title if the goods are deliverable either to bearer or to the order of the person in possession; or
- (iii) the person in control of a negotiable electronic document of title.

(22) "**Insolvency proceeding.**" Includes an assignment for the benefit of creditors or other proceeding intended to liquidate or rehabilitate the estate of the person involved.

(23) "**Insolvent.**" As follows:

- (i) having generally ceased to pay debts in the ordinary course of business other than as a result of bona fide dispute;
- (ii) being unable to pay debts as they become due; or
- (iii) being insolvent within the meaning of federal bankruptcy law.

(24) "**Money.**" A medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries.

(25) "**Organization.**" A person other than an individual.

(26) "**Party.**" As distinguished from "third party", a person that has engaged in a transaction or made an agreement subject to this title [the Uniform Commercial Code].

(27) "**Person.**" Any individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or other legal or commercial entity.

(28) "**Present value.**" The amount as of a date certain of one or more sums payable in the future, discounted to the date certain by use of either:

- (i) an interest rate specified by the parties if that rate is not manifestly unreasonable at the time the transaction is entered into or,
- (ii) if an interest rate is not so specified, a commercially reasonable rate that takes into account the facts and circumstances at the time the transaction is entered into.

(29) "**Purchase.**" Taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or other voluntary transaction creating an interest in property.

(30) "**Purchaser.**" A person that takes by purchase.

(31) "**Record.**" Information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(32) "**Remedy.**" Any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

(33) "**Representative.**" A person empowered to act for another, including an agent; an officer of a corporation or association; and a trustee, executor, or administrator of an estate.

(34) "**Right.**" Includes remedy.

(35) "**Security interest.**" An interest in personal property or fixtures which secures payment or performance of an obligation.

- (i) The term includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Division 9 (relating to secured transactions).
- (ii) The term does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under section 2401 (relating to passing of title; reservation for security; limited application of section), but a buyer may also acquire a "security interest" by complying with Division 9 (relating to secured transactions).

(iii) Except as otherwise provided in section 2505 (relating to shipment by seller under reservation), the right of a seller or lessor of goods under Division 2 (relating to sales) or Division 2A (relating to leases) to retain or acquire possession of the goods is not a "security interest"; but a seller or lessor may also acquire a "security interest" by complying with Division 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under section 2401 is limited in effect to a reservation of a "security interest."

(iv) Whether a transaction in the form of a lease creates a "security interest" is determined pursuant to section 1203 (relating to lease distinguished from security interest).

(36) "**Send.**" In connection with a writing, record, or notice:

(i) to deposit in the mail or deliver for transmission by any other usual means of communication:

(A) with postage or cost of transmission provided for;

(B) properly addressed and,

(C) in the case of an instrument:

(i) to an address specified thereon or otherwise agreed upon; or

(ii) if no address is specified or agreed upon, to any address reasonable under the circumstances; or

(ii) in any other way to cause to be received any record or notice within the time it would have arrived if properly sent.

(37) "**Signed.**" Includes using any symbol executed or adopted with present intention to adopt or accept a writing.

(38) "**State.**" A State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(39) "**Surety.**" Includes a guarantor or other secondary obligor.

(40) "**Term.**" A portion of an agreement that relates to a particular matter.

(41) "**Unauthorized signature.**" A signature made without actual, implied, or apparent authority. The term includes a forgery.

(42) "**Warehouse receipt.**" A receipt issued by a person engaged in the business of storing goods for hire.

(43) "**Writing.**" Includes printing, typewriting, or any other intentional reduction to tangible form.

(44) "**Written.**" Includes printing, typewriting or any other intentional reduction to tangible form.

Official Comment to § 1-201.

§ 1202. Notice; Knowledge

(a) Notice. Subject to subsection (f), a person has notice of a fact if the person:

- (1) has actual knowledge of it;
- (2) has received a notice or notification of it; or
- (3) from all the facts and circumstances known to the person at the time in question, has reason to know that it exists.

(b) Knowledge. "Knowledge" means actual knowledge. "Knows" has a corresponding meaning.

(c) Reason to know distinguished. "Discover", "learn", or words of similar import refer to knowledge rather than to reason to know.

(d) Notify. A person notifies or gives a notice or notification to another person by taking such steps as may be reasonably required to inform the other person in ordinary course, whether or not the other person actually comes to know of it.

(e) Be notified. Subject to subsection (f), a person receives a notice or notification when:

- (1) it comes to that person's attention; or
- (2) it is duly delivered in a form reasonable under the circumstances at:
 - (i) the place of business through which the contract was made; or
 - (ii) another location held out by that person as the place for receipt of such communications.

(f) Communication to organizations. Notice, knowledge, or a notice or notification received by an organization is effective for a particular transaction from the time it is brought to the attention of the individual conducting that transaction and, in any event, from the time it would have been brought to the individual's attention if the organization had exercised due diligence. An

organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

Official Comment to § 1-202.

§ 1203. Lease Distinguished from Security Interest.

(a) Factual determination. Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.

(b) Sufficient attributes for security interest. A transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee, and:

- (1) the original term of the lease is equal to or greater than the remaining economic life of the goods;
- (2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;
- (3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or
- (4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

(c) Insufficient attributes for security interest. A transaction in the form of a lease does not create a security interest merely because:

- (1) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;
- (2) the lessee assumes risk of loss of the goods;
- (3) the lessee agrees to pay, with respect to the goods, taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;
- (4) the lessee has an option to renew the lease or to become the owner of the goods;

(5) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or

(6) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

(d) Nominal consideration. Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Additional consideration is not nominal if:

(1) when the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or

(2) when the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed.

(e) Remaining economic life and reasonable predictability. The "remaining economic life of the goods" and "reasonably predictable" fair market rent, fair market value, or cost of performing under the lease agreement must be determined with reference to the facts and circumstances at the time the transaction is entered into.

Official Comment to § 1-203.

§ 1204. Value

Except as otherwise provided in Divisions 3 (relating to negotiable instruments), 4 (relating to bank deposits and collections), and 5 (relating to letters of credit), a person gives value for rights if the person acquires them:

(1) in return for a binding commitment to extend credit or for the extension of immediately available credit, whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection;

(2) as security for, or in total or partial satisfaction of, a preexisting claim;

(3) by accepting delivery under a preexisting contract for purchase; or

(4) in return for any consideration sufficient to support a simple contract.

Official Comment to § 1-204.

§ 1205. Reasonable time; Seasonableness

(a) Reasonable time. Whether a time for taking an action required by this title [the Uniform Commercial Code] is reasonable depends on the nature, purpose, and circumstances of the action.

(b) Seasonableness. An action is taken seasonably if it is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time.

[Official Comment to § 1-205.](#)

§ 1206. Presumptions

Whenever this title [the Uniform Commercial Code] creates a "presumption" with respect to a fact, or provides that a fact is "presumed," the trier of fact must find the existence of the fact unless and until evidence is introduced that supports a finding of its nonexistence.

[Official Comment to § 1-206.](#)

Chapter 13. Territorial Applicability and General Rules

§ 1301. Territorial Applicability; Parties' Power to Choose Applicable Law.

(a) Agreement; reasonable relation requirement. Except as otherwise provided in this section, when a transaction bears a reasonable relation to this Commonwealth and also to another state or nation, the parties may agree that the law either of this Commonwealth or of such other state or nation shall govern their rights and duties.

(b) Absence of agreement; approved relation requirement. In the absence of an agreement effective under subsection (a), and except as provided in subsection (c), this title applies to transactions bearing an appropriate relation to this Commonwealth.

(c) Mandatory applicability of title. If one of the following provisions of this title specifies the applicable law, that provision governs, and a contrary agreement is effective only to the extent permitted by the law so specified:

(1) Section 2402 (relating to rights of creditors of seller against sold goods).

(2) Sections 2A105 (relating to territorial application of division to goods covered by certificate of title) and 2A106 (relating to limitation on power of parties to consumer lease to choose applicable law and judicial forum).

(3) Section 4102 (relating to applicability).

(4) Section 4A507 (relating to choice of law).

- (5) Section 5116 (relating to choice of law and forum).
- (6) Section 8110 (relating to applicability; choice of law).
- (7) Ch. 93 Subch. A (relating to law governing perfection and priority).

Official Comment to § 1-301.

§ 1302. Variation by Agreement

(a) General Rule. Except as otherwise provided in subsection (b) or elsewhere in this title [the Uniform Commercial Code], the effect of provisions of this title [the Uniform Commercial Code] may be varied by agreement.

(b) Exceptions. The obligations of good faith, diligence, reasonableness, and care prescribed by this title [the Uniform Commercial Code] may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever this title [the Uniform Commercial Code] requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

(c) Effect of terminology. The presence in certain provisions of this title [the Uniform Commercial Code] of the phrase "unless otherwise agreed", or words of similar import, does not imply that the effect of other provisions may not be varied by agreement under this section.

Official Comment to § 1-302.

§ 1303. Course of Performance, Course of Dealing, and Usage of Trade

(a) Course of performance. A "course of performance" is a sequence of conduct between the parties to a particular transaction that exists if:

- (1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and
- (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.

(b) Course of dealing. A "course of dealing" is a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(c) Usage of trade. A "usage of trade" is any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage

must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law.

(d) Evidentiary effect. A course of performance or course of dealing between the parties or usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware is relevant in ascertaining the meaning of the parties' agreement, may give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement. A usage of trade applicable in the place in which part of the performance under the agreement is to occur may be so utilized as to that part of the performance.

(e) Construction in general. Except as otherwise provided in subsection (f), the express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade must be construed whenever reasonable as consistent with each other. If such a construction is unreasonable:

- (1) express terms prevail over course of performance, course of dealing, and usage of trade;
- (2) course of performance prevails over course of dealing and usage of trade; and
- (3) course of dealing prevails over usage of trade.

(f) Waiver or modification. Subject to Section 2-209, a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

(g) Evidence. Evidence of a relevant usage of trade offered by one party is not admissible unless that party has given the other party notice that the court finds sufficient to prevent unfair surprise to the other party.

[Official Comment to § 1-303.](#)

§ 1304. Obligation of Good Faith

Every contract or duty within this title [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.

[Official Comment to § 1-304.](#)

§ 1305. Remedies to be Liberally Administered

(a) Administration. The remedies provided by this title [the Uniform Commercial Code] must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special damages nor penal damages may be had except as specifically provided in this title [the Uniform Commercial Code] or by other rule of law.

(b) Enforceability. Any right or obligation declared by this title [the Uniform Commercial Code] is enforceable by action unless the provision declaring it specifies a different and limited effect.

[Official Comment to § 1-305.](#)

§ 1306. Waiver or Renunciation of Claim or Right After Breach

A claim or right arising out of an alleged breach may be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record.

[Official Comment to § 1-306.](#)

§ 1307. Prima Facie Evidence by Third-Party Documents

A document in due form purporting to be a bill of lading, policy or certificate of insurance, official weigher's or inspector's certificate, consular invoice, or any other document authorized or required by the contract to be issued by a third party is prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party.

[Official Comment to § 1-307.](#)

§ 1308. Performance or Acceptance Under Reservation of Rights

(a) General Rule. A party that with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice," "under protest," or the like are sufficient.

(b) Exception. Subsection (a) does not apply to an accord and satisfaction.

[Official Comment to § 1-308.](#)

§ 1309. Option to Accelerate at Will

A term providing that one party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or when the party "deems itself insecure," or words of similar import, means that the party has power to do so only if that party in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against which the power has been exercised.

[Official Comment to § 1-309.](#)

§ 1310. Subordinated Obligations

An obligation may be issued as subordinated to performance of another obligation of the person obligated, or a creditor may subordinate its right to performance of an obligation by agreement with either the person obligated or another creditor of the person obligated. Subordination does not create a security interest as against either the common debtor or a subordinated creditor.

Official Comment to § 1-310.

Division 2, Pennsylvania Commercial Code. Sales

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Chapter 21. Short Title of Division

§ 2101. Short Title

This Division shall be known and may be cited as the Uniform Commercial Code, Article 2, Sales.

Official Comment to § 2-101

§ 2102. Scope; Certain Security and Other Transactions Excluded From Division

Unless the context otherwise requires, this division [Article 2 of the Uniform Commercial Code] applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this division [Article 2 of the Uniform Commercial Code] impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

Official Comment to § 2-102

§ 2103. Definitions and Index of Definitions

(a) Definitions. The following words and phrases when used in this division shall have, unless the context clearly indicates otherwise, the meanings given to them in this subsection:

“Buyer.” A person who buys or contracts to buy goods.

“Receipt.” Receipt of goods means taking physical possession of them.

“Seller.” A person who sells or contracts to sell goods.

(b) Index of other definitions in division. Other definitions applying to this division or to specified chapters thereof, and the sections in which they appear are:

“Acceptance.” Section 2606.

“Banker's credit.” Section 2325.

“Between merchants.” Section 2104.

“Cancellation.” Section 2106(d).

“Commercial unit.” Section 2105.

“Confirmed credit.” Section 2325.

“Conforming to contract.” Section 2106.

“Contract for sale.” Section 2106.

“Cover.” Section 2712.

“Entrusting.” Section 2403.

“Financing agency.” Section 2104.

“Future goods.” Section 2105.

“Goods.” Section 2105.

“Identification.” Section 2501.

“Installment contract.” Section 2612.

“Letter of credit.” Section 2325.

“Lot.” Section 2105.

“Merchant.” Section 2104.

“Overseas.” Section 2323.

“Person in position of seller.” Section 2707.

“Present sale.” Section 2106.

“Sale.” Section 2106.

“Sale on approval.” Section 2326.

“Sale or return.” Section 2326.

“Termination.” Section 2106.

(c) Index of definitions in other divisions. The following definitions in other divisions apply to this division:

“Check.” Section 3104.

“Consignee.” Section 7102.

“Consignor.” Section 7102.

“Consumer goods.” Section 9102.

“Control.” Section 7106.

“Dishonor.” Section 3502.

“Draft.” Section 3104.

(d) Applicability of general definitions and principles. In addition, Division 1 (relating to general provisions) contains general definitions and principles of construction and interpretation applicable throughout this division.

Official Comment to § 2-103

§ 2104. Definitions: “Merchant”; “Between Merchants”; “Financing Agency”

The following words and phrases when used in this division [Article 2 of the Uniform Commercial Code] shall have the meanings given to them in this section:

“Between merchants.” Between merchants means in any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants.

“Financing agency.” Any bank, finance company or other person who in the ordinary course of business makes advances against goods or documents of title or who by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale, as by purchasing or paying the seller's draft or making advances against it or by merely taking it for collection whether or not documents of title accompany or are associated with the draft. The term includes also a bank or other person who similarly intervenes between persons who are in the position of seller and buyer in respect to the goods (Section 2707).

“Merchant.” A person who

(1) deals in goods of the kind; or

(2) otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill

may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

Official Comment to § 2-104

§ 2105. Definitions: Transferability; “Goods”; “Future” Goods; “Lot”; “Commercial Unit”

(a) “Goods.” “Goods” means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Division 8) and things in action. “Goods” also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (section 2107).

(b) Transferability; “future” goods. Goods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are “future” goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(c) Sale of part interest in goods. There may be a sale of a part interest in existing identified goods.

(d) Fungible goods. An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

(e) “Lot.” “Lot” means a parcel or a single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract.

(f) “Commercial unit.” “Commercial unit” means such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine) or a set of articles (as a suite of furniture or an assortment of sizes) or a quantity (as a bale, gross, or carload) or any other unit treated in use or in the relevant market as a single whole.

Official Comment to § 2-105

§ 2106. Definitions: “Contract”; “Agreement”; “Contract for Sale”; “Sale”; “Present Sale”; “Conforming” to Contract; “Termination”; “Cancellation”

(1) “Contract”, “agreement”, “sale”. In this Division unless the context otherwise requires “contract” and “agreement” are limited to those relating to the present or future sale of goods. “Contract for sale” includes both a present sale of goods and a contract to sell goods at a future time. A “sale” consists in the passing of title from the seller to the buyer for a price (Section 2-401). A “present sale” means a sale which is accomplished by the making of the contract.

(2) “Conforming” to contract. Goods or conduct including any part of a performance are “conforming” or conform to the contract when they are in accordance with the obligations under the contract.

(3) “Termination.” “Termination” occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On “termination” all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) “Cancellation.” “Cancellation” occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of “termination” except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.

[Official Comment to § 2-106](#)

§ 2107. Goods to Be Severed From Realty: Recording

(a) Minerals and structures. A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this division if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(b) Other property severable without material harm. A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) or of timber to be cut is a contract for the sale of goods within this division whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(c) Recording. The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

[Official Comment to § 2-107](#)

Chapter 22. Form, Formation and Readjustment of Contract.

§ 2201. Formal Requirements; Statute of Frauds

(a) General rule. Except as otherwise provided in this section a contract for the sale of goods for the price of \$500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the

contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(b) Writing confirming contract between merchants. Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received.

(c) Enforceability of contracts not satisfying general requirements. A contract which does not satisfy the requirements of subsection (a) but which is valid in other respects is enforceable

- (1) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or
- (2) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or
- (3) with respect to goods for which payment has been made and accepted or which have been received and accepted (section 2606).

(d) Qualified financial contracts. Subsection (a) does not apply to a qualified financial contract, as defined in section 1206(c)(1) (relating to statute of frauds for kinds of personal property not otherwise covered), if either:

- (1) there is, as provided in section 1206(c)(3), sufficient evidence to indicate that a contract has been made; or
- (2) the parties, by means of a prior or subsequent written contract, have agreed to be bound by the terms of the qualified financial contract from the time they reach agreement (by telephone, by exchange of electronic messages or otherwise) on those terms.

Official Comment to § 2-201.

§ 2202. Final Written Expression: Parol or Extrinsic Evidence

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

- (1) by course of performance, course of dealing, or usage of trade (Section 1-303); and

(2) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

Official Comment to § 2-202.

§ 2203. Seals Inoperative

The affixing of a seal to a writing evidencing a contract for sale or an offer to buy or sell goods does not constitute the writing a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer.

Official Comment to § 2-203.

§ 2204. Formation in general

(a) General rule. A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.

(b) Effect of undetermined time of making agreement. An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(c) Effect of open terms. Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy

Official Comment to § 2-204.

§ 2205. Firm Offers

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

Official Comment to § 2-205.

§2206. Offer and Acceptance in Formation of Contract

(a) General rule. Unless otherwise unambiguously indicated by the language or circumstances

(1) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;

(2) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods, but such a shipment of non-conforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(b) Beginning requested performance without notice. Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

[Official Comment to § 2-206.](#)

§2207. Additional Terms in Acceptance or Confirmation

(a) General rule. A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(b) Effect on contract. The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(1) the offer expressly limits acceptance to the terms of the offer;

(2) they materially alter it; or

(3) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(c) Conduct establishing contract. Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

[Official Comment to § 2-207.](#)

§ 2208. [Deleted]

Text of section was deleted to conform to the 2001 Revision of Article 1 of the Code.

[Official Comment to § 2-208.](#)

§ 2209. Modification, Rescission and Waiver

- (a) Consideration unnecessary for modification.** An agreement modifying a contract within this division needs no consideration to be binding.
- (b) Writing excluding modification or rescission.** A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.
- (c) Compliance of modified contract with statute of frauds.** The requirements of the statute of frauds section of this division (section 2201) must be satisfied if the contract as modified is within its provisions.
- (d) Ineffective modification or rescission as waiver.** Although an attempt at modification or rescission does not satisfy the requirements of subsection (b) or (c) it can operate as a waiver.

(e) Retraction of waiver. A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

Official Comment to § 2-209.

§ 2210. Delegation of Performance; Assignment of Rights

- (a) Delegation of performance.** A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.
- (b) Assignment of rights.** Except as otherwise provided in section 9406 (relating to discharge of account debtor; notification of assignment; identification and proof of assignment; restrictions on assignment of accounts, chattel paper, payment intangibles and promissory notes ineffective), unless otherwise agreed, all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise.
- (c) Effect of security interest.** The creation, attachment, perfection, or enforcement of a security interest in the seller's interest under a contract is not a transfer that materially changes the duty of or increases materially the burden or risk imposed on the buyer or impairs materially the buyer's chance of obtaining return performance within the purview of subsection (2) unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the seller. Even in that event, the creation, attachment, perfection, and enforcement of the security interest remain effective, but

(1) the seller is liable to the buyer for damages caused by the delegation to the extent that the damages could not reasonably be prevented by the buyer, and

(2) a court having jurisdiction may grant other appropriate relief, including cancellation of the contract for sale or an injunction against enforcement of the security interest or consummation of the enforcement.

(d) Assignment prohibition limited to performance. Unless the circumstances indicate the contrary a prohibition of assignment of “the contract” is to be construed as barring only the delegation to the assignee of the assignor's performance.

(e) Effect and enforceability of general assignment. An assignment of “the contract” or of “all my rights under the contract” or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

(f) Security for assignment delegating performance. The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee (Section 2-609).

[Official Comment to § 2-210.](#)

Chapter 23. General Obligation and Construction of Contract.

§ 2301. General Obligations of Parties

The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract.

[Official Comment to § 2-301.](#)

§ 2302. Unconscionable Contract or Clause

(a) Finding and authority of court. If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may

(1) refuse to enforce the contract;

(2) enforce the remainder of the contract without the unconscionable clause; or

(3) so limit the application of any unconscionable clause as to avoid any unconscionable result.

(b) Evidence by parties. When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

[Official Comment to § 2-302.](#)

§ 2303. Allocation or Division of Risks

Where this division [Article 2] allocates a risk or a burden as between the parties “unless otherwise agreed,” the agreement may not only shift the allocation but may also divide the risk or burden.

[Official Comment to § 2-303.](#)

§ 2304. Price Payable in Money, Goods, Realty, or Otherwise

(a) General rule. The price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer.

(b) Realty. Even though all or part of the price is payable in an interest in realty the transfer of the goods and the seller's obligations with reference to them are subject to this division, but not the transfer of the interest in realty or the transferor's obligations in connection therewith.

[Official Comment to § 2-304.](#)

§ 2305. Open Price Term

(a) General rule. The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if

- (1) nothing is said as to price; or
- (2) the price is left to be agreed by the parties and they fail to agree; or
- (3) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(b) Price to be fixed by party. A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(c) Price not fixed through fault of party. When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(d) Intent not to be bound without established price. Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

[Official Comment to § 2-305.](#)

§ 2306. Output, Requirements and Exclusive Dealings

(a) Quantity measured by output or requirements. A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.

(b) Obligations of parties in exclusive dealings. A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

[Official Comment to § 2-306.](#)

§ 2307. Delivery in Single Lot or Several Lots

Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery and payment is due only on such tender but where the circumstances give either party the right to make or demand delivery in lots the price if it can be apportioned may be demanded for each lot.

[Official Comment to § 2-307.](#)

§ 2308. Absence of Specified Place for Delivery

Unless otherwise agreed:

- (1) the place for delivery of goods is the seller's place of business or if he has none his residence; but
- (2) in a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and
- (3) documents of title may be delivered through customary banking channels.

[Official Comment to § 2-308.](#)

§ 2309. Absence of Specific Time Provisions; Notice of Termination

(a) Shipment, delivery, or other action. The time for shipment or delivery or any other action under a contract if not provided in this division or agreed upon shall be a reasonable time.

(b) Duration of provision for successive performances. Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party.

(c) Notice of termination. Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable.

[Official Comment to § 2-309.](#)

§ 2310. Open Time for Payment or Running of Credit; Authority to Ship under Reservation

Unless otherwise agreed:

(1) Payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery.

(2) If the seller is authorized to send the goods he may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due unless such inspection is inconsistent with the terms of the contract (section 2513); and

(3) If delivery is authorized and made by way of documents of title otherwise than by paragraph (2) then payment is due regardless of where the goods are to be received

(i) at the time and place at which the buyer is to receive delivery of the tangible documents; or

(ii) at the time the buyer is to receive delivery of the electronic documents and at the seller's place of business or if none, the seller's residence.

(4) Where the seller is required or authorized to ship the goods on credit the credit period runs from the time of shipment but post-dating the invoice or delaying its dispatch will correspondingly delay the starting of the credit period.

[Official Comment to § 2-310.](#)

§2311. Options and Cooperation Respecting Performance

(a) Specifying particulars of performance. An agreement for sale which is otherwise sufficiently definite (subsection (3) of Section 2-204) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within limits set by commercial reasonableness.

(b) Specifying assortment of goods and shipping arrangements. Unless otherwise agreed specifications relating to assortment of the goods are at the buyer's option and except as otherwise provided in subsections (1)(c) and (3) of Section 2-319 specifications or arrangements relating to shipment are at the seller's option.

(c) Remedies for failure to specify or cooperate. Where such specification would materially affect the other party's performance but is not seasonably made or where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies

- (1) is excused for any resulting delay in his own performance; and
- (2) may also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods.

Official Comment to § 2-311.

§ 2312. Warranty of Title and Against Infringement; Buyer's Obligation Against Infringement

(a) General rule. Subject to subsection (b) there is in a contract for sale a warranty by the seller that

- (1) the title conveyed shall be good, and its transfer rightful; and
- (2) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(b) Exclusion or modification of warranty. A warranty under subsection (a) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(c) Warranty of merchant regularly dealing in goods. Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

Official Comment to § 2-312.

§ 2313. Express Warranties by Affirmation, Promise, Description, Sample

(a) General rule. Express warranties by the seller are created as follows:

- (1) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
- (2) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
- (3) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(b) Formal words or specific intent unnecessary. It is not necessary to the creation of an express warranty that the seller use formal words such as “warrant” or “guarantee” or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

Official Comment to § 2-313.

§ 2314. Implied Warranty: Merchantability; Usage of Trade

(a) Sale by merchant. Unless excluded or modified (section 2316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(b) Merchantability standards for goods. Goods to be merchantable must be at least such as

- (1) pass without objection in the trade under the contract description; and
- (2) in the case of fungible goods, are of fair average quality within the description; and
- (3) are fit for the ordinary purposes for which such goods are used; and
- (4) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
- (5) are adequately contained, packaged, and labeled as the agreement may require; and
- (6) conform to the promise or affirmations of fact made on the container or label if any.

(c) Course of dealing or usage of trade. Unless excluded or modified (section 2316) other implied warranties may arise from course of dealing or usage of trade.

[Official Comment to § 2-314.](#)

§ 2315. Implied Warranty: Fitness for Particular Purpose

Where the seller at the time of contracting has reason to know:

- (1) any particular purpose for which the goods are required; and
- (2) that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods,

there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

[Official Comment to § 2-315.](#)

§ 2316. Exclusion or Modification of Warranties

(a) Construction of words or conduct limiting warranties. Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this division on parol or extrinsic evidence (section 2202) negation or limitation is inoperative to the extent that such construction is unreasonable.

(b) Implied warranties of merchantability and fitness. Subject to subsection (c), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(c) Implied warranties in general. Notwithstanding subsection (b)

(1) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(2) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(3) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(d) Limitation of remedies for breach of warranty. Remedies for breach of warranty can be limited in accordance with the provisions of this division on liquidation or limitation of damages (section 2718) and on contractual modification of remedy (section 2719).

[Official Comment to § 2-316.](#)

§ 2317. Cumulation and Conflict of Warranties Express or Implied

Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

- (1) Exact or technical specifications displace an inconsistent sample or model or general language of description.
- (2) A sample from an existing bulk displaces inconsistent general language of description.
- (3) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

[Official Comment to § 2-317.](#)

§ 2318. Third Party Beneficiaries of Warranties Express or Implied.

The warranty of a seller whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

[Official Comment to § 2-318.](#)

§ 2319. F.O.B. and F.A.S. Terms

(a) Definition of F.O.B. Unless otherwise agreed the term F.O.B. (which means “free on board”) at a named place, even though used only in connection with the stated price, is a delivery term under which:

- (1) When the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this division (section 2504 (relating to shipment by seller)) and bear the expense and risk of putting them into the possession of the carrier.

(2) When the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this division (section 2503 (relating to manner of tender of delivery by seller)).

(3) When under either paragraph (1) or (2) the term is also F.O.B. vessel, car or other vehicle, the seller must in addition at his own expense and risk load the goods on board. If the term is F.O.B. vessel the buyer must name the vessel and in an appropriate case the seller must comply with the provisions of this division on the form of bill of lading (section 2323).

(b) Definition of F.A.S. Unless otherwise agreed the term F.A.S. vessel (which means “free alongside”) at a named port, even though used only in connection with the stated price, is a delivery term under which the seller must:

(1) at his own expense and risk deliver the goods alongside the vessel in the manner usual in that port or on a dock designated and provided by the buyer; and

(2) obtain and tender a receipt for the goods in exchange for which the carrier is under a duty to issue a bill of lading.

(c) Duty of buyer to give instructions. Unless otherwise agreed in any case falling within subsection (a)(1) or (3) or subsection (b) the buyer must seasonably give any needed instructions for making delivery, including when the term is F.A.S. or F.O.B. the loading berth of the vessel and in an appropriate case its name and sailing date. The seller may treat the failure of needed instructions as a failure of cooperation under this division (section 2311 (relating to options and cooperation respecting performance)). He may also at his option move the goods in any reasonable manner preparatory to delivery or shipment.

(d) Tender of documents and payment. Under the term F.O.B. vessel or F.A.S. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

Official Comment to § 2-319.

§ 2320. C.I.F. and C. & F. Terms

(a) Definitions. The term C.I.F. means that the price includes in a lump sum the cost of the goods and the insurance and freight to the named destination. The term C. & F. or C.F. means that the price so includes cost and freight to the named destination.

(b) Effect of C.I.F. destination term. Unless otherwise agreed and even though used only in connection with the stated price and destination, the term C.I.F. destination or its equivalent requires the seller at his own expense and risk to do the following:

- (1) Put the goods into the possession of a carrier at the port for shipment and obtain a negotiable bill or bills of lading covering the entire transportation to the named destination.
- (2) Load the goods and obtain a receipt from the carrier (which may be contained in the bill of lading) showing that the freight has been paid or provided for.
- (3) Obtain a policy or certificate of insurance, including any war risk insurance, of a kind and on terms then current at the port of shipment in the usual amount, in the currency of the contract, shown to cover the same goods covered by the bill of lading and providing for payment of loss to the order of the buyer or for the account of whom it may concern; but the seller may add to the price the amount of the premium for any such war risk insurance.
- (4) Prepare an invoice of the goods and procure any other documents required to effect shipment or to comply with the contract.
- (5) Forward and tender with commercial promptness all the documents in due form and with any indorsement necessary to perfect the rights of the buyer.

(c) Effect of C. & F. term. Unless otherwise agreed the term C. & F. or its equivalent has the same effect and imposes upon the seller the same obligations and risks as a C.I.F. term except the obligation as to insurance.

(d) Tender of documents and payment. Under the term C.I.F. or C. & F. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

Official Comment to § 2-320.

§ 2321. C.I.F. or C. & F.: “Net Landed Weights”; “Payment on Arrival”; Warranty of Condition on Arrival

Under a contract containing a term C.I.F. or C. & F.

- (1) Where the price is based on or is to be adjusted according to “net landed weights”, “delivered weights”, “out turn” quantity or quality or the like, unless otherwise agreed the seller must reasonably estimate the price. The payment due on tender of the documents called for by the contract is the amount so estimated, but after final adjustment of the price a settlement must be made with commercial promptness.
- (2) An agreement described in subsection (a) or any warranty of quality or condition of the goods on arrival places upon the seller the risk of ordinary deterioration, shrinkage and the like in transportation but has no effect on the place or time of identification to the contract for sale or delivery or on the passing of the risk of loss.

(3) Unless otherwise agreed where the contract provides for payment on or after arrival of the goods the seller must before payment allow such preliminary inspection as is feasible; but if the goods are lost delivery of the documents and payment are due when the goods should have arrived.

Official Comment to § 2-321.

§ 2322. Delivery “Ex-Ship”

(a) Definition. Unless otherwise agreed a term for delivery of goods “ex-ship” (which means from the carrying vessel) or in equivalent language is not restricted to a particular ship and requires delivery from a ship which has reached a place at the named port of destination where goods of the kind are usually discharged.

(b) Effect. Under such a term unless otherwise agreed

- (1) the seller must discharge all liens arising out of the carriage and furnish the buyer with a direction which puts the carrier under a duty to deliver the goods; and
- (2) the risk of loss does not pass to the buyer until the goods leave the ship's tackle or are otherwise properly unloaded.

Official Comment to § 2-322.

§ 2323. Form of Bill of Lading Required in Overseas Shipment; “Overseas”

(a) General rule. Where the contract contemplates overseas shipment and contains a term C.I.F., C. & F. or F.O.B. vessel, the seller unless otherwise agreed must obtain a negotiable bill of lading stating that the goods have been loaded on board or, in the case of a term C.I.F. or C. & F., received for shipment.

(b) Bill in set of parts. Where in a case within subsection (a) a tangible bill of lading has been issued in a set of parts, unless otherwise agreed if the documents are not to be sent from abroad the buyer may demand tender of the full set; otherwise only one part of the bill of lading need be tendered. Even if the agreement expressly requires a full set:

- (1) due tender of a single part is acceptable within the provisions of this division on cure of improper delivery (section 2508(a)); and
- (2) even though the full set is demanded, if the documents are sent from abroad the person tendering an incomplete set may nevertheless require payment upon furnishing an indemnity which the buyer in good faith deems adequate.

(c) Definition of “overseas”. A shipment by water or by air or a contract contemplating such shipment is “overseas” insofar as by usage of trade or agreement it is subject to the commercial, financing or shipping practices characteristic of international deep water commerce.

Official Comment to § 2-323.

§ 2324. “No Arrival, No Sale” Term

Under a term “no arrival, no sale” or terms of like meaning, unless otherwise agreed,

- (1) the seller must properly ship conforming goods and if they arrive by any means he must tender them on arrival but he assumes no obligation that the goods will arrive unless he has caused the non-arrival; and
- (2) where without fault of the seller the goods are in part lost or have so deteriorated as no longer to conform to the contract or arrive after the contract time, the buyer may proceed as if there had been casualty to identified goods (Section 2-613).

Official Comment to § 2-324.

§ 2325. “Letter of Credit” Term; “Confirmed Credit”

(a) Failure to furnish letter. Failure of the buyer seasonably to furnish an agreed letter of credit is a breach of the contract for sale.

(b) Effect of delivering letter. The delivery to seller of a proper letter of credit suspends the obligation of the buyer to pay. If the letter of credit is dishonored, the seller may on reasonable notification to the buyer require payment directly from him.

(c) Definitions. Unless otherwise agreed the term “letter of credit” or “banker's credit” in a contract for sale means an irrevocable credit issued by a financing agency of good repute and, where the shipment is overseas, of good international repute. The term “confirmed credit” means that the credit must also carry the direct obligation of such an agency which does business in the financial market of the seller.

Official Comment to § 2-325.

§ 2326. Sale on Approval and Sale or Return; Rights of Creditors

(a) Definitions. Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is:

- (1) a “sale on approval” if the goods are delivered primarily for use; and
- (2) a “sale or return” if the goods are delivered primarily for resale.

(b) Rights of creditors of buyer generally. Goods held on approval are not subject to the claims of the creditors of the buyer until acceptance; goods held on sale or return are subject to such claims while in the possession of the buyer.

(c) Treatment of “or return” term. Any “or return” term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this division (section 2201) and as contradicting the sale aspect of the contract within the provisions of this division on parol or extrinsic evidence (section 2202).

Official Comment to § 2-326.

§ 2327. Special Incidents of Sale on Approval and Sale or Return

(a) Sale on approval. Under a sale on approval unless otherwise agreed:

- (1) Although the goods are identified to the contract the risk of loss and the title do not pass to the buyer until acceptance.
- (2) Use of the goods consistent with the purpose of trial is not acceptance but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract acceptance of any part is acceptance of the whole.
- (3) After due notification of election to return, the return is at the risk and expense of the seller but a merchant buyer must follow any reasonable instructions.

(b) Sale or return. Under a sale or return unless otherwise agreed:

- (1) The option to return extends to the whole or any commercial unit of the goods while in substantially their original condition, but must be exercised seasonably.
- (2) The return is at the risk and expense of the buyer.

Official Comment to § 2-327.

§ 2328. Sale by Auction

(a) Sale in lots. In a sale by auction if goods are put up in lots each lot is the subject of a separate sale.

(b) When sale complete. A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. Where a bid is made while the hammer is falling in acceptance of a prior bid the auctioneer may in his discretion reopen the bidding or declare the goods sold under the bid on which the hammer was falling.

(c) With or without reserve. Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may withdraw the goods at any

time until he announces completion of the sale. In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time. In either case a bidder may retract his bid until the announcement by the auctioneer of completion of the sale, but the retraction by a bidder does not revive any previous bid.

(d) Bidding by or for seller. If the auctioneer knowingly receives a bid on the behalf of the seller or the seller makes or procures such a bid, and notice has not been given that liberty for such bidding is reserved, the buyer may at his option avoid the sale or take the goods at the price of the last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at a forced sale.

Official Comment to § 2-328.

Chapter 24. Title, Creditors and Good Faith Purchasers.

§ 2401. Passing of Title; Reservation for Security; Limited Application of This Section

Each provision of this division with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this division and matters concerning title become material the following rules apply:

(1) Identification of goods and reservation of title. Title to goods cannot pass under a contract for sale prior to their identification to the contract (section 2501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this Act. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the division on Secured Transactions (Division 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Place of delivery of goods. Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading

- (i) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but
- (ii) if the contract requires delivery at destination, title passes on tender there.

(3) Delivery without moving goods. Unless otherwise explicitly agreed where delivery is to be made without moving the goods,

(i) if the seller is to deliver a tangible document of title, title passes at the time when and the place where he delivers such documents and if the seller is to deliver an electronic document of title, title passes when the seller delivers the document; or

(ii) if the goods are at the time of contracting already identified and no documents of title are to be delivered, title passes at the time and place of contracting.

(4) Revesting of title upon rejection of goods or revocation of acceptance. A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance revests title to the goods in the seller. Such revesting occurs by operation of law and is not a “sale”.

Official Comment to § 2-401.

§ 2402. Rights of Seller’s Creditors Against Sold Goods

(a) Priority of buyer over unsecured creditors. Except as provided in subsections (b) and (c), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the rights of the buyer to recover the goods under this division (section 2502 (relating to right of buyer to goods on insolvency of seller) and section 2716 (relating to right of buyer to specific performance or replevin)).

(b) Right to void sale upon fraudulent retention of goods. A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

(c) Other rights of creditors unimpaired. Nothing in this division shall be deemed to impair the rights of creditors of the seller:

(1) under the provisions of Division 9 (relating to secured transactions); or

(2) where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security or the like and is made under circumstances which under any rule of law of the state where the goods are situated would apart from this division constitute the transaction a fraudulent transfer or voidable preference.

Official Comment to § 2-402.

§ 2403. Power to Transfer; Good Faith Purchase of Goods; ‘Entrusting’

(a) Transfer of title. A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good

faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though:

- (1) the transferor was deceived as to the identity of the purchaser;
- (2) the delivery was in exchange for a check which is later dishonored;
- (3) it was agreed that the transaction was to be a “cash sale”; or
- (4) the delivery was procured through fraud punishable as larcenous under the criminal law.

(b) Transfer by merchant entrusted with possession of goods. Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(c) Definition of “entrusting”. “Entrusting” includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the disposition of the goods by the possessor has been such as to be larcenous under the criminal law.

(d) Rights of other purchasers and lien creditors. The rights of other purchasers of goods and of lien creditors are governed by Division 7 (relating to documents of title) and Division 9 (relating to secured transactions).

Official Comment to § 2-403.

Chapter 25. Performance.

§ 2501. Insurable Interest in Goods; Manner of Identification of Goods

(a) General rule. The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are nonconforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs as follows:

- (1) When the contract is made if it is for the sale of goods already existing and identified.
- (2) If the contract is for the sale of future goods other than those described in paragraph (3), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers.
- (3) When the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within 12 months

after contracting or for the sale of crops to be harvested within 12 months or the next normal harvest season after contracting whichever is longer.

(b) Duration of insurable interest and substitution of goods. The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in him and where the identification is by the seller alone he may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.

(c) Other insurable interests unimpaired. Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

Official Comment to § 2-501.

§ 2502. Buyer's Right to Goods on Seller's Repudiation, Failure to Deliver, or Insolvency

(a) General rule. Subject to subsections (b) and (c) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of section 2501 (relating to insurable interest in goods; manner of identification of goods) may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if:

- (1) in the case of goods bought for personal, family or household purposes, the seller repudiates or fails to deliver as required by the contract; or
- (2) in all cases, the seller becomes insolvent within ten days after receipt of the first installment on their price.

(b) Vesting. The buyer's right to recover the goods under subsection (a)(1) vests upon acquisition of a special property even if the seller had not then repudiated or failed to deliver.

(c) Identification made by buyer. If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.

Official Comment to § 2-502.

§ 2503. Manner of Seller's Tender of Delivery

(a) General rule. Tender of delivery requires that the seller put and hold conforming goods at the disposition of the buyer and give the buyer any notification reasonably necessary to enable him to take delivery. The manner, time and place for tender are determined by the agreement and this division, and in particular:

(1) tender must be at a reasonable hour, and if it is of goods they must be kept available for the period reasonably necessary to enable the buyer to take possession; but

(2) unless otherwise agreed the buyer must furnish facilities reasonably suited to the receipt of the goods.

(b) Delivery at particular destination not required. Where the case is within section 2504 (relating to shipment by seller) tender requires that the seller comply with its provisions.

(c) Delivery at particular destination required. Where the seller is required to deliver at a particular destination tender requires that he comply with subsection (a) and also in any appropriate case tender documents as described in subsections (d) and (e).

(d) Goods in possession of bailee and deliverable without being moved. Where goods are in the possession of a bailee and are to be delivered without being moved:

(1) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the right of the buyer to possession of the goods; but

(2) tender to the buyer of a nonnegotiable document of title or of a record directing the bailee to deliver is sufficient tender unless the buyer seasonably objects, and except as otherwise provided in Division 9 (relating to secured transactions) receipt by the bailee of notification of the rights of the buyer fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the nonnegotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

(e) Form and manner of delivering documents. Where the contract requires the seller to deliver documents:

(1) he must tender all such documents in correct form, except as provided in this division with respect to bills of lading in a set (section 2323(b)); and

(2) tender through customary banking channels is sufficient and dishonor of a draft accompanying or associated with the documents constitutes nonacceptance or rejection.

[Official Comment to § 2-503.](#)

§ 2504. Shipment by Seller

Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then unless otherwise agreed he must

- (1) put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case; and
- (2) obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and
- (3) promptly notify the buyer of the shipment.

Failure to notify the buyer under paragraph (3) or to make a proper contract under paragraph (1) is a ground for rejection only if material delay or loss ensues.

Official Comment to § 2-504.

§ 2505. Seller's Shipment Under Reservation

(a) General rule. Where the seller has identified goods to the contract by or before shipment:

- (1) His procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the expectation of the seller of transferring that interest to the person named.
- (2) A nonnegotiable bill of lading to himself or his nominee reserves possession of the goods as security, but except in a case of conditional delivery (section 2507(b)) a nonnegotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession or control of the bill of lading.

(b) Shipment in violation of contract. When shipment by the seller with reservation of a security interest is in violation of the contract for sale it constitutes an improper contract for transportation within section 2504 (relating to shipment by seller) but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the powers of the seller as a holder of a negotiable document of title.

Official Comment to § 2-505.

§ 2506. Rights of Financing Agency

(1) General rule. A financing agency by paying or purchasing for value a draft which relates to a shipment of goods acquires to the extent of the payment or purchase and in addition to its own

rights under the draft and any document of title securing it any rights of the shipper in the goods including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

(2) Right to reimbursement unimpaired by latent defect. The right to reimbursement of a financing agency which has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by subsequent discovery of defects with reference to any relevant document which was apparently regular.

[Official Comment to § 2-506.](#)

§ 2507. Effect of Seller's Tender; Delivery on Condition

(a) Effect of tender by seller. Tender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract.

(b) Delivery on condition. Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due.

[Official Comment to § 2-507.](#)

§ 2508. Cure by Seller of Improper Tender or Delivery; Replacement

(a) General rule. Where any tender or delivery by the seller is rejected because nonconforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(b) Rejection of tender which seller believed acceptable. Where the buyer rejects a nonconforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

[Official Comment to § 2-508.](#)

§ 2509. Risk of Loss in the Absence of Breach

(a) Seller to ship by carrier. Where the contract requires or authorizes the seller to ship the goods by carrier:

(1) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (section 2505); but

(2) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.

(b) Goods held by bailee. Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer:

- (1) on his receipt, possession or control of a negotiable document of title covering the goods;
- (2) on acknowledgment by the bailee of the right of the buyer to possession of the goods; or
- (3) after his receipt, possession or control of a nonnegotiable document of title or other direction to deliver in a record, as provided in section 2503(d)(2) (relating to manner of tender of delivery by seller).

(c) All other cases. In any case not within subsection (a) or (b), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise on tender of delivery.

(d) Limitations on operation of section. The provisions of this section are subject to contrary agreement of the parties and to the provisions of this division on sale on approval (section 2327) and on effect of breach on risk of loss (section 2510).

Official Comment to § 2-509.

§ 2510. Effect of Breach on Risk of Loss

(a) Tender of nonconforming goods. Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance.

(b) Revocation of acceptance by buyer. Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

(c) Repudiation or breach by buyer. Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.

Official Comment to § 2-510.

§ 2511. Tender of Payment by Buyer; Payment by Check

- (a) Tender of payment condition to delivery.** Unless otherwise agreed tender of payment is a condition to the duty of the seller to tender and complete any delivery.
- (b) Manner of tender of payment.** Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

(c) Payment by check. Subject to the provisions of this title on the effect of an instrument on an obligation (section 3310), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment.

[Official Comment to § 2-511.](#)

§ 2512. Payment by Buyer Before Inspection

(a) General rule. Where the contract requires payment before inspection nonconformity of the goods does not excuse the buyer from so making payment unless:

- (1) the nonconformity appears without inspection; or
- (2) despite tender of the required documents the circumstances would justify injunction against honor under this title, including section 5109(b) (relating to conditions for injunction).

(b) Effect of payment on rights of buyer. Payment pursuant to subsection (a) does not constitute an acceptance of goods or impair the right of the buyer to inspect or any of his remedies.

[Official Comment to § 2-512.](#)

§ 2513. Buyer's Right to Inspection of Goods

(a) General rule. Unless otherwise agreed and subject to subsection (c), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

(b) Expenses of inspection. Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.

(c) Limitation on right of inspection prior to payment. Unless otherwise agreed and subject to the provisions of this division on C.I.F. contracts (section 2321(3)), the buyer is not entitled to inspect the goods before payment of the price when the contract provides:

- (1) for delivery “C.O.D.” or on other like terms; or
- (2) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.

(d) Agreement as to place and method of inspection. A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract.

[Official Comment to § 2-513.](#)

§ 2514. When Documents Deliverable on Acceptance; When on Payment

Unless otherwise agreed documents against which a draft is drawn are to be delivered to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment.

[Official Comment to § 2-514.](#)

§ 2515. Preserving Evidence of Goods in Dispute

In furtherance of the adjustment of any claim or dispute

- (1) either party on reasonable notification to the other and for the purpose of ascertaining the facts and preserving evidence has the right to inspect, test and sample the goods including such of them as may be in the possession or control of the other; and
- (2) the parties may agree to a third party inspection or survey to determine the conformity or condition of the goods and may agree that the findings shall be binding upon them in any subsequent litigation or adjustment.

[Official Comment to § 2-515.](#)

Chapter 26. Breach, Repudiation or Excuse

§ 2601. Buyer's Rights on Improper Delivery

Subject to the provisions of this division on breach in installment contracts (section 2612) and unless otherwise agreed under the sections on contractual limitations of remedy (sections 2718 and 2719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

- (1) reject the whole; or
- (2) accept the whole; or
- (3) accept any commercial unit or units and reject the rest.

Official Comment to § 2-601.

§ 2602. Manner and Effect of Rightful Rejection

(a) Time and notice of rejection. Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

(b) Duties of buyer after rightful rejection. Subject to the provisions of sections 2603 (relating to duties of merchant buyer as to rightfully rejected goods) and 2604 (relating to options of buyer as to salvage of rightfully rejected goods):

- (1) after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller; and
- (2) if the buyer has before rejection taken physical possession of goods in which he does not have a security interest under the provisions of this division (section 2711(c) (relating to security interest of buyer in rejected goods)), he is under a duty after rejection to hold them with reasonable care at the disposition of the seller for a time sufficient to permit the seller to remove them; but
- (3) the buyer has no further obligations with regard to goods rightfully rejected.

(c) Rights of seller after wrongful rejection. The rights of the seller with respect to goods wrongfully rejected are governed by the provisions of this division on remedies of seller in general (section 2703).

Official Comment to § 2-602.

§ 2603. Merchant Buyer's Duties as to Rightfully Rejected Goods

(a) General rule. Subject to any security interest in the buyer (section 2711(c)), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make

reasonable efforts to sell them for the account of the seller if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(b) Reimbursement for expenses and commission. When the buyer sells goods under subsection (a), he is entitled to reimbursement from the seller or out of the proceeds for reasonable expenses of caring for and selling them, and if the expenses include no selling commission then to such commission as is usual in the trade or if there is none to a reasonable sum not exceeding 10% on the gross proceeds.

(c) Good faith conduct. In complying with this section the buyer is held only to good faith and good faith conduct under this section is neither acceptance nor conversion nor the basis of an action for damages.

[Official Comment to § 2-603.](#)

§ 2604. Buyer's Options as to Salvage of Rightfully Rejected Goods

Subject to the provisions of the immediately preceding section on perishables if the seller gives no instructions within a reasonable time after notification of rejection the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in the preceding section. Such action is not acceptance or conversion.

[Official Comment to § 2-604.](#)

§ 2605. Waiver of Buyer's Objections by Failure to Particularize

(a) General rule. The failure of the buyer to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach:

- (1) where the seller could have cured it if stated seasonably; or
- (2) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

(b) Payment against defective documents. Payment against documents made without reservation of rights precludes recovery of the payment for defects apparent in the documents.

[Official Comment to § 2-605.](#)

§ 2606. What Constitutes Acceptance of Goods

(a) General rule. Acceptance of goods occurs when the buyer:

- (1) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their nonconformity;
- (2) fails to make an effective rejection (section 2602(a)), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or
- (3) does any act inconsistent with the ownership of the seller; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(b) Part of commercial unit. Acceptance of a part of any commercial unit is acceptance of that entire unit.

[Official Comment to § 2-606.](#)

§ 2607. Effect of Acceptance; Notice of Breach; Burden of Establishing Breach After Acceptance; Notice of Claim or Litigation to Person Answerable Over

(a) Payment for accepted goods. The buyer must pay at the contract rate for any goods accepted.

(b) Effect of acceptance on remedies for breach. Acceptance of goods by the buyer precludes rejection of the goods accepted and if made with knowledge of a nonconformity cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured but acceptance does not of itself impair any other remedy provided by this division for nonconformity.

(c) Notice of breach. Where a tender has been accepted:

(1) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and

(2) if the claim is one for infringement or the like (section 2312(c)) and the buyer is sued as a result of such a breach he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

(d) Burden of establishing breach. The burden is on the buyer to establish any breach with respect to the goods accepted.

(e) Notice of litigation to person answerable over. Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over:

(1) He may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against

him by his buyer by any determination of fact common to the two litigations, then unless the seller after reasonable receipt of the notice does come in and defend he is so bound.

(2) If the claim is one for infringement or the like (section 2312(c)), the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then unless the buyer after reasonable receipt of the demand does turn over control the buyer is so barred.

(f) Obligation of buyer to hold seller harmless. The provisions of subsections (c), (d) and (e) apply to any obligation of a buyer to hold the seller harmless against infringement or the like (section 2312(c) (relating to warranty of merchant regularly dealing in goods).

[Official Comment to § 2-607.](#)

§ 2608. Revocation of Acceptance in Whole or in Part

(a) Grounds for revocation. The buyer may revoke his acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to him if he has accepted it:

- (1) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or
- (2) without discovery of such nonconformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the assurances of the seller.

(b) Time and notice of revocation. Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(c) Rights and duties of revoking buyer. A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

[Official Comment to § 2-608.](#)

§ 2609. Right to Adequate Assurance of Performance

(a) General rule. A contract for sale imposes an obligation on each party that the expectation of the other of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(b) Reasonableness and adequacy between merchants. Between merchants the reasonableness

of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(c) Effect of acceptance of improper delivery or payment. Acceptance of any improper delivery or payment does not prejudice the right of the aggrieved party to demand adequate assurance of future performance.

(d) Effect of failure to provide assurance. After receipt of a justified demand failure to provide within a reasonable time not exceeding 30 days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

[Official Comment to § 2-609.](#)

§ 2610. Anticipatory Repudiation

When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

- (1) for a commercially reasonable time await performance by the repudiating party; or
- (2) resort to any remedy for breach (section 2703 or 2711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and
- (3) in either case suspend his own performance or proceed in accordance with the provisions of this division on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (section 2704).

[Official Comment to § 2-610.](#)

§ 2611. Retraction of Anticipatory Repudiation

(a) When allowable. Until the next performance is due by the repudiating party he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(b) Method. Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this division (section 2609).

(c) Effect on contract rights. Retraction reinstates the rights of the repudiating party under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

[Official Comment to § 2-611.](#)

§ 2612. “Installment Contract”; Breach

(a) Definition of “installment contract”. An “installment contract” is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause “each delivery is a separate contract” or its equivalent.

(b) Right to reject nonconforming installment. The buyer may reject any installment which is nonconforming if the nonconformity substantially impairs the value of that installment and cannot be cured or if the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (c) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(c) Breach. Whenever nonconformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a nonconforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

[Official Comment to § 2-612.](#)

§ 2613. Casualty to Identified Goods

Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a “no arrival, no sale” term (section 2324) then

- (1) if the loss is total the contract is avoided; and
- (2) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller.

[Official Comment to § 2-613.](#)

§ 2614. Substituted Performance

(a) Manner of delivery. Where without fault of either party the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

(b) Manner of payment. If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If

delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the obligation of the buyer unless the regulation is discriminatory, oppressive or predatory.

Official Comment to § 2-614.

§ 2615. Excuse by Failure of Presupposed Conditions

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

- (1) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (2) and (3) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.
- (2) Where the causes mentioned in paragraph (1) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.
- (3) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (2), of the estimated quota thus made available for the buyer.

Official Comment to § 2-615.

§ 2616. Procedure on Notice Claiming Excuse

(a) Right of buyer to terminate or modify contract. Where the buyer receives notification of a material or indefinite delay or an allocation justified under section 2615 (relating to excuse by failure of presupposed conditions) he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this division relating to breach of installment contracts (section 2612), then also as to the whole:

- (1) terminate and thereby discharge any unexecuted portion of the contract; or
- (2) modify the contract by agreeing to take his available quota in substitution.

(b) Time limitation on modification. If after receipt of such notification from the seller the buyer fails so to modify the contract within a reasonable time not exceeding 30 days the contract

lapses with respect to any deliveries affected.

(c) Effect of agreement on section. The provisions of this section may not be negated by agreement except insofar as the seller has assumed a greater obligation under section 2615.

[Official Comment to § 2-616.](#)

Chapter 27. Remedies

§ 2701. Remedies for Breach of Collateral Contracts Not Impaired

Remedies for breach of any obligation or promise collateral or ancillary to a contract for sale are not impaired by the provisions of this division.

[Official Comment to § 2-701.](#)

§ 2702. Seller's Remedies on Discovery of Buyer's Insolvency

(a) Right to refuse or stop delivery. Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract and stop delivery under this division (section 2705).

(b) Reclamation of goods on credit. Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten-day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(c) Limitations on right of reclamation. The right of the seller to reclaim under subsection (b) is subject to the rights of a buyer in ordinary course or other good faith purchaser under this division (section 2403). Successful reclamation of goods excludes all other remedies with respect to them.

[Official Comment to § 2-702.](#)

§ 2703. Seller's Remedies in General

Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or on the whole, then with respect to any goods directly affected and, if the breach is of the whole contract (section 2612), then also with respect to the whole undelivered balance, the aggrieved seller may:

(1) Withhold delivery of such goods.

(2) Stop delivery by any bailee as provided in section 2705 (relating to stoppage by seller of

delivery in transit or otherwise).

- (3) Proceed under section 2704 (relating to right of seller to identify goods to contract notwithstanding breach or to salvage unfinished goods).
- (4) Resell and recover damages as hereafter provided (section 2706 (relating to resale by seller including contract for resale)).
- (5) Recover damages for nonacceptance (section 2708) or in a proper case the price (section 2709).
- (6) Cancel.

[Official Comment to § 2-703.](#)

§ 2704. Seller's Right to Identify Goods to the Contract Notwithstanding Breach or to Salvage Unfinished Goods

(a) Identification and resale of goods. An aggrieved seller under section 2703 (relating to remedies of seller in general) may:

- (1) Identify to the contract conforming goods not already identified if at the time he learned of the breach they are in his possession or control.
- (2) Treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished.

(b) Unfinished goods. Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

[Official Comment to § 2-704.](#)

§ 2705. Seller's Stoppage of Delivery in Transit or Otherwise

(a) General rule. The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (section 2702) and may stop delivery of carload, truckload, planeload or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery, or if for any other reason the seller has a right to withhold or reclaim the goods.

(b) When seller loses right. As against such buyer the seller may stop delivery until:

- (1) receipt of the goods by the buyer;

(2) acknowledgment to the buyer by any bailee of the goods, except a carrier, that the bailee holds the goods for the buyer;

(3) such acknowledgment to the buyer by a carrier by reshipment or as a warehouse; or

(4) negotiation to the buyer of any negotiable document of title covering the goods.

(c) Notice and compliance.

(1) To stop delivery the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(2) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages.

(3) If a negotiable document of title has been issued for goods the bailee is not obliged to obey a notification to stop until surrender of possession or control of the document.

(4) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

Official Comment to § 2-705.

§ 2706. Seller's Resale Including Contract for Resale

(a) General rule. Under the conditions stated in section 2703 (relating to remedies of seller in general), the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this division (section 2710), but less expenses saved in consequence of the breach by the buyer.

(b) Manner of resale. Except as otherwise provided in subsection (c) or unless otherwise agreed resale may be at public or private sale including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.

(c) Notice of private sale. Where the resale is at private sale the seller must give the buyer reasonable notification of his intention to resell.

(d) Public sale. Where the resale is at public sale:

(1) Only identified goods can be sold except where there is a recognized market for a public

sale of futures in goods of the kind.

(2) It must be made at a usual place or market for public sale if one is reasonably available and except in the case of goods which are perishable or threaten to decline in value speedily the seller must give the buyer reasonable notice of the time and place of the resale.

(3) If the goods are not to be within the view of those attending the sale the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders.

(4) The seller may buy.

(e) Rights of good faith purchaser. A purchaser who buys in good faith at a resale takes the goods free of any rights of the original buyer even though the seller fails to comply with one or more of the requirements of this section.

(f) Accountability for profit. The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (section 2707), or buyer who has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as defined in section 2711(c) (relating to remedies of buyer in general; security interest of buyer in rejected goods).

Official Comment to § 2-706.

§ 2707. “Person in the Position of a Seller”

(a) Definition. A “person in the position of a seller” includes:

(1) as against a principal an agent who has paid or become responsible for the price of goods on behalf of his principal; or

(2) anyone who otherwise holds a security interest or other right in goods similar to that of a seller.

(b) Rights. A person in the position of a seller may as provided in this division:

(1) withhold or stop delivery (section 2705);

(2) resell (section 2706); and

(3) recover incidental damages (section 2710).

Official Comment to § 2-707.

§ 2708. Seller's Damages for Non-acceptance or Repudiation

(a) General rule. Subject to subsection (b) and to the provisions of this division with respect to proof of market price (section 2723), the measure of damages for nonacceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this division (section 2710) but less expenses saved in consequence of the breach by the buyer.

(b) Exception. If the measure of damages provided in subsection (a) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this division (section 2710), due allowance for costs reasonably incurred, and due credit for payments or proceeds of resale.

Official Comment to § 2-708.

§ 2709. Action for the Price

(a) When allowable. When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under section 2710 (relating to incidental damages of seller), the price of:

(1) goods accepted or conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(2) goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(b) Duties of seller. Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(c) Remedy if price not allowable. After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (section 2610), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for nonacceptance under section 2708 (relating to damages of seller for nonacceptance or repudiation).

Official Comment to § 2-709.

§ 2710. Seller's Incidental Damages

Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise

resulting from the breach.

Official Comment to § 2-710.

§ 2711. Buyer's Remedies in General; Buyer's Security Interest in Rejected Goods

(a) Cancellation and additional remedies. Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (section 2612 (relating to “installment contract”; breach)), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid:

- (1) “cover” and have damages under section 2712 (relating to “cover”; procurement by buyer of substitute goods) as to all the goods affected whether or not they have been identified to the contract; or
- (2) recover damages for nondelivery as provided in this division (section 2713 (relating to damages of buyer for nondelivery or repudiation)).

(b) Additional remedies for nondelivery or repudiation. Where the seller fails to deliver or repudiates the buyer may also:

- (1) if the goods have been identified recover them as provided in this division (section 2502 (relating to right of buyer to goods upon insolvency of seller)); or
- (2) in a proper case obtain specific performance or replevy the goods as provided in this division (section 2716).

(c) Security interest of buyer in rejected goods. On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (section 2706).

Official Comment to § 2-711.

§ 2712. “Cover”; Buyer's Procurement of Substitute Goods

(a) Right and manner of cover. After a breach within section 2711 (relating to remedies of buyer in general; security interest of buyer in rejected goods) the buyer may “cover” by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(b) Damages recoverable. The buyer may recover from the seller as damages the difference between the cost of cover and the contract price, together with any incidental or consequential damages as defined in section 2715 (relating to incidental and consequential damages of buyer)

but less expenses saved in consequence of the breach by the seller.

(c) Other remedies unaffected by failure to cover. Failure of the buyer to effect cover within this section does not bar him from any other remedy.

[Official Comment to § 2-712.](#)

§ 2713. Buyer's Damages for Non-delivery or Repudiation

(a) Damages recoverable. Subject to the provisions of this division with respect to proof of market price (section 2723), the measure of damages for nondelivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price, together with any incidental and consequential damages provided in this division (section 2715), but less expenses saved in consequence of the breach by the seller.

(b) Determination of market price. Market price is to be determined as of the place for tender, or in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

[Official Comment to § 2-713.](#)

§ 2714. Buyer's Damages for Breach in Regard to Accepted Goods

(a) Damages for nonconformity of tender. Where the buyer has accepted goods and given notification (section 2607(c)) he may recover as damages for any nonconformity of tender the loss resulting in the ordinary course of events from the breach of the seller as determined in any manner which is reasonable.

(b) Measure of damages for breach of warranty. The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(c) Incidental and consequential damages. In a proper case any incidental and consequential damages under section 2715 (relating to incidental and consequential damages of buyer) may also be recovered.

[Official Comment to § 2-714.](#)

§ 2715. Buyer's Incidental and Consequential Damages

(a) Incidental damages. Incidental damages resulting from the breach of the seller include:

(1) expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected;

(2) any commercially reasonable charges, expenses or commissions in connection with effecting cover; and

(3) any other reasonable expense incident to the delay or other breach.

(b) Consequential damages. Consequential damages resulting from the breach of the seller include:

(1) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(2) injury to person or property proximately resulting from any breach of warranty.

Official Comment to § 2-715.

§ 2716. Buyer's Right to Specific Performance or Replevin

(a) Specific performance. Specific performance may be decreed where the goods are unique or in other proper circumstances.

(b) Terms and conditions of decree. The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(c) Replevin. The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing, or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. In the case of goods bought for personal, family or household purposes, the buyer's right of replevin vests upon acquisition of a special property even if the seller had not then repudiated or failed to deliver.

Official Comment to § 2-716.

§ 2717. Deduction of Damages From the Price

The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.

Official Comment to § 2-717.

§ 2718. Liquidation or Limitation of Damages; Deposits

(a) Liquidated damages in agreement. Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or

actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

(b) Right of buyer to restitution. Where the seller justifiably withholds delivery of goods because of the breach of the buyer, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds:

- (1) the amount to which the seller is entitled by virtue of terms liquidating the damages of the seller in accordance with subsection (a); or
- (2) in the absence of such terms, 20% of the value of the total performance for which the buyer is obligated under the contract or \$500, whichever is smaller.

(c) Offset. The right of the buyer to restitution under subsection (b) is subject to offset to the extent that the seller establishes:

- (1) a right to recover damages under the provisions of this division other than subsection (a); and
- (2) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(d) Payment in goods. Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (b); but if the seller has notice of the breach of the buyer before reselling goods received in part performance, his resale is subject to the conditions laid down in this division on resale by an aggrieved seller (section 2706).

[Official Comment to § 2-718.](#)

§ 2719. Contractual Modification or Limitation of Remedy.

(a) General rule. Subject to the provisions of subsections (b) and (c) and of section 2718 (relating to liquidation or limitation of damages; deposits):

- (1) The agreement may provide for remedies in addition to or in substitution for those provided in this division and may limit or alter the measure of damages recoverable under this division, as by limiting the remedies of the buyer to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts.
- (2) Resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(b) Exclusive remedy failing in purpose. Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this title.

(c) Limitation of consequential damages. Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is *prima facie* unconscionable but limitation of damages where the loss is commercial is not.

[Official Comment to § 2-719.](#)

§ 2720. Effect of “Cancellation” or “Rescission” on Claims for Antecedent Breach

Unless the contrary intention clearly appears, expressions of “cancellation” or “rescission” of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach.

[Official Comment to § 2-720.](#)

§ 2721. Remedies for Fraud.

Remedies for material misrepresentation or fraud include all remedies available under this division for non-fraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy.

[Official Comment to § 2-721.](#)

§ 2722. Who Can Sue Third Parties for Injury to Goods

Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract

- (1) a right of action against the third party is in either party to the contract for sale who has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have been destroyed or converted a right of action is also in the party who either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other;
- (2) if at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, his suit or settlement is, subject to his own interest, as a fiduciary for the other party to the contract;
- (3) either party may with the consent of the other sue for the benefit of whom it may concern.

[Official Comment to § 2-722.](#)

§ 2723. Proof of Market Price: Time and Place

(a) Determination of market price generally. If an action based on anticipatory repudiation comes to trial before the time for performance with respect to some or all of the goods, any damages based on market price (section 2708 or 2713) shall be determined according to the price of such goods prevailing at the time when the aggrieved party learned of the repudiation.

(b) Other evidence available. If evidence of a price prevailing at the times or places described in this division is not readily available the price prevailing within any reasonable time before or after the time described or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described, may be used, making any proper allowance for the cost of transporting the goods to or from such other place.

(c) Admissibility of other relevant evidence. Evidence of a relevant price prevailing at a time or place other than the one described in this division offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise.

[Official Comment to § 2-723.](#)

§ 2724. Admissibility of Market Quotations

Whenever the prevailing price or value of any goods regularly bought and sold in any established commodity market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of such market shall be admissible in evidence. The circumstances of the preparation of such a report may be shown to affect its weight but not its admissibility.

[Official Comment to § 2-724.](#)

§ 2725. Statute of Limitations in Contracts for Sale

(a) General rule. An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

(b) Accrual of cause of action. A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

(c) New action after termination of another. Where an action commenced within the time limited by subsection (a) is so terminated as to leave available a remedy by another action for the same breach such other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from

voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(d) Laws and actions unaffected by section. This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this title becomes effective.

Official Comment to § 2-725.

Division 8. Pennsylvania Commercial Code – Investment Securities

§ 8-106. Control.

(a) A purchaser has “control” of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(b) A purchaser has “control” of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

- (1) the certificate is indorsed to the purchaser or in blank by an effective indorsement; or
- (2) the certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has “control” of an uncertificated security if:

- (1) the uncertificated security is delivered to the purchaser; or
- (2) the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

(d) A purchaser has “control” of a security entitlement if:

- (1) the purchaser becomes the entitlement holder;
- (2) the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder; or
- (3) another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser.

(e) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(f) A purchaser who has satisfied the requirements of subsection (c) or (d) has control, even if the registered owner in the case of subsection (c) or the entitlement holder in the case of subsection (d) retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(g) An issuer or a securities intermediary may not enter into an agreement of the kind described in subsection (c)(2) or (d)(2) without the consent of the registered owner or entitlement holder,

but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder.

Division 9, Pennsylvania Commercial Code. Secured Transactions

Chapter 91. General Provisions

Subchapter A. Short Title, Definitions, and General Concepts

§ 9101. Short title of division.

This division shall be known and may be cited as the Uniform Commercial Code, Division 9, Secured Transactions.

Official Comment

§ 9102. Definitions and index of definitions.

(a) **Division 9 definitions.** The following words and phrases when used in this division shall have the meanings given to them in this subsection:

"Accession." Goods which are physically united with other goods in such a manner that the identity of the original goods is not lost.

"Account."

(1) Except as used in "account for," a right to payment of a monetary obligation, whether or not earned by performance:

(i) for property which has been or is to be sold, leased, licensed, assigned or otherwise disposed of;

(ii) for services rendered or to be rendered;

(iii) for a policy of insurance issued or to be issued;

(iv) for a secondary obligation incurred or to be incurred;

(v) for energy provided or to be provided;

(vi) for the use or hire of a vessel under a charter or other contract;

(vii) arising out of the use of a credit or charge card or information contained on or for use with the card; or

(viii) as winnings in a lottery or other game of chance operated or sponsored by a state, governmental unit of a state or person licensed or authorized to operate the game by a state or governmental unit of a state.

(2) The term includes health-care-insurance receivables.

(3) The term does not include:

(i) rights to payment evidenced by chattel paper or an instrument;

(ii) commercial tort claims;

(iii) deposit accounts;

(iv) investment property;

(v) letter-of-credit right or letters of credit; or

(vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

"Account debtor." A person obligated on an account, chattel paper or general intangible. The term does not include persons obligated to pay a negotiable instrument even if the instrument constitutes part of chattel paper.

"Accounting." Except as used in "accounting for," a record:

(1) authenticated by a secured party;

(2) indicating the aggregate unpaid secured obligations as of a date not more than 35 days earlier or 35 days later than the date of the record; and

(3) identifying the components of the obligations in reasonable detail.

"Agricultural lien." An interest in farm products:

(1) which secures payment or performance of an obligation for:

(i) goods or services furnished in connection with a debtor's farming operation; or

(ii) rent on real property leased by a debtor in connection with its farming operation;

(2) which is created by statute in favor of a person that:

- (i) in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or
 - (ii) leased real property to a debtor in connection with the debtor's farming operation; and
- (3) whose effectiveness does not depend on the person's possession of the personal property.

"As-extracted collateral." Any of the following:

- (1) Oil, gas or other minerals which are subject to a security interest which:
 - (i) is created by a debtor having an interest in the minerals before extraction; and
 - (ii) attaches to the minerals as extracted.
- (2) Accounts arising out of the sale at the wellhead or minehead of oil, gas or other minerals in which the debtor had an interest before extraction.

"Authenticate." To:

- (i) sign; or
- (ii) with present intent to adopt or accept a record, attach to or logically associate with the record an electrical sound, symbol or process.

"Bank." An organization which is engaged in the business of banking. The term includes any savings bank, savings and loan association, credit union or trust company.

"Cash proceeds." Proceeds which are money, checks, deposit accounts or the like.

"Certificate of title." A certificate of title with respect to which a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. The term includes another record maintained as an alternative to a certificate of title by the governmental unit that issues certificates of title if a statute permits the security interest in question to be indicated on the record as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.

"Chattel paper." A record or records which evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods or a lease of specific goods and license of software used in the goods. In this definition, "monetary obligation" means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The

term does not include charters or other contracts involving the use or hire of a vessel or records which evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.

"Collateral." The property subject to a security interest or agricultural lien. The term includes:

- (1) proceeds to which a security interest attaches;
- (2) accounts, chattel paper, payment intangibles and promissory notes which have been sold; and
- (3) goods which are the subject of a consignment.

"Commercial tort claim." A claim arising in tort with respect to which:

- (1) the claimant is an organization; or
- (2) the claimant is an individual and the claim:
 - (i) arose in the course of the claimant's business or profession; and
 - (ii) does not include damages arising out of personal injury to or the death of an individual.

"Commodity account." An account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer.

"Commodity contract." A commodity futures contract, an option on a commodity futures contract, a commodity option or another contract if the contract or option is:

- (1) traded on or subject to the rules of a board of trade which has been designated as a contract market for such a contract pursuant to Federal commodities laws; or
- (2) traded on a foreign commodity board of trade, exchange or market and carried on the books of a commodity intermediary for a commodity customer.

"Commodity customer." A person for whom or which a commodity intermediary carries a commodity contract on its books.

"Commodity intermediary." A person that:

- (1) is registered as a futures commission merchant under Federal commodities law; or

(2) in the ordinary course of its business provides clearance or settlement services for a board of trade which has been designated as a contract market pursuant to Federal commodities law.

"Communicate." Any of the following:

- (1) To send a written or other tangible record.
- (2) To transmit a record by any means agreed upon by the persons sending and receiving the record.
- (3) In the case of transmission of a record to or by a filing office, to transmit a record by any means prescribed by filing-office rule.

"Consignee." A merchant to whom or which goods are delivered in a consignment.

"Consignment." A transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and all of the following apply:

- (1) The merchant:
 - (i) deals in goods of that kind under a name other than the name of the person making delivery;
 - (ii) is not an auctioneer; and
 - (iii) is not generally known by its creditors to be substantially engaged in selling the goods of others.
- (2) With respect to each delivery, the aggregate value of the goods is \$1,000 or more at the time of delivery.
- (3) The goods are not consumer goods immediately before delivery.
- (4) The transaction does not create a security interest which secures an obligation.

"Consignor." A person that delivers goods to a consignee in a consignment.

"Consumer debtor." A debtor in a consumer transaction.

"Consumer goods." Goods which are used or bought for use primarily for personal, family or household purposes.

"Consumer-goods transaction." A consumer transaction in which:

(1) an individual incurs an obligation primarily for personal, family or household purposes; and

(2) a security interest in consumer goods secures the obligation.

"Consumer obligor." An obligor who:

(1) is an individual; and

(2) incurred the obligation as part of a transaction entered into primarily for personal, family or household purposes.

"Consumer transaction." A transaction in which:

(1) an individual incurs an obligation primarily for personal, family or household purposes;

(2) a security interest secures the obligation; and

(3) the collateral is held or acquired primarily for personal, family or household purposes.

The term includes consumer-goods transactions.

"Continuation statement." An amendment of a financing statement which:

(1) identifies, by its file number, the initial financing statement to which it relates; and

(2) indicates that it is a continuation statement for, or that it is filed to continue the effectiveness of, the identified financing statement.

"Debtor." A:

(1) person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor;

(2) seller of accounts, chattel paper, payment intangibles or promissory notes; or

(3) consignee.

"Deposit account." A demand, time, savings, passbook or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.

"Document." A document of title or a receipt of the type described in section 7201(b) (relating to person that may issue a warehouse receipt; storage under bond).

"Electronic chattel paper." Chattel paper evidenced by a record consisting of information stored in an electronic medium.

"Encumbrance." A right, other than an ownership interest, in real property. The term includes a mortgage and any other lien on real property.

"Equipment." Goods other than inventory, farm products or consumer goods.

"Farm products." Goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are any of the following:

(1) Crops grown, growing or to be grown, including:

- (i) crops produced on trees, vines and bushes; and
- (ii) aquatic goods produced in aquacultural operations.

(2) Livestock, born or unborn, including aquatic goods produced in aquacultural operations.

(3) Supplies used or produced in a farming operation.

(4) Products of crops or livestock in their unmanufactured states.

"Farming operation." Raising, cultivating, propagating, fattening or grazing or any other farming, livestock or aquacultural operation.

"File number." The number assigned to an initial financing statement pursuant to section 9519(a) (relating to filing office duties).

"Filing office." An office designated in section 9501 (relating to filing office) as the place to file a financing statement.

"Filing-office rule." A rule adopted pursuant to section 9526 (relating to filing-office rules).

"Financing statement." A record or records composed of an initial financing statement and any filed record relating to the initial financing statement.

"Fixture filing." The filing of a financing statement:

(1) covering goods which are, or are to become, fixtures; and

(2) satisfying section 9502(a) (relating to sufficiency of financing statement) and (b) (relating to real-property-related financing statements).

The term includes the filing of a financing statement covering goods of a transmitting utility which are, or are to become, fixtures.

"Fixtures." Goods which have become so related to particular real property that an interest in them arises under real property law.

"General intangible." 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.

"Good faith." (Deleted by amendment).

"Goods." All things which are movable when a security interest attaches.

(1) The term includes all of the following:

- (i) Fixtures.
- (ii) Standing timber which is to be cut and removed under a conveyance or contract for sale.
- (iii) The unborn young of animals.
- (iv) Crops grown, growing or to be grown, even if the crops are produced on trees, vines or bushes.
- (v) Manufactured homes.
- (vi) A computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if:
 - (A) the program is associated with the goods in such a manner that it customarily is considered part of the goods; or
 - (B) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods.

The term does not include a computer program embedded in goods which consist solely of the medium in which the program is embedded.

(2) The term does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money or oil, gas or other minerals before extraction.

"Governmental unit." A subdivision, agency, department, county, parish, municipality or other unit of the government of the United States, a state or a foreign country. The term includes an organization having a separate corporate existence if the organization is eligible to issue debt on which interest is exempt from income taxation under the laws of the United States.

"Health-care-insurance receivable." An interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided or to be provided.

"Instrument." A negotiable instrument or any other writing which evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease and is of a type which in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include:

- (1) investment property;
- (2) letters of credit; or
- (3) writings which evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

"Inventory." Goods, other than farm products, which:

- (1) are leased by a person as lessor;
- (2) are held by a person for sale or lease or to be furnished under a contract of service;
- (3) are furnished by a person under a contract of service; or
- (4) consist of raw materials, work in process or materials used or consumed in a business.

"Investment property." A security whether certificated or uncertificated, security entitlement, securities account, commodity contract or commodity account.

"Jurisdiction of organization." With respect to a registered organization, the jurisdiction under whose law the organization is formed or organized.

"Letter-of-credit right." A right to payment or performance under a letter of credit, whether or not the beneficiary has demanded or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit.

"Lien creditor." Any of the following:

- (1) A creditor that has acquired a lien on the property involved by attachment, levy or the like.

- (2) An assignee for benefit of creditors from the time of assignment.
- (3) A trustee in bankruptcy from the date of the filing of the petition.
- (4) A receiver in equity from the time of appointment.

"Manufactured home." A structure, transportable in one or more sections, which, in the traveling mode, is eight body feet or more in width or 40 body feet or more in length, or, when erected on site, is 320 or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-conditioning, and electrical systems contained therein. The term includes any structure that meets all of the requirements of this paragraph except the size requirements and with respect to which the manufacturer voluntarily files a certification required by the United States Secretary of Housing and Urban Development and complies with the standards established under 42 U.S.C. (relating to public health and welfare).

"Manufactured-home transaction." A secured transaction:

- (1) which creates a purchase-money security interest in a manufactured home, other than a manufactured home held as inventory; or
- (2) in which a manufactured home, other than a manufactured home held as inventory, is the primary collateral.

"Mortgage." A consensual interest in real property, including fixtures, which secures payment or performance of an obligation.

"New debtor." A person that becomes bound as debtor under section 9203(d) (relating to when person becomes bound by another person's security agreement) by a security agreement previously entered into by another person.

"New value." Any of the following:

- (1) Money.
- (2) Money's worth in property, services or new credit.
- (3) Release by a transferee of an interest in property previously transferred to the transferee.

The term does not include an obligation substituted for another obligation.

"Noncash proceeds." Proceeds other than cash proceeds.

"Obligor." A person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral:

- (1) owes payment or other performance of the obligation;
- (2) has provided property other than the collateral to secure payment or other performance of the obligation; or
- (3) is otherwise accountable in whole or in part for payment or other performance of the obligation.

The term does not include any issuer or nominated person under a letter of credit.

"Original debtor." Except as used in section 9310(c) (relating to assignment of perfected security interest), a person that, as debtor, entered into a security agreement to which a new debtor has become bound under section 9203(d) (relating to when person becomes bound by another person's security agreement).

"Payment intangible." A general intangible under which the account debtor's principal obligation is a monetary obligation.

"Person related to." One of the following:

- (1) With respect to an individual:
 - (i) the spouse of the individual;
 - (ii) a brother, brother-in-law, sister or sister-in-law of the individual;
 - (iii) an ancestor or lineal descendant of the individual or the individual's spouse; or
 - (iv) any other relative, by blood or marriage, of the individual or the individual's spouse, who shares the same home with the individual.
- (2) With respect to an organization:
 - (i) a person directly or indirectly controlling, controlled by or under common control with the organization;
 - (ii) an officer or director of or a person performing similar functions with respect to the organization;
 - (iii) an officer or director of or a person performing similar functions with respect to a person described in subparagraph (i);

- (iv) the spouse of an individual described in subparagraph (i), (ii) or (iii); or
- (v) an individual related by blood or marriage to an individual described in subparagraph (i), (ii), (iii) or (iv) who shares the same home with the individual.

"Proceeds." Except as used in section 9609(b) (relating to secured party's right to take possession after default), the following property:

- (1) Whatever is acquired upon the sale, lease, license, exchange or other disposition of collateral.
- (2) Whatever is collected on or distributed on account of collateral.
- (3) Rights arising out of collateral.
- (4) To the extent of the value of collateral, claims arising out of:
 - (i) loss of the collateral;
 - (ii) nonconformity of the collateral;
 - (iii) interference with the use of the collateral;
 - (iv) defects in the collateral;
 - (v) infringement of rights in the collateral; or
 - (vi) damage to the collateral.
- (5) To the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of:
 - (i) loss of the collateral;
 - (ii) nonconformity of the collateral;
 - (iii) defects in the collateral;
 - (iv) infringement of rights in the collateral; or
 - (v) damage to the collateral.

"Promissory note." An instrument which:

- (1) evidences a promise to pay a monetary obligation;

- (2) does not evidence an order to pay; and
- (3) does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.

"Proposal." A record authenticated by a secured party which includes the terms on which the secured party is willing to accept collateral in full or partial satisfaction of the obligation it secures under sections 9620 (relating to acceptance of collateral in full or partial satisfaction of obligation; compulsory disposition of collateral), 9621 (relating to notification of proposal to accept collateral) and 9622 (relating to effect of acceptance of collateral).

"Public organic record." A record that is available to the public for inspection and is:

- (1) a record consisting of the record initially filed with or issued by a state or the United States to form or organize an organization and any record filed with or issued by the state or the United States which amends or restates the initial record;
- (2) an organic record of a business trust consisting of the record initially filed with a state and any record filed with the state which amends or restates the initial record, if a statute of the state governing business trusts requires that the record be filed with the state; or
- (3) a record consisting of legislation enacted by the legislature of a state or the Congress of the United States which forms or organizes an organization, any record amending the legislation and any record filed with or issued by the state or the United States which amends or restates the name of the organization.

"Public-finance transaction." A secured transaction in connection with which all of the following apply:

- (1) Debt securities are issued.
- (2) All or a portion of the securities issued have an initial stated maturity of at least 20 years.
- (3) Any of the following is a state or a governmental unit of a state:
 - (i) The debtor.
 - (ii) The obligor.
 - (iii) The secured party.
 - (iv) The account debtor or other person obligated on collateral.
 - (v) The assignor or assignee of a secured obligation.

(vi) The assignor or assignee of a security interest.

"Pursuant to commitment." With respect to an advance made or other value given by a secured party, pursuant to the secured party's obligation, whether or not a subsequent event of default or other event not within the secured party's control has relieved or may relieve the secured party from its obligation.

"Record." Except as used in "for record," "of record," "record or legal title" or "record owner," either of the following:

- (1) Information which is inscribed on a tangible medium.
- (2) Information which is:
 - (i) stored in an electronic or other medium; and
 - (ii) retrievable in perceivable form.

"Registered organization." An organization formed or organized solely under the law of a single state or the United States by the filing of a public organic record, with the issuance of a public organic record by or the enactment of legislation by the state or the United States. The term includes a business trust that is formed or organized under the law of a single state if a statute of the state governing business trusts requires that a business trust's organic record be filed with the state.

"Secondary obligor." An obligor to the extent that:

- (1) the obligor's obligation is secondary; or
- (2) the obligor has a right of recourse with respect to an obligation secured by collateral against the debtor or another obligor or property of either.

"Secured party." Any of the following:

- (1) A person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding.
- (2) A person that holds an agricultural lien.
- (3) A consignor.
- (4) A person to whom or which accounts, chattel paper, payment intangibles or promissory notes have been sold.
- (5) A trustee, indenture trustee, agent, collateral agent or other representative in whose favor a security interest or agricultural lien is created or provided for.

(6) A person that holds a security interest arising under section 2401 (relating to passing of title; reservation for security; limited application of section), 2505 (relating to shipment by seller under reservation), 2711(c) (relating to security interest of buyer in rejected goods), 2A508(e) (relating to security interest in goods in lessee's possession), 4210 (relating to security interest of collecting bank in items, accompanying documents and proceeds) or 5118 (relating to security interest of issuer or nominated person).

"Security agreement." An agreement which creates or provides for a security interest.

"Send." In connection with a record or notification:

- (1) to deposit in the mail, deliver for transmission or transmit by any other usual means of communication, with postage or cost of transmission provided for, addressed to any address reasonable under the circumstances; or
- (2) to cause the record or notification to be received within the time which it would have been received if properly sent under paragraph (1).

"Software." A computer program and any supporting information provided in connection with a transaction relating to the program. The term does not include a computer program which is included in the definition of goods.

"State." A state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands or any territory or insular possession subject to the jurisdiction of the United States.

"Supporting obligation." A letter-of-credit right or secondary obligation which supports the payment or performance of an account, chattel paper, a document, a general intangible, an instrument or investment property.

"Tangible chattel paper." Chattel paper evidenced by a record or records consisting of information which is inscribed on a tangible medium.

"Termination statement." An amendment of a financing statement which:

- (1) identifies, by its file number, the initial financing statement to which it relates; and
- (2) indicates either that it is a termination statement or that the identified financing statement is no longer effective.

"Transmitting utility." A person primarily engaged in the business of:

- (1) operating a railroad, subway, street railway or trolley bus;
- (2) transmitting communications electrically, electromagnetically or by light;

- (3) transmitting goods by pipeline or sewer; or
- (4) transmitting or producing and transmitting electricity, steam, gas or water.

(b) Definitions in other divisions. The following definitions in other divisions apply to this division:

"Applicant." Section 5102.
"Beneficiary." Section 5102.
"Broker." Section 8102.
"Certificated security." Section 8102.
"Check." Section 3104.
"Clearing corporation." Section 8102.
"Contract for sale." Section 2106.
"Control." With respect to a document of title, section 7106.
"Customer." Section 4104.
"Entitlement holder." Section 8102.
"Financial asset." Section 8102.
"Holder in due course." Section 3302.
"Issuer." With respect to a letter of credit or letter-of-credit right, section 5102.
"Issuer." With respect to a document of title, section 7102.
"Issuer." With respect to a security, section 8201.
"Lease." Section 2A103.
"Lease agreement." Section 2A103.
"Lease contract." Section 2A103.
"Leasehold interest." Section 2A103.
"Lessee." Section 2A103.
"Lessee in ordinary course of business." Section 2A103.
"Lessor." Section 2A103.
"Lessor's residual interest." Section 2A103.
"Letter of credit." Section 5102.
"Merchant." Section 2104.
"Negotiable instrument." Section 3104.
"Nominated person." Section 5102.
"Note." Section 3104.
"Proceeds of a letter of credit." Section 5114.
"Prove." Section 3103.
"Sale." Section 2106.
"Securities account." Section 8501.
"Securities intermediary." Section 8102.
"Security." Section 8102.
"Security certificate." Section 8102.
"Security entitlement." Section 8102.
"Uncertificated security." Section 8102.

Official Comment

§ 9103. Purchase-money security interest; application of payments; burden of establishing.

(a) Definitions. As used in this section, the following words and phrases shall have the meanings given to them in this subsection:

"Purchase-money collateral." Goods or software which secures a purchase-money obligation incurred with respect to that collateral.

"Purchase-money obligation." 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 or the use of the collateral if the value is in fact so used.

(b) Purchase-money security interest in goods. A security interest in goods is a purchase-money security interest:

- (1) to the extent that the goods are purchase-money collateral with respect to that security interest;
- (2) if the security interest is in inventory which is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest; and
- (3) also to the extent that the security interest secures a purchase-money obligation incurred with respect to software in which the secured party holds or held a purchase-money security interest.

(c) Purchase-money security interest in software. A security interest in software is a purchase-money security interest to the extent that the security interest also secures a purchase-money obligation incurred with respect to goods in which the secured party holds or held a purchase-money security interest if:

- (1) the debtor acquired its interest in the software in an integrated transaction in which it acquired an interest in the goods; and
- (2) the debtor acquired its interest in the software for the principal purpose of using the software in the goods.

(d) Consignor's inventory purchase-money security interest. The security interest of a consignor in goods which are the subject of a consignment is a purchase-money security interest in inventory.

(e) Application of payment in nonconsumer-goods transaction. In a transaction other than a consumer-goods transaction, if the extent to which a security interest is a purchase-money

security interest depends on the application of a payment to a particular obligation, the payment must be applied:

- (1) in accordance with any reasonable method of application to which the parties agree;
- (2) in the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or
- (3) in the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:
 - (i) to obligations which are not secured; and
 - (ii) if more than one obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred.

(f) No loss of status of purchase-money security interest in nonconsumer-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 which is not a purchase-money obligation;
- (2) collateral which is not purchase-money collateral also secures the purchase-money obligation; or
- (3) the purchase-money obligation has been renewed, refinanced, consolidated or restructured.

(g) Burden of proof in nonconsumer-goods transaction. In a transaction other than a consumer-goods transaction, a secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security interest is a purchase-money security interest.

(h) Nonconsumer-goods transactions; no inference. The limitation of the rules in subsections (e), (f) and (g) to transactions other than consumer-goods transactions is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper rule in consumer-goods transactions and may continue to apply established approaches.

Official Comment

§ 9104. Control of deposit account.

(a) Requirements for control. A secured party has control of a deposit account if:

- (1) the secured party is the bank with which the deposit account is maintained;
- (2) the debtor, secured party and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or
- (3) the secured party becomes the bank's customer with respect to the deposit account.

(b) Debtor's right to direct disposition. A secured party that has satisfied subsection (a) has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.

Official Comment

§ 9105. Control of electronic chattel paper.

(a) General rule; control of electronic chattel paper. A secured party has control of electronic chattel paper if a system employed for evidencing the transfer of interests in the chattel paper reliably establishes the secured party as the person to which the chattel paper was assigned.

(b) Specific facts giving control. A system satisfies subsection (a) if the record or records comprising the chattel paper are created, stored and assigned in such a manner that:

- (1) a single authoritative copy of the record or records exists which is unique, identifiable and, except as otherwise provided in paragraphs (4), (5) and (6), unalterable;
- (2) the authoritative copy identifies the secured party as the assignee of the record or records;
- (3) the authoritative copy is communicated to and maintained by the secured party or its designated custodian;
- (4) copies or amendments which add or change an identified assignee of the authoritative copy can be made only with the consent of the secured party;
- (5) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy which is not the authoritative copy; and
- (6) any amendment of the authoritative copy is readily identifiable as authorized or unauthorized.

Official Comment

§ 9106. Control of investment property.

(a) Control under section 8106. A person has control of a certificated security, an uncertificated security or a security entitlement as provided in section 8106 (relating to control).

(b) Control of commodity contract. A secured party has control of a commodity contract if:

- (1) the secured party is the commodity intermediary with which the commodity contract is carried; or
- (2) the commodity customer, secured party and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer.

(c) Effect of control of securities account or commodity account. A secured party having control of all security entitlements or commodity contracts carried in a securities account or commodity account has control over the securities account or commodity account.

Official Comment

§ 9107. Control of letter-of-credit right.

A secured party has control of a letter-of-credit right to the extent of any right to payment or performance by the issuer or any nominated person if the issuer or nominated person has consented to an assignment of proceeds of the letter of credit under section 5114(c) (relating to recognition of assignment of proceeds) or otherwise applicable law or practice.

Official Comment

§ 9108. Sufficiency of description.

(a) Sufficiency of description. Except as otherwise provided in subsections (c), (d) and (e), a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.

(b) Examples of reasonable identification. Except as otherwise provided in subsection (d), a description of collateral reasonably identifies the collateral if it identifies the collateral by:

- (1) specific listing;
- (2) category;
- (3) except as otherwise provided in subsection (e), a type of collateral defined in this title;
- (4) quantity;
- (5) computational or allocational formula or procedure; Or

(6) except as otherwise provided in subsection (c), any other method, if the identity of the collateral is objectively determinable.

(c) Supergeneric description not sufficient. A description of collateral as "all the debtor's assets" or "all the debtor's personal property" or using words of similar import does not reasonably identify the collateral.

(d) Investment property. Except as otherwise provided in subsection (e), a description of a security entitlement, securities account or commodity account is sufficient if it describes:

- (1) the collateral by those terms or as investment property; or
- (2) the underlying financial asset or commodity contract.

(e) When description by type insufficient. A description only by type of collateral defined in this title is an insufficient description of:

- (1) a commercial tort claim; or
- (2) in a consumer transaction, consumer goods, a security entitlement, a securities account or a commodity account.

Official Comment

Subchapter B. Applicability of Division

§ 9109. Scope.

(a) General scope of division. Except as otherwise provided in subsections (c) and (d), this division applies to:

- (1) a transaction, regardless of its form, which creates a security interest in personal property or fixtures by contract;
- (2) an agricultural lien;
- (3) a sale of accounts, chattel paper, payment intangibles or promissory notes;
- (4) a consignment;
- (5) a security interest arising under section 2401 (relating to passing of title; reservation for security; limited application of section), 2505 (relating to shipment by seller under reservation), 2711(c) (relating to security interest of buyer in rejected goods) or 2A508(e) (relating to security interest in goods in lessee's possession), as provided in section 9110 (relating to security interests arising under Division 2 or 2A); and

(6) a security interest arising under section 4210 (relating to security interest of collecting bank in items, accompanying documents and proceeds) or 5118 (relating to security interest of issuer or nominated person).

(b) Security interest in secured obligation. The application of this division to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this division does not apply.

(c) Extent to which division does not apply. This division does not apply to the extent that:

- (1) a statute, regulation or treaty of the United States preempts this division;
- (2) another statute of this Commonwealth expressly governs the creation, perfection, priority or enforcement of a security interest created by the Commonwealth or a governmental unit of the Commonwealth;
- (3) a statute of another state, a foreign country or a governmental unit of another state or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority or enforcement of a security interest created by the state, country or governmental unit; or
- (4) the rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under section 5114 (relating to assignment of proceeds).

(d) Inapplicability of division. This division does not apply to any of the following:

- (1) A landlord's lien other than an agricultural lien.
- (2) A lien, other than an agricultural lien, given by statute or other rule of law for services or materials. Section 9333 (relating to priority of certain liens arising by operation of law) applies with respect to priority of the lien.
- (3) An assignment of a claim for wages, salary or other compensation of an employee.
- (4) A sale of accounts, chattel paper, payment intangibles or promissory notes as part of a sale of the business out of which they arose.
- (5) An assignment of accounts, chattel paper, payment intangibles or promissory notes which is for the purpose of collection only.
- (6) An assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract.
- (7) An assignment of a single account, payment intangible or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness.

(8) A transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment. Sections 9315 (relating to secured party's rights on disposition of collateral and in proceeds) and 9322 (relating to priorities among conflicting security interests in and agricultural liens on same collateral) apply with respect to proceeds and priorities in proceeds.

(9) An assignment of a right represented by a judgment, other than a judgment taken on a right to payment which was collateral.

(10) A right of recoupment or set-off. However:

(i) section 9340 (relating to effectiveness of right of recoupment or set-off against deposit account) applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts; and

(ii) section 9404 (relating to rights acquired by assignee; claims and defenses against assignee) applies with respect to defenses or claims of an account debtor.

(11) The creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:

(i) liens on real property in sections 9203 (relating to attachment and enforceability of security interest; proceeds; supporting obligations; formal requisites) and 9308 (relating to when security interest or agricultural lien is perfected; continuity of perfection);

(ii) fixtures in section 9334 (relating to priority of security interests in fixtures and crops);

(iii) fixture filings in sections 9501 (relating to filing office), 9502 (relating to contents of financing statement; record of mortgage as financing statement; time of filing financing statement), 9512 (relating to amendment of financing statement), 9516 (relating to what constitutes filing; effectiveness of filing) and 9519 (relating to numbering, maintaining and indexing records; communicating information provided in records); and

(iv) security agreements covering personal and real property in section 9604 (relating to procedure if security agreement covers real property or fixtures).

(12) An assignment of a claim arising in tort, other than a commercial tort claim. Sections 9315 and 9322 apply with respect to proceeds and priorities in proceeds.

(13) An assignment of a deposit account in a consumer transaction. Sections 9315 and 9322 apply with respect to proceeds and priorities in proceeds.

(14) A security interest in intangible transition property, as defined in 66 Pa.C.S. § 2812(g) (relating to approval of transition bonds), to the extent that such security interest is governed by 66 Pa.C.S. § 2812 rather than by this title.

Official Comment

§ 9110. Security interests arising under Division 2 or 2A.

A security interest arising under section 2401 (relating to passing of title; reservation for security; limited application of section), 2505 (relating to shipment by seller under reservation), 2711(c) (relating to security interest of buyer in rejected goods) or 2A508(e) (relating to security interest in goods in lessee's possession) is subject to this division. However, until the debtor obtains possession of the goods:

- (1) the security interest is enforceable, even if section 9203(b)(3) (relating to enforceability) has not been satisfied;
- (2) filing is not required to perfect the security interest;
- (3) the rights of the secured party after default by the debtor are governed by Division 2 (relating to sales) or 2A (relating to leases); and
- (4) the security interest has priority over a conflicting security interest created by the debtor.

Official Comment

Chapter 92. Effectiveness of Security Agreement, Attachment of Security Interest and Rights of Parties to Security Agreement

Subchapter A. Effectiveness and Attachment

§ 9201. General effectiveness of security agreement.

(a) General effectiveness. Except as otherwise provided in this title, a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors.

(b) Applicable consumer laws and other law. A transaction subject to this division is subject to:

- (1) any applicable rule of law which establishes a different rule for consumers;
- (2) any other statute or regulation of the Commonwealth which regulates the rates, charges, agreements and practices for loans, credit sales or other extensions of credit; and

(3) any consumer protection statute or regulation of the Commonwealth.

(c) Other applicable law controls. In case of conflict between this division and a rule of law, statute or regulation described in subsection (b), the rule of law, statute or regulation controls. Failure to comply with a statute or regulation described in subsection (b) has only the effect the statute or regulation specifies.

(d) Further deference to other applicable law. This division does not:

- (1) validate any rate, charge, agreement or practice which violates a rule of law, statute or regulation described in subsection (b); or
- (2) extend the application of the rule of law, statute or regulation to a transaction not otherwise subject to it.

Official Comment

§ 9202. Title to collateral immaterial.

Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, payment intangibles or promissory notes, the provisions of this division with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.

Official Comment

§ 9203. Attachment and enforceability of security interest; proceeds; supporting obligations; formal requisites.

(a) Attachment. A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral unless an agreement expressly postpones the time of attachment.

(b) Enforceability. Except as otherwise provided in subsections (c) through (i), a security interest is enforceable against the debtor and third parties with respect to the collateral only if all of the following apply:

- (1) Value has been given.
- (2) The debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party.
- (3) One of the following conditions is met:

- (i) The debtor has authenticated a security agreement which provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned.
- (ii) The collateral is not a certificated security and is in the possession of the secured party under section 9313 (relating to when possession by or delivery to secured party perfects security interest without filing) pursuant to the debtor's security agreement.
- (iii) The collateral is a certificated security in registered form, and the security certificate has been delivered to the secured party under section 8301 (relating to delivery) pursuant to the debtor's security agreement.
- (iv) The collateral is deposit accounts, electronic chattel paper, investment property, letter-of-credit rights or electronic documents, and the secured party has control under section 7106 (relating to control of electronic document of title), 9104 (relating to control of deposit account), 9105 (relating to control of electronic chattel paper), 9106 (relating to control of investment property) or 9107 (relating to control of letter-of-credit right) pursuant to the debtor's security agreement.

(c) Other Title 13 provisions. Subsection (b) is subject to sections 4210 (relating to security interest of collecting bank in items, accompanying documents and proceeds), 5118 (relating to security interest of issuer or nominated person), 9110 (relating to security interests arising under Division 2 or 2A) and 9206 (relating to security interest arising in purchase or delivery of financial asset).

(d) When person becomes bound by another person's security agreement. A person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than this division or by contract:

- (1) the security agreement becomes effective to create a security interest in the person's property; or
- (2) the person becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.

(e) Effect of new debtor becoming bound. If a new debtor becomes bound as debtor by a security agreement entered into by another person:

- (1) the agreement satisfies subsection (b)(3) with respect to existing or after-acquired property of the new debtor to the extent the property is described in the agreement; and
- (2) another agreement is not necessary to make a security interest in the property enforceable.

(f) Proceeds and supporting obligations. The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by section 9315 (relating to secured party's rights on disposition of collateral and in proceeds) and is also attachment of a security interest in a supporting obligation for the collateral.

(g) Lien securing right to payment. The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage or other lien.

(h) Security entitlement carried in securities account. The attachment of a security interest in a securities account is also attachment of a security interest in the security entitlements carried in the securities account.

(i) Commodity contracts carried in commodity account. The attachment of a security interest in a commodity account is also attachment of a security interest in the commodity contracts carried in the commodity account.

Official Comment

§ 9204. After-acquired property; future advances.

(a) After-acquired collateral. Except as otherwise provided in subsection (b), a security agreement may create or provide for a security interest in after-acquired collateral.

(b) When after-acquired property clause not effective. A security interest does not attach under a term constituting an after-acquired property clause to:

- (1) consumer goods, other than an accession when given as additional security, unless the debtor acquires rights in them within ten days after the secured party gives value; or
- (2) a commercial tort claim.

(c) Future advances and other value. A security agreement may provide that collateral secures, or that accounts, chattel paper, payment intangibles or promissory notes are sold in connection with, future advances or other value, whether or not the advances or value are given pursuant to commitment.

Official Comment

§ 9205. Use or disposition of collateral permissible.

(a) When security interest not invalid or fraudulent. A security interest is not invalid or fraudulent against creditors solely because any of the following apply:

- (1) The debtor has the right or ability to:

- (i) use, commingle or dispose of all or part of the collateral, including returned or reposessed goods;
 - (ii) collect, compromise, enforce or otherwise deal with collateral;
 - (iii) accept the return of collateral or make repossession; or
 - (iv) use, commingle or dispose of proceeds.
- (2) The secured party fails to require the debtor to account for proceeds or replace collateral.

(b) Requirements of possession not relaxed. This section does not relax the requirements of possession if attachment, perfection or enforcement of a security interest depends upon possession of the collateral by the secured party.

Official Comment

§ 9206. Security interest arising in purchase or delivery of financial asset.

(a) Security interest when person buys through securities intermediary. A security interest in favor of a securities intermediary attaches to a person's security entitlement if:

- (1) the person buys a financial asset through the securities intermediary in a transaction in which the person is obligated to pay the purchase price to the securities intermediary at the time of the purchase; and
- (2) the securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary.

(b) Security interest secures obligation to pay for financial asset. The security interest described in subsection (a) secures the person's obligation to pay for the financial asset.

(c) Security interest in payment against delivery transaction. A security interest in favor of a person that delivers a certificated security or other financial asset represented by a writing attaches to the security or other financial asset if all of the following apply:

- (1) The security or other financial asset:
 - (i) in the ordinary course of business is transferred by delivery with any necessary indorsement or assignment; and
 - (ii) is delivered under an agreement between persons in the business of dealing with such securities or financial assets.

(2) The agreement calls for delivery against payment.

(d) Security interest secures obligation to pay for delivery. The security interest described in subsection (c) secures the obligation to make payment for the delivery.

Official Comment

Subchapter B. Rights and Duties

§ 9207. Rights and duties of secured party having possession or control of collateral.

(a) Duty of care when secured party in possession. Except as otherwise provided in subsection (d), a secured party shall use reasonable care in the custody and preservation of collateral in the secured party's possession. In the case of chattel paper or an instrument, reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(b) Expenses, risks, duties and rights when secured party in possession. Except as otherwise provided in subsection (d), if a secured party has possession of collateral:

(1) Reasonable expenses, including the cost of insurance and payment of taxes or other charges, incurred in the custody, preservation, use or operation of the collateral are chargeable to the debtor and are secured by the collateral.

(2) The risk of accidental loss or damage is on the debtor to the extent of a deficiency in any effective insurance coverage.

(3) The secured party shall keep the collateral identifiable, but fungible collateral may be commingled.

(4) The secured party may use or operate the collateral:

(i) for the purpose of preserving the collateral or its value;

(ii) as permitted by an order of a court having competent jurisdiction; or

(iii) except in the case of consumer goods, in the manner and to the extent agreed by the debtor.

(c) Duties and rights when secured party in possession or control. Except as otherwise provided in subsection (d), a secured party having possession of collateral or control of collateral under section 7106 (relating to control of electronic document of title), 9104 (relating to control of deposit account), 9105 (relating to control of electronic chattel paper), 9106 (relating to control of investment property) or 9107 (relating to control of letter-of-credit right):

(1) may hold as additional security any proceeds, except money or funds, received from the collateral;

(2) shall apply money or funds received from the collateral to reduce the secured obligation unless remitted to the debtor; and

(3) may create a security interest in the collateral.

(d) Buyer of certain rights to payment. If the secured party is a buyer of accounts, chattel paper, payment intangibles or promissory notes or a consignor:

(1) Subsection (a) does not apply unless the secured party is entitled under an agreement:

(i) to charge back uncollected collateral; or

(ii) otherwise to full or limited recourse against the debtor or a secondary obligor based on the nonpayment or other default of an account debtor or other obligor on the collateral.

(2) Subsections (b) and (c) do not apply.

Official Comment

§ 9208. Additional duties of secured party having control of collateral.

(a) Applicability of section. This section applies to cases in which there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations or otherwise give value.

(b) Duties of secured party after receiving demand from debtor. Within ten days after receiving an authenticated demand by the debtor:

(1) A secured party having control of a deposit account under section 9104(a)(2) (relating to control of deposit account) shall send to the bank with which the deposit account is maintained an authenticated statement which releases the bank from any further obligation to comply with instructions originated by the secured party.

(2) A secured party having control of a deposit account under section 9104(a)(3) shall:

(i) pay the debtor the balance on deposit in the deposit account; or

(ii) transfer the balance on deposit into a deposit account in the debtor's name.

(3) A secured party, other than a buyer, having control of electronic chattel paper under section 9105 (relating to control of electronic chattel paper) shall:

(i) communicate the authoritative copy of the electronic chattel paper to the debtor or its designated custodian;

- (ii) if the debtor designates a custodian that is the designated custodian with whom or which the authoritative copy of the electronic chattel paper is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and
 - (iii) take appropriate action to enable the debtor or its designated custodian to make copies of or revisions to the authoritative copy which add or change an identified assignee of the authoritative copy without the consent of the secured party.
- (4) A secured party having control of investment property under section 8106(d)(2) (relating to control of security entitlement) or 9106(b) (relating to control of commodity contract) shall send to the securities intermediary or commodity intermediary with which the security entitlement or commodity contract is maintained an authenticated record which releases the securities intermediary or commodity intermediary from any further obligation to comply with entitlement orders or directions originated by the secured party.
- (5) A secured party having control of a letter-of-credit right under section 9107 (relating to control of letter-of-credit right) shall send to each person having an unfulfilled obligation to pay or deliver proceeds of the letter of credit to the secured party an authenticated release from any further obligation to pay or deliver proceeds of the letter of credit to the secured party.
- (6) A secured party having control of an electronic document shall:
- (i) give control of the electronic document to the debtor or its designated custodian;
 - (ii) if the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic document is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and
 - (iii) take appropriate action to enable the debtor or its designated custodian to make copies of or revisions to the authoritative copy which add or change an identified assignee of the authoritative copy without the consent of the secured party.

Official Comment

§ 9209. Duties of secured party if account debtor has been notified of assignment.

(a) Applicability of section. Except as otherwise provided in subsection (c), this section applies if:

- (1) there is no outstanding secured obligation; and
- (2) the secured party is not committed to make advances, incur obligations or otherwise give value.

(b) Duties of secured party after receiving demand from debtor. Within ten days after receiving an authenticated demand by the debtor, a secured party shall send to an account debtor that has received notification of an assignment to the secured party as assignee under section 9406(a) (relating to discharge of account debtor; effect of notification) an authenticated record which releases the account debtor from any further obligation to the secured party.

(c) Inapplicability to sales. This section does not apply to an assignment constituting the sale of an account, chattel paper or payment intangible.

Official Comment

§ 9210. Request for accounting; request regarding list of collateral or statement of account.

(a) Definitions. As used in this section, the following words and phrases shall have the meanings given to them in this subsection:

"Request." A:

- (1) request for an accounting;
- (2) request regarding a list of collateral; or
- (3) request regarding a statement of account.

"Request for an accounting." A record authenticated by a debtor requesting that the recipient provide an accounting of the unpaid obligations secured by collateral and reasonably identifying the transaction or relationship which is the subject of the request.

"Request regarding a list of collateral." A record authenticated by a debtor requesting that the recipient approve or correct a list of what the debtor believes to be the collateral securing an obligation and reasonably identifying the transaction or relationship which is the subject of the request.

"Request regarding a statement of account." A record authenticated by a debtor requesting that the recipient approve or correct a statement indicating what the debtor believes to be the

aggregate amount of unpaid obligations secured by collateral as of a specified date and reasonably identifying the transaction or relationship which is the subject of the request.

(b) Duty to respond to requests. Subject to subsections (c), (d), (e) and (f), a secured party, other than a buyer of accounts, chattel paper, payment intangibles or promissory notes or a consignor, shall comply with a request within 14 days after receipt:

- (1) in the case of a request for an accounting, by authenticating and sending to the debtor an accounting; and
- (2) in the case of a request regarding a list of collateral or a request regarding a statement of account, by authenticating and sending to the debtor an approval or correction.

(c) Request regarding list of collateral; statement concerning type of collateral. A secured party that claims a security interest in all of a particular type of collateral owned by the debtor may comply with a request regarding a list of collateral by sending to the debtor an authenticated record including a statement to that effect within 14 days after receipt.

(d) Request regarding list of collateral; no interest claimed. A person that receives a request regarding a list of collateral, claims no interest in the collateral when it receives the request and claimed an interest in the collateral at an earlier time shall comply with the request within 14 days after receipt by sending to the debtor an authenticated record:

- (1) disclaiming any interest in the collateral; and
- (2) if known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the collateral.

(e) Request for accounting or regarding statement of account; no interest in obligation claimed. A person that receives a request for an accounting or a request regarding a statement of account, claims no interest in the obligations when it receives the request and claimed an interest in the obligations at an earlier time shall comply with the request within 14 days after receipt by sending to the debtor an authenticated record:

- (1) disclaiming any interest in the obligations; and
- (2) if known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the obligations.

(f) Charges for responses. A debtor is entitled without charge to one response to a request under this section during any six-month period. The secured party may require payment of a charge not exceeding \$25 for each additional response.

[Official Comment](#)

Chapter 93. Perfection and Priority.

Subchapter A. Law Governing Perfection and Priority.

§ 9301. Law governing perfection and priority of security interests.

(a) General rule; location of debtor. Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection and the priority of a security interest in collateral.

(b) Possessory security interests; location of collateral. While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection and the priority of a possessory security interest in that collateral.

(c) Fixture filings, timber to be cut, priority of nonpossessory tangible personal property security interests; location of collateral. Except as otherwise provided in subsection (d), while collateral is located in a jurisdiction, the local law of that jurisdiction governs:

- (1) perfection of a security interest in goods by filing a fixture filing;
- (2) perfection of a security interest in timber to be cut; and
- (3) the effect of perfection or nonperfection and the priority of a nonpossessory security interest in tangible negotiable documents, goods, instruments, money or tangible chattel paper.

(d) As-extracted collateral; location of wellhead or minehead. The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection and the priority of a security interest in as-extracted collateral.

(e) Other exceptions. The rules of this section are subject to:

- (1) Section 9303 (relating to law governing perfection and priority of security interests in goods covered by certificate of title).
- (2) Section 9304 (relating to law governing perfection and priority of security interests in deposit accounts).
- (3) Section 9305 (relating to law governing perfection and priority of security interests in investment property).
- (4) Section 9306 (relating to law governing perfection and priority of security interests in letter-of-credit rights).

Official Comment

§ 9302. Law governing perfection and priority of agricultural liens.

While farm products are located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection and the priority of an agricultural lien on the farm products.

Official Comment

§ 9303. Law governing perfection and priority of security interests in goods covered by certificate of title.

(a) Applicability of section. This section applies to goods covered by a certificate of title even if there is no other relationship between the jurisdiction under whose certificate of title the goods are covered and the goods or the debtor.

(b) When goods covered by certificate of title. Goods become covered by a certificate of title when a valid application for the certificate of title and the applicable fee are delivered to the appropriate authority. Goods cease to be covered by a certificate of title at the earlier of the time the certificate of title ceases to be effective under the law of the issuing jurisdiction or the time the goods become covered subsequently by a certificate of title issued by another jurisdiction.

(c) Applicable law. The local law of the jurisdiction under whose certificate of title the goods are covered governs perfection, the effect of perfection or nonperfection and the priority of a security interest in goods covered by a certificate of title from the time the goods become covered by the certificate of title until the goods cease to be covered by the certificate of title.

Official Comment

§ 9304. Law governing perfection and priority of security interests in deposit accounts.

(a) Law of bank's jurisdiction governs. The local law of a bank's jurisdiction governs perfection, the effect of perfection or nonperfection and the priority of a security interest in a deposit account maintained with that bank.

(b) Bank's jurisdiction. The following rules determine a bank's jurisdiction for purposes of this chapter:

(1) If an agreement between the bank and its customer governing the deposit account expressly provides that a particular jurisdiction is the bank's jurisdiction for purposes of this chapter or this division, that jurisdiction is the bank's jurisdiction.

(2) If paragraph (1) does not apply and an agreement between the bank and its customer governing the deposit account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the bank's jurisdiction.

(3) If neither paragraph (1) nor paragraph (2) applies and an agreement between the bank and its customer governing the deposit account expressly provides that the deposit

account is maintained at an office in a particular jurisdiction, that jurisdiction is the bank's jurisdiction.

(4) If none of the preceding paragraphs applies, the bank's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the customer's account is located.

(5) If none of the preceding paragraphs applies, the bank's jurisdiction is the jurisdiction in which the chief executive office of the bank is located.

Official Comment

§ 9305. Law governing perfection and priority of security interests in investment property.

(a) Governing law; general rules. Except as otherwise provided in subsection (c), the following rules apply:

(1) While a security certificate is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection and the priority of a security interest in the certificated security represented thereby.

(2) The local law of the issuer's jurisdiction as specified in section 8110(d) (relating to applicability; choice of law) governs perfection, the effect of perfection or nonperfection and the priority of a security interest in an uncertificated security.

(3) The local law of the securities intermediary's jurisdiction as specified in section 8110(e) governs perfection, the effect of perfection or nonperfection and the priority of a security interest in a security entitlement or securities account.

(4) The local law of the commodity intermediary's jurisdiction governs perfection, the effect of perfection or nonperfection and the priority of a security interest in a commodity contract or commodity account.

(b) Commodity intermediary's jurisdiction. The following rules determine a commodity intermediary's jurisdiction for purposes of this part:

(1) If an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that a particular jurisdiction is the commodity intermediary's jurisdiction for purposes of this chapter, this division or this title, that jurisdiction is the commodity intermediary's jurisdiction.

(2) If paragraph (1) does not apply and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

- (3) If neither paragraph (1) nor paragraph (2) applies and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.
- (4) If none of the preceding paragraphs applies, the commodity intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the commodity customer's account is located.
- (5) If none of the preceding paragraphs applies, the commodity intermediary's jurisdiction is the jurisdiction in which the chief executive office of the commodity intermediary is located.

(c) When perfection governed by law of jurisdiction where debtor located. The local law of the jurisdiction in which the debtor is located governs:

- (1) perfection of a security interest in investment property by filing;
- (2) automatic perfection of a security interest in investment property created by a broker or securities intermediary; and
- (3) automatic perfection of a security interest in a commodity contract or commodity account created by a commodity intermediary.

Official Comment

§ 9306. Law governing perfection and priority of security interests in letter-of-credit rights.

(a) Governing law; issuer's or nominated person's jurisdiction. Subject to subsection (c), the local law of the issuer's jurisdiction or a nominated person's jurisdiction governs perfection, the effect of perfection or nonperfection and the priority of a security interest in a letter-of-credit right if the issuer's jurisdiction or nominated person's jurisdiction is a state.

(b) Issuer's or nominated person's jurisdiction. For purposes of this chapter, an issuer's jurisdiction or nominated person's jurisdiction is the jurisdiction whose law governs the liability of the issuer or nominated person with respect to the letter-of-credit right as provided in section 5116 (relating to choice of law and forum).

(c) When section not applicable. This section does not apply to a security interest which is perfected only under section 9308(d) (relating to supporting obligation).

Official Comment

§ 9307. Location of debtor.

(a) Place of business. As used in this section, the term "place of business" means a place where a debtor conducts its affairs.

(b) Debtor's location: general rules. Except as otherwise provided in this section, the following rules determine a debtor's location:

- (1) A debtor who is an individual is located at the individual's principal residence.
- (2) A debtor which is an organization and has only one place of business is located at its place of business.
- (3) A debtor which is an organization and has more than one place of business is located at its chief executive office.

(c) Limitation of applicability of subsection (b). Subsection (b) applies only if a debtor's residence, place of business or chief executive office, as applicable, is located in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. If subsection (b) does not apply, the debtor is located in the District of Columbia.

(d) Continuation of location: cessation of existence, etc. A person that ceases to exist, ceases to have a residence or ceases to have a place of business continues to be located in the jurisdiction specified by subsections (b) and (c).

(e) Location of registered organization organized under state law. A registered organization which is organized under the law of a state is located in that state.

(f) Location of registered organization organized under Federal law; bank branches and agencies. Except as otherwise provided in subsection (i), a registered organization which is organized under the law of the United States and a branch or agency of a bank which is not organized under the law of the United States or a state are located:

- (1) in the state which the law of the United States designates, if the law designates a state of location;
- (2) in the state which the registered organization, branch or agency designates, if the law of the United States authorizes the registered organization, branch or agency to designate its state of location, including by designating its main office, home office or other comparable office; or
- (3) in the District of Columbia, if neither paragraph (1) nor paragraph (2) applies.

(g) Continuation of location: change in status of registered organization. A registered organization continues to be located in the jurisdiction specified by subsection (e) or (f) notwithstanding:

- (1) the suspension, revocation, forfeiture or lapse of the registered organization's status as such in its jurisdiction of organization; or
- (2) the dissolution, winding up or cancellation of the existence of the registered organization.

(h) Location of United States. The location of the United States is the District of Columbia.

(i) Location of foreign bank branch or agency if licensed in only one state. A branch or agency of a bank which is not organized under the law of the United States or a state is located in the state in which the branch or agency is licensed, if all branches and agencies of the bank are licensed in only one state.

(j) Location of foreign air carrier. A foreign air carrier under the Federal Aviation Act of 1958 (Public Law 85-726, 72 Stat. 731), as amended, is located at the designated office of the agent upon which service of process may be made on behalf of the carrier.

(k) Section applies only to this chapter. This section applies only for purposes of this chapter.

Official Comment

Subchapter B. Perfection.

§ 9308. When security interest or agricultural lien is perfected; continuity of perfection.

(a) Perfection of security interest. Except as otherwise provided in this section and section 9309 (relating to security interest perfected upon attachment), a security interest is perfected if it has attached and all of the applicable requirements for perfection in sections 9310 (relating to when filing required to perfect security interest or agricultural lien; security interests and agricultural liens to which filing provisions do not apply) through 9316 (relating to effect of change in governing law) have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.

(b) Perfection of agricultural lien. An agricultural lien is perfected if it has become effective and all of the applicable requirements for perfection in section 9310 have been satisfied. An agricultural lien is perfected when it becomes effective if the applicable requirements are satisfied before the agricultural lien becomes effective.

(c) Continuous perfection; perfection by different methods. A security interest or agricultural lien is perfected continuously if it is originally perfected by one method under this division and is later perfected by another method under this division without an intermediate period when it was unperfected.

(d) Supporting obligation. Perfection of a security interest in collateral also perfects a security interest in a supporting obligation for the collateral.

(e) Lien securing right to payment. Perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage or other lien on personal or real property securing the right.

(f) Security entitlement carried in securities account. Perfection of a security interest in a securities account also perfects a security interest in the security entitlements carried in the securities account.

(g) Commodity contract carried in commodity account. Perfection of a security interest in a commodity account also perfects a security interest in the commodity contracts carried in the commodity account.

Official Comment

§ 9309. Security interest perfected upon attachment.

The following security interests are perfected when they attach:

(1) A purchase-money security interest in consumer goods, except as otherwise provided in section 9311(b) (relating to perfection of security interests in property subject to certain statutes, regulations and treaties) with respect to consumer goods which are subject to a statute or treaty described in section 9311(a).

(2) An assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles.

(3) A sale of a payment intangible.

(4) A sale of a promissory note.

(5) A security interest created by the assignment of a health-care-insurance receivable to the provider of the health-care goods or services.

(6) A security interest arising under section 2401 (relating to passing of title; reservation for security; limited application of section), 2505 (relating to shipment by seller under reservation), 2711(c) (relating to security interest of buyer in rejected goods) or 2A508(e) (relating to security interest in goods in lessee's possession) until the debtor obtains possession of the collateral.

(7) A security interest of a collecting bank arising under section 4210 (relating to security interest of collecting bank in items, accompanying documents and proceeds).

- (8) A security interest of an issuer or nominated person arising under section 5118 (relating to security interest of issuer or nominated person).
- (9) A security interest arising in the delivery of a financial asset under section 9206(c) (relating to security interest in payment against delivery transaction).
- (10) A security interest in investment property created by a broker or securities intermediary.
- (11) A security interest in a commodity contract or a commodity account created by a commodity intermediary.
- (12) An assignment for the benefit of all creditors of the transferor and subsequent transfers by the assignee thereunder.
- (13) A security interest created by an assignment of a beneficial interest in a decedent's estate.
- (14) A sale by an individual of an account that is a right to payment of winnings in a lottery or other game of chance.

Official Comment

§ 9310. When filing required to perfect security interest or agricultural lien; security interests and agricultural liens to which filing provisions do not apply.

(a) General rule: perfection by filing. Except as otherwise provided in subsection (b) and section 9312(b) (relating to control or possession of certain collateral), a financing statement must be filed to perfect all security interests and agricultural liens.

(b) Exceptions: filing not necessary. The filing of a financing statement is not necessary to perfect a security interest:

- (1) which is perfected under section:
 - (i) 9308(d) (relating to supporting obligation);
 - (ii) 9308(e) (relating to lien securing right to payment);
 - (iii) 9308(f) (relating to security entitlement carried in securities account); or
 - (iv) 9308(g) (relating to commodity contract carried in commodity account);
- (2) which is perfected under section 9309 (relating to security interest perfected upon attachment) when it attaches;

- (3) in property subject to a statute, regulation or treaty described in section 9311(a) (relating to perfection of security interests in property subject to certain statutes, regulations and treaties);
- (4) in goods in possession of a bailee which is perfected under section 9312(d)(1) or (2) (relating to goods covered by nonnegotiable document);
- (5) in certificated securities, documents, goods or instruments which is perfected without filing, control or possession under section:
 - (i) 9312(e) (relating to temporary perfection: new value);
 - (ii) 9312(f) (relating to temporary perfection: goods or documents made available to debtor); or
 - (iii) 9312(g) (relating to temporary perfection: delivery of security certificate or instrument to debtor);
- (6) in collateral in the secured party's possession under section 9313 (relating to when possession by or delivery to secured party perfects security interest without filing);
- (7) in a certificated security which is perfected by delivery of the security certificate to the secured party under section 9313;
- (8) in deposit accounts, electronic chattel paper, electronic documents, investment property or letter-of-credit rights which is perfected by control under section 9314 (relating to perfection by control);
- (9) in proceeds which is perfected under section 9315 (relating to secured party's rights on disposition of collateral and in proceeds); or
- (10) which is perfected under section 9316 (relating to effect of change in governing law).

(c) Assignment of perfected security interest. If a secured party assigns a perfected security interest or agricultural lien, a filing under this division is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

Official Comment

§ 9311. Perfection of security interests in property subject to certain statutes, regulations and treaties.

(a) Security interest subject to other law. Except as otherwise provided in subsection (d), the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to:

- (1) a statute, regulation or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt section 9310(a) (relating to when filing required to perfect security interest or agricultural lien; security interests and agricultural liens to which filing provisions do not apply);
- (2) a statute of this Commonwealth or regulations promulgated thereunder, to the extent such statute or regulations provide for a security interest to be indicated on certificate of title as a condition or result of perfection; or
- (3) a statute of another jurisdiction which provides for a security interest to be indicated on a certificate of title as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the property.

(b) Compliance with other law. Compliance with the requirements of a statute, regulation or treaty described in subsection (a) for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this division. Except as otherwise provided in subsection (d) and sections 9313 (relating to when possession by or delivery to secured party perfects security interest without filing) and 9316(d) and (e) (relating to effect of change in governing law) for goods covered by a certificate of title, a security interest in property subject to a statute, regulation or treaty described in subsection (a) may be perfected only by compliance with those requirements, and a security interest so perfected remains perfected notwithstanding a change in the use or transfer of possession of the collateral.

(c) Duration and renewal of perfection. Except as otherwise provided in subsection (d) and section 9316(d) and (e), duration and renewal of perfection of a security interest perfected by compliance with the requirements prescribed by a statute, regulation or treaty described in subsection (a) are governed by the statute, regulation or treaty. In other respects, the security interest is subject to this division.

(d) Inapplicability to certain inventory. During any period in which collateral subject to a statute specified in subsection (a)(2) is inventory held for sale or lease by a person or leased by that person as lessor and that person is in the business of selling goods of that kind, this section does not apply to a security interest in that collateral created by that person.

Official Comment

§ 9312. Perfection of security interests in chattel paper, deposit accounts, documents, goods covered by documents, instruments, investment property, letter-of-credit rights and money; perfection by permissive filing; temporary perfection without filing or transfer of possession.

(a) Perfection by filing permitted. A security interest in chattel paper, negotiable documents, instruments or investment property may be perfected by filing.

(b) Control or possession of certain collateral. Except as otherwise provided in section 9315(c) (relating to perfection of security interest in proceeds) and (d) (relating to continuation of perfection) for proceeds:

- (1) a security interest in a deposit account may be perfected only by control under section 9314 (relating to perfection by control);
- (2) except as otherwise provided in section 9308(d) (relating to supporting obligation), a security interest in a letter-of-credit right may be perfected only by control under section 9314; and
- (3) a security interest in money may be perfected only by the secured party's taking possession under section 9313 (relating to when possession by or delivery to secured party perfects security interest without filing).

(c) Goods covered by negotiable document. While goods are in the possession of a bailee that has issued a negotiable document covering the goods:

- (1) a security interest in the goods may be perfected by perfecting a security interest in the document; and
- (2) a security interest perfected in the document has priority over any security interest which becomes perfected in the goods by another method during that time.

(d) Goods covered by nonnegotiable document. While goods are in the possession of a bailee that has issued a nonnegotiable document covering the goods, a security interest in the goods may be perfected by:

- (1) issuance of a document in the name of the secured party;
- (2) the bailee's receipt of notification of the secured party's interest; or
- (3) filing as to the goods.

(e) Temporary perfection: new value. A security interest in certificated securities, negotiable documents or instruments is perfected without filing or the taking of possession or control for a period of 20 days from the time it attaches to the extent that it arises for new value given under an authenticated security agreement.

(f) Temporary perfection: goods or documents made available to debtor. A perfected security interest in a negotiable document or goods in possession of a bailee, other than one that has issued a negotiable document for the goods, remains perfected for 20 days without filing if

the secured party makes available to the debtor the goods or documents representing the goods for the purpose of:

- (1) ultimate sale or exchange; or
- (2) loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange.

(g) Temporary perfection: delivery of security certificate or instrument to debtor. A perfected security interest in a certificated security or instrument remains perfected for 20 days without filing if the secured party delivers the security certificate or instrument to the debtor for the purpose of:

- (1) ultimate sale or exchange; or
- (2) presentation, collection, enforcement, renewal or registration of transfer.

(h) Expiration of temporary perfection. After the 20-day period specified in subsection (e), (f) or (g) expires, perfection depends upon compliance with this division.

Official Comment

§ 9313. When possession by or delivery to secured party perfects security interest without filing.

(a) Perfection by possession or delivery. Except as otherwise provided in subsection (b), a secured party may perfect a security interest in tangible negotiable documents, goods, instruments, money or tangible chattel paper by taking possession of the collateral. A secured party may perfect a security interest in certificated securities by taking delivery under section 8301 (relating to delivery).

(b) Goods covered by certificate of title. With respect to goods covered by a certificate of title issued by the Commonwealth, a secured party may perfect a security interest in the goods by taking possession of the goods only in the circumstances described in section 9316(d) (relating to effect of change in governing law).

(c) Collateral in possession of person other than debtor. With respect to collateral other than certificated securities and goods covered by a document, a secured party takes possession of collateral in the possession of a person other than the debtor, the secured party or a lessee of the collateral from the debtor in the ordinary course of the debtor's business when:

- (1) the person in possession authenticates a record acknowledging that the person holds possession of the collateral for the secured party's benefit; or

(2) the person takes possession of the collateral after having authenticated a record acknowledging that the person will hold possession of the collateral for the secured party's benefit.

(d) Time of perfection by possession; continuation of perfection. If perfection of a security interest depends upon possession of the collateral by a secured party, perfection occurs no earlier than the time the secured party takes possession and continues only while the secured party retains possession.

(e) Time of perfection by delivery; continuation of perfection. A security interest in a certificated security in registered form is perfected by delivery when delivery of the certificated security occurs under section 8301 and remains perfected by delivery until the debtor obtains possession of the security certificate.

(f) Acknowledgment not required. A person in possession of collateral is not required to acknowledge that the person holds possession for a secured party's benefit.

(g) Effectiveness of acknowledgment; no duties or confirmation. If a person acknowledges that the person holds possession for the secured party's benefit:

(1) the acknowledgment is effective under subsection(c) or section 8301(a) (relating to delivery of certificated security) even if the acknowledgment violates the rights of a debtor; and

(2) unless the person otherwise agrees or law other than this division otherwise provides, the person does not owe any duty to the secured party and is not required to confirm the acknowledgment to another person.

(h) Secured party's delivery to person other than debtor. A secured party having possession of collateral does not relinquish possession by delivering the collateral to a person other than the debtor or a lessee of the collateral from the debtor in the ordinary course of the debtor's business if the person was instructed before the delivery or is instructed contemporaneously with the delivery:

(1) to hold possession of the collateral for the secured party's benefit; or

(2) to redeliver the collateral to the secured party.

(i) Effect of delivery under subsection (h); no duties or confirmation. A secured party does not relinquish possession even if a delivery under subsection (h) violates the rights of a debtor. A person to which collateral is delivered under subsection (h) does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this division otherwise provides.

Official Comment

§ 9314. Perfection by control.

(a) Perfection by control. A security interest in investment property, deposit accounts, letter-of-credit rights, electronic chattel paper or electronic documents may be perfected by control of the collateral under section 7106 (relating to control of electronic document of title), 9104 (relating to control of deposit account), 9105 (relating to control of electronic chattel paper), 9106 (relating to control of investment property) or 9107 (relating to control of letter-of-credit right).

(b) Specified collateral: time of perfection by control; continuation of perfection. A security interest in deposit accounts, electronic chattel paper, letter-of-credit rights or electronic documents is perfected by control under section 7106, 9104, 9105 or 9107 when the secured party obtains control and remains perfected by control only while the secured party retains control.

(c) Investment property: time of perfection by control; continuation of perfection. A security interest in investment property is perfected by control under section 9106 from the time the secured party obtains control and remains perfected by control until both of the following paragraphs apply:

- (1) The secured party does not have control.
- (2) One of the following occurs:
 - (i) If the collateral is a certificated security, the debtor has or acquires possession of the security certificate.
 - (ii) If the collateral is an uncertificated security, the issuer has registered or registers the debtor as the registered owner.
 - (iii) If the collateral is a security entitlement, the debtor is or becomes the entitlement holder.

Official Comment

§ 9315. Secured party's rights on disposition of collateral and in proceeds.

(a) Disposition of collateral: continuation of security interest or agricultural lien; proceeds. Except as otherwise provided in this division and in section 2403(b) (relating to transfer by merchant entrusted with possession of goods):

- (1) a security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and
- (2) a security interest attaches to any identifiable proceeds of collateral.

(b) When commingled proceeds identifiable. Proceeds which are commingled with other property are identifiable proceeds:

- (1) if the proceeds are goods, to the extent provided by section 9336 (relating to commingled goods); and
- (2) if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this division with respect to commingled property of the type involved.

(c) Perfection of security interest in proceeds. A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.

(d) Continuation of perfection. A perfected security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds unless one of the following paragraphs applies:

- (1) The conditions set forth in all of the following subparagraphs are satisfied:
 - (i) A filed financing statement covers the original collateral.
 - (ii) The proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed.
 - (iii) The proceeds are not acquired with cash proceeds.
- (2) The proceeds are identifiable cash proceeds.
- (3) The security interest in the proceeds is perfected other than under subsection (c) when the security interest attaches to the proceeds or within 20 days thereafter.

(e) When perfected security interest in proceeds becomes unperfected. If a filed financing statement covers the original collateral, a security interest in proceeds which remains perfected under subsection (d)(1) becomes unperfected at the later of:

- (1) when the effectiveness of the filed financing statement lapses under section 9515 (relating to duration and effectiveness of financing statement; effect of lapsed financing statement) or is terminated under section 9513 (relating to termination statement); or
- (2) the 21st day after the security interest attaches to the proceeds.

Official Comment

§ 9316. Effect of change in governing law.

(a) General rule: effect on perfection of change in governing law. A security interest perfected pursuant to the law of the jurisdiction designated in section 9301(a) (relating to general rule: location of debtor) or 9305(c) (relating to when perfection governed by law of jurisdiction where debtor located) remains perfected until the earliest of:

- (1) the time perfection would have ceased under the law of that jurisdiction;
- (2) the expiration of four months after a change of the debtor's location to another jurisdiction; or
- (3) the expiration of one year after a transfer of collateral to a person that thereby becomes a debtor and is located in another jurisdiction.

(b) Security interest perfected or unperfected under law of new jurisdiction. If a security interest described in subsection (a) becomes perfected under the law of the other jurisdiction before the earliest time or event described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earliest time or event, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

(c) Possessory security interest in collateral moved to new jurisdiction. A possessory security interest in collateral, other than goods covered by a certificate of title and as-extracted collateral consisting of goods, remains continuously perfected if:

- (1) the collateral is located in one jurisdiction and subject to a security interest perfected under the law of that jurisdiction;
- (2) thereafter the collateral is brought into another jurisdiction; and
- (3) upon entry into the other jurisdiction, the security interest is perfected under the law of the other jurisdiction.

(d) Goods covered by certificate of title from the Commonwealth. Except as otherwise provided in subsection (e), a security interest in goods covered by a certificate of title which is perfected by any method under the law of another jurisdiction when the goods become covered by a certificate of title from the Commonwealth remains perfected until the security interest would have become unperfected under the law of the other jurisdiction had the goods not become so covered.

(e) When subsection (d) security interest becomes unperfected against purchasers. A security interest described in subsection (d) becomes unperfected as against a purchaser of the goods for value and is deemed never to have been perfected as against a purchaser of the goods for value if the applicable requirements for perfection under section 9311(b) (relating to perfection of security interests in property subject to certain statutes, regulations and treaties) or 9313 (relating to when possession by or delivery to secured party perfects security interest without filing) are not satisfied before the earlier of:

(1) the time the security interest would have become unperfected under the law of the other jurisdiction had the goods not become covered by a certificate of title from the Commonwealth; or

(2) the expiration of four months after the goods had become so covered.

(f) Change in jurisdiction of bank, issuer, nominated person, securities intermediary or commodity intermediary. A security interest in deposit accounts, letter-of-credit rights or investment property which is perfected under the law of the bank's jurisdiction, the issuer's jurisdiction, a nominated person's jurisdiction, the securities intermediary's jurisdiction or the commodity intermediary's jurisdiction, as applicable, remains perfected until the earlier of:

(1) the time the security interest would have become unperfected under the law of that jurisdiction; or

(2) the expiration of four months after a change of the applicable jurisdiction to another jurisdiction.

(g) Subsection (f) security interest perfected or unperfected under law of new jurisdiction. If a security interest described in subsection (f) becomes perfected under the law of the other jurisdiction before the earlier of the time or the end of the period described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earlier of that time or the end of that period, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

(h) Effect on filed financing statement of change in governing law. The following rules apply to collateral to which a security interest attaches within four months after the debtor changes its location to another jurisdiction:

(1) A financing statement filed before the change pursuant to the law of the jurisdiction designated in section 9301(a) or 9305(c) is effective to perfect a security interest in the collateral if the financing statement would have been effective to perfect a security interest in the collateral had the debtor not changed its location.

(2) If a security interest perfected by a financing statement that is effective under paragraph (1) becomes perfected under the law of the other jurisdiction before the earlier of the time the financing statement would have become ineffective under the law of the jurisdiction designated in section 9301(a) or 9305(c) or the expiration of the four-month period, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earlier time or event, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

(i) Effect of change in governing law on financing statement filed against original debtor. If a financing statement naming an original debtor is filed pursuant to the law of the jurisdiction designated in section 9301(a) or 9305(c) and the new debtor is located in another jurisdiction, the following rules apply:

- (1) The financing statement is effective to perfect a security interest in collateral acquired by the new debtor before, and within four months after, the new debtor becomes bound under section 9203(d) (relating to attachment and enforceability of security interest; proceeds; supporting obligations; formal requisites), if the financing statement would have been effective to perfect a security interest in the collateral had the collateral been acquired by the original debtor.
- (2) A security interest perfected by the financing statement and which becomes perfected under the law of the other jurisdiction before the earlier of the time the financing statement would have become ineffective under the law of the jurisdiction designated in section 9301(a) or 9305(c) or the expiration of the four-month period remains perfected thereafter. A security interest that is perfected by the financing statement but which does not become perfected under the law of the other jurisdiction before the earlier time or event becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

Official Comment

Subchapter C. Priority.

§ 9317. Interests which take priority over or take free of security interest or agricultural lien.

(a) Conflicting security interests and rights of lien creditors. A security interest or agricultural lien is subordinate to the rights of all of the following:

- (1) A person entitled to priority under section 9322 (relating to priorities among conflicting security interests in and agricultural liens on same collateral).
- (2) Except as otherwise provided in subsection (e), a person that becomes a lien creditor before the earlier of the time:
 - (i) the security interest or agricultural lien is perfected; or
 - (ii) one of the conditions specified in section 9203(b)(3) (relating to enforceability) is met and a financing statement covering the collateral is filed.

(b) Buyers that receive delivery. Except as otherwise provided in subsection (e), a buyer, other than a secured party, of tangible chattel paper, tangible documents, goods, instruments or a certificated security takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

(c) Lessees that receive delivery. Except as otherwise provided in subsection (e), a lessee of goods takes free of a security interest or agricultural lien if the lessee gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

(d) Licensees and buyers of certain collateral. A licensee of a general intangible or a buyer, other than a secured party, of collateral other than tangible chattel paper, tangible documents, goods, instruments or a certificated security takes free of a security interest if the licensee or buyer gives value without knowledge of the security interest and before it is perfected.

(e) Purchase-money security interest. Except as otherwise provided in sections 9320 (relating to buyer of goods) and 9321 (relating to licensee of general intangible and lessee of goods in ordinary course of business), if a person files a financing statement with respect to a purchase-money security interest before or within 20 days after the debtor receives delivery of the collateral, the security interest takes priority over the rights of a buyer, lessee or lien creditor which arise between the time the security interest attaches and the time of filing.

Official Comment

§ 9318. No interest retained in right to payment which is sold; rights and title of seller of account or chattel paper with respect to creditors and purchasers.

(a) Seller retains no interest. A debtor that has sold an account, chattel paper, payment intangible or promissory note does not retain a legal or equitable interest in the collateral sold.

(b) Deemed rights of debtor if buyer's security interest unperfected. For purposes of determining the rights of creditors of and purchasers for value of an account or chattel paper from a debtor that has sold an account or chattel paper, while the buyer's security interest is unperfected, the debtor is deemed to have rights and title to the account or chattel paper identical to those the debtor sold.

Official Comment

§ 9319. Rights and title of consignee with respect to creditors and purchasers.

(a) Consignee has consignor's rights. Except as otherwise provided in subsection (b), for purposes of determining the rights of creditors of and purchasers for value of goods from a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.

(b) Applicability of other law. For purposes of determining the rights of a creditor of a consignee, law other than this division determines the rights and title of a consignee while goods are in the consignee's possession if, under this chapter, a perfected security interest held by the consignor would have priority over the rights of the creditor.

Official Comment

§ 9320. Buyer of goods.

(a) Buyer in ordinary course of business. Except as otherwise provided in subsection (e), a buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

(b) Buyer of consumer goods. Except as otherwise provided in subsection (e), a buyer of goods from a person who used or bought the goods for use primarily for personal, family or household purposes takes free of a security interest, even if perfected, if the buyer buys:

- (1) without knowledge of the security interest;
- (2) for value;
- (3) primarily for the buyer's personal, family or household purposes; and
- (4) before the filing of a financing statement covering the goods.

(c) Effectiveness of filing for subsection (b). To the extent that it affects the priority of a security interest over a buyer of goods under subsection (b), the period of effectiveness of a filing made in the jurisdiction in which the seller is located is governed by section 9316(a) and (b) (relating to effect of change in governing law).

(d) Buyer in ordinary course of business at wellhead or minehead. A buyer in ordinary course of business buying oil, gas or other minerals at the wellhead or minehead or after extraction takes free of an interest arising out of an encumbrance.

(e) Possessory security interest not affected. Subsections (a) and (b) do not affect a security interest in goods in the possession of the secured party under section 9313 (relating to when possession by or delivery to secured party perfects security interest without filing).

Official Comment

§ 9321. Licensee of general intangible and lessee of goods in ordinary course of business.

(a) Licensee in ordinary course of business. As used in this section, the term "licensee in ordinary course of business" means a person that becomes a licensee of a general intangible in good faith, without knowledge that the license violates the rights of another person in the general intangible, and in the ordinary course from a person in the business of licensing general intangibles of that kind. A person becomes a licensee in the ordinary course if the license to the person comports with the usual or customary practices in the kind of business in which the licensor is engaged or with the licensor's own usual or customary practices.

(b) Rights of licensee in ordinary course of business. A licensee in ordinary course of business takes its rights under a nonexclusive license free of a security interest in the general intangible created by the licensor even if the security interest is perfected and the licensee knows of its existence.

(c) Rights of lessee in ordinary course of business. A lessee in ordinary course of business takes its leasehold interest free of a security interest in the goods created by the lessor even if the security interest is perfected and the lessee knows of its existence.

Official Comment

§ 9322. Priorities among conflicting security interests in and agricultural liens on same collateral.

(a) General priority rules. Except as otherwise provided in this section, priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules:

- (1) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection.
- (2) A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien.
- (3) The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected.

(b) Time of perfection: proceeds and supporting obligations. For the purposes of subsection (a)(1):

- (1) the time of filing or perfection as to a security interest in collateral is also the time of filing or perfection as to a security interest in proceeds; and
- (2) the time of filing or perfection as to a security interest in collateral supported by a supporting obligation is also the time of filing or perfection as to a security interest in the supporting obligation.

(c) Special priority rules: proceeds and supporting obligations. Except as otherwise provided in subsection (f), a security interest in collateral which qualifies for priority over a conflicting security interest under section 9327 (relating to priority of security interests in deposit account), 9328 (relating to priority of security interests in investment property), 9329 (relating to priority of security interests in letter-of-credit right), 9330 (relating to priority of purchaser of chattel paper or instrument) or 9331 (relating to priority of rights of purchasers of instruments, documents and securities under other divisions; priority of interests in financial assets and

security entitlements under Division 8) also has priority over a conflicting security interest in all of the following:

- (1) Any supporting obligation for the collateral.
- (2) Proceeds of the collateral if:
 - (i) the security interest in proceeds is perfected;
 - (ii) the proceeds are cash proceeds or of the same type as the collateral; and
 - (iii) in the case of proceeds which are proceeds of proceeds, all intervening proceeds are:
 - (A) cash proceeds;
 - (B) proceeds of the same type as the collateral; Or
 - (C) an account relating to the collateral.

(d) First-to-file priority rule for certain collateral. Subject to subsection (e) and except as otherwise provided in subsection (f), if a security interest in chattel paper, deposit accounts, negotiable documents, instruments, investment property or letter-of-credit rights is perfected by a method other than filing, conflicting perfected security interests in proceeds of the collateral rank according to priority in time of filing.

(e) Applicability of subsection (d). Subsection (d) applies only if the proceeds of the collateral are not cash proceeds, chattel paper, negotiable documents, instruments, investment property or letter-of-credit rights.

(f) Limitations on subsections (a) through (e). Subsections (a) through (e) are subject to:

- (1) subsection (g) and the other provisions of this chapter;
- (2) section 4210 (relating to security interest of collecting bank in items, accompanying documents and proceeds);
- (3) section 5118 (relating to security interest of issuer or nominated person); and
- (4) section 9110 (relating to security interests arising under Division 2 or 2A).

(g) Priority under agricultural lien statute. A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides.

Official Comment

§ 9323. Future advances.

(a) When priority based on time of advance. Except as otherwise provided in subsection (c), for purposes of determining the priority of a perfected security interest under section 9322(a)(1) (relating to general priority rules), perfection of the security interest dates from the time an advance is made to the extent that the security interest secures an advance which:

- (1) is made while the security interest is perfected only:
 - (i) under section 9309 (relating to security interest perfected upon attachment) when it attaches; or
 - (ii) temporarily under any of the following sections:
 - (A) 9312(e) (relating to temporary perfection: new value);
 - (B) 9312(f) (relating to temporary perfection: goods or documents made available to debtor); or
 - (C) 9312(g) (relating to temporary perfection: delivery of security certificate or instrument to debtor); and
- (2) is not made pursuant to a commitment entered into before or while the security interest is perfected by a method other than under section 9309 or 9312(e), (f) or (g).

(b) Lien creditor. Except as otherwise provided in subsection (c), a security interest is subordinate to the rights of a person that becomes a lien creditor to the extent that the security interest secures an advance made more than 45 days after the person becomes a lien creditor unless the advance is made:

- (1) without knowledge of the lien; or
- (2) pursuant to a commitment entered into without knowledge of the lien.

(c) Buyer of receivables. Subsections (a) and (b) do not apply to a security interest held by a secured party that is a buyer of accounts, chattel paper, payment intangibles or promissory notes or a consignor.

(d) Buyer of goods. Except as otherwise provided in subsection (e), a buyer of goods other than a buyer in ordinary course of business takes free of a security interest to the extent that it secures advances made after the earlier of:

- (1) the time the secured party acquires knowledge of the buyer's purchase; or
- (2) 45 days after the purchase.

(e) Advances made pursuant to commitment: priority of buyer of goods. Subsection (d) does not apply if the advance is made pursuant to a commitment entered into without knowledge of the buyer's purchase and before the expiration of the 45-day period.

(f) Lessee of goods. Except as otherwise provided in subsection (g), a lessee of goods, other than a lessee in ordinary course of business, takes the leasehold interest free of a security interest to the extent that it secures advances made after the earlier of:

- (1) the time the secured party acquires knowledge of the lease; or
- (2) 45 days after the lease contract becomes enforceable.

(g) Advances made pursuant to commitment: priority of lessee of goods. Subsection (f) does not apply if the advance is made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the 45-day period.

Official Comment

§ 9324. Priority of purchase-money security interests.

(a) General rule: purchase-money priority. Except as otherwise provided in subsection (g), a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in section 9327 (relating to priority of security interests in deposit account), a perfected security interest in its identifiable proceeds also has priority if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.

(b) Inventory purchase-money priority. Subject to subsection (c) and except as otherwise provided in subsection (g), a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory; has priority over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper if so provided in section 9330 (relating to priority of purchaser of chattel paper or instrument); and, except as otherwise provided in section 9327, also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer, if:

- (1) the purchase-money security interest is perfected when the debtor receives possession of the inventory;
- (2) the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;
- (3) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(4) the notification states that the person sending the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.

(c) Holders of conflicting inventory security interests to be notified. Subsection (b)(2) through (4) apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of inventory:

(1) if the purchase-money security interest is perfected by filing, before the date of the filing; or

(2) if the purchase-money security interest is temporarily perfected without filing or possession under section 9312(f) (relating to temporary perfection: goods or documents made available to debtor), before the beginning of the 20-day period thereunder.

(d) Livestock purchase-money priority. Subject to subsection (e) and except as otherwise provided in subsection (g), a perfected purchase-money security interest in livestock which are farm products has priority over a conflicting security interest in the same livestock; and, except as otherwise provided in section 9327, a perfected security interest in their identifiable proceeds and identifiable products in their unmanufactured state also has priority, if:

(1) the purchase-money security interest is perfected when the debtor receives possession of the livestock;

(2) the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;

(3) the holder of the conflicting security interest receives the notification within six months before the debtor receives possession of the livestock; and

(4) the notification states that the person sending the notification has or expects to acquire a purchase-money security interest in livestock of the debtor and describes the livestock.

(e) Holders of conflicting livestock security interests to be notified. Subsection (d)(2) through (4) apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of livestock:

(1) if the purchase-money security interest is perfected by filing, before the date of the filing; or

(2) if the purchase-money security interest is temporarily perfected without filing or possession under section 9312(f), before the beginning of the 20-day period thereunder.

(f) Software purchase-money priority. Except as otherwise provided in subsection (g), a perfected purchase-money security interest in software has priority over a conflicting security interest in the same collateral; and, except as otherwise provided in section 9327, a perfected security interest in its identifiable proceeds also has priority, to the extent that the purchase-

money security interest in the goods in which the software was acquired for use has priority in the goods and proceeds of the goods under this section.

(g) Conflicting purchase-money security interests. If more than one security interest qualifies for priority in the same collateral under subsection (a), (b), (d) or (f):

- (1) a security interest securing an obligation incurred as all or part of the price of the collateral has priority over a security interest securing an obligation incurred for value given to enable the debtor to acquire rights in or the use of collateral; and
- (2) in all other cases, section 9322(a) (relating to general priority rules) applies to the qualifying security interests.

Official Comment

§ 9325. Priority of security interests in transferred collateral.

(a) Subordination of security interest in transferred collateral. Except as otherwise provided in subsection (b), a security interest created by a debtor is subordinate to a security interest in the same collateral created by another person if:

- (1) the debtor acquired the collateral subject to the security interest created by the other person;
- (2) the security interest created by the other person was perfected when the debtor acquired the collateral; and
- (3) there is no period thereafter when the security interest is unperfected.

(b) Limitation of subsection (a) subordination. Subsection (a) subordinates a security interest only if the security interest:

- (1) otherwise would have priority solely under section 9322(a) (relating to general priority rules) or 9324 (relating to priority of purchase-money security interests); or
- (2) arose solely under section 2711(c) (relating to security interest of buyer in rejected goods) or 2A508(e) (relating to security interest in goods in lessee's possession).

Official Comment

§ 9326. Priority of security interests created by new debtor.

(a) Subordination of security interest created by new debtor. Subject to subsection (b), a security interest that is created by a new debtor in collateral in which the new debtor has or acquires rights and is perfected solely by a filed financing statement which would be ineffective to perfect the security interest but for the application of section 9316(i)(1) (relating to effect of

change in governing law) or 9508 (relating to effectiveness of financing statement if new debtor becomes bound by security agreement) is subordinate to a security interest in the same collateral which is perfected other than by such a filed financing statement.

(b) Priority under other provisions; multiple original debtors. The other provisions of this chapter determine the priority among conflicting security interests in the same collateral perfected by filed financing statements described in subsection (a). However, if the security agreements to which a new debtor became bound as debtor were not entered into by the same original debtor, the conflicting security interests rank according to priority in time of the new debtor's having become bound.

Official Comment

§ 9327. Priority of security interests in deposit account.

The following rules govern priority among conflicting security interests in the same deposit account:

- (1) A security interest held by a secured party having control of the deposit account under section 9104 (relating to control of deposit account) has priority over a conflicting security interest held by a secured party that does not have control.
- (2) Except as otherwise provided in paragraphs (3) and (4), security interests perfected by control under section 9314 (relating to perfection by control) rank according to priority in time of obtaining control.
- (3) Except as otherwise provided in paragraph (4), a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.
- (4) A security interest perfected by control under section 9104(a)(3) has priority over a security interest held by the bank with which the deposit account is maintained.

Official Comment

§ 9328. Priority of security interests in investment property.

The following rules govern priority among conflicting security interests in the same investment property:

- (1) A security interest of a secured party having control of investment property under section 9106 (relating to control of investment property) has priority over a security interest of a secured party that does not have control over the investment property.

(2) Except as otherwise provided in paragraphs (3) and (4), conflicting security interests held by secured parties each of which has control under section 9106 rank according to priority in time of:

- (i) if the collateral is a security, obtaining control;
- (ii) if the collateral is a security entitlement carried in a securities account and:
 - (A) if the secured party obtained control under section 8106(d)(1) (relating to control), the secured party's becoming the person for which the securities account is maintained;
 - (B) if the secured party obtained control under section 8106(d)(2), the securities intermediary's agreement to comply with the secured party's entitlement orders with respect to security entitlements carried or to be carried in the securities account; or
 - (C) if the secured party obtained control through another person under section 8106(d)(3), the time on which priority would be based under this subsection if the other person were the secured party; or
- (iii) if the collateral is a commodity contract carried with a commodity intermediary, the satisfaction of the requirement for control specified in section 9106(b)(2) with respect to commodity contracts carried or to be carried with the commodity intermediary.

(3) A security interest held by a securities intermediary in a security entitlement or a securities account maintained with the securities intermediary has priority over a conflicting security interest held by another secured party.

(4) A security interest held by a commodity intermediary in a commodity contract or a commodity account maintained with the commodity intermediary has priority over a conflicting security interest held by another secured party.

(5) A security interest in a certificated security in registered form which is perfected by taking delivery under section 9313(a) (relating to perfection by possession or delivery) and not by control under section 9314 (relating to perfection by control) has priority over a conflicting security interest perfected by a method other than control.

(6) Conflicting security interests created by a broker, securities intermediary or commodity intermediary which are perfected without control under section 9106 rank equally.

(7) In all other cases, priority among conflicting security interests in investment property is governed by sections 9322 (relating to priorities among conflicting security interests in and agricultural liens on same collateral) and 9323 (relating to future advances).

Official Comment

§ 9329. Priority of security interests in letter-of-credit right.

The following rules govern priority among conflicting security interests in the same letter-of-credit right:

- (1) A security interest held by a secured party having control of the letter-of-credit right under section 9107 (relating to control of letter-of-credit right) has priority to the extent of its control over a conflicting security interest held by a secured party that does not have control.
- (2) Security interests perfected by control under section 9314 (relating to perfection by control) rank according to priority in time of obtaining control.

Official Comment

§ 9330. Priority of purchaser of chattel paper or instrument.

(a) Purchaser's priority: security interest claimed merely as proceeds. A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory subject to a security interest if:

- (1) in good faith and in the ordinary course of the purchaser's business, the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under section 9105 (relating to control of electronic chattel paper); and
- (2) the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

(b) Purchaser's priority: other security interests. A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed other than merely as proceeds of inventory subject to a security interest if the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under section 9105 in good faith, in the ordinary course of the purchaser's business and without knowledge that the purchase violates the rights of the secured party.

(c) Chattel paper purchaser's priority in proceeds. Except as otherwise provided in section 9327 (relating to priority of security interests in deposit account), a purchaser having priority in chattel paper under subsection (a) or (b) also has priority in proceeds of the chattel paper to the extent that:

- (1) section 9322 (relating to priorities among conflicting security interests in and agricultural liens on same collateral) provides for priority in the proceeds; or

(2) the proceeds consist of the specific goods covered by the chattel paper or cash proceeds of the specific goods even if the purchaser's security interest in the proceeds is unperfected.

(d) Instrument purchaser's priority. Except as otherwise provided in section 9331(a) (relating to rights under Divisions 3, 7 and 8 not limited), a purchaser of an instrument has priority over a security interest in the instrument perfected by a method other than possession if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party.

(e) Holder of purchase-money security interest gives new value. For purposes of subsections (a) and (b), the holder of a purchase-money security interest in inventory gives new value for chattel paper constituting proceeds of the inventory.

(f) Indication of assignment gives knowledge. For purposes of subsections (b) and (d), if chattel paper or an instrument indicates that it has been assigned to an identified secured party other than the purchaser, a purchaser of the chattel paper or instrument has knowledge that the purchase violates the rights of the secured party.

Official Comment

§ 9331. Priority of rights of purchasers of instruments, documents and securities under other divisions; priority of interests in financial assets and security entitlements under Division 8.

(a) Rights under Divisions 3, 7 and 8 not limited. This division does not limit the rights of a holder in due course of a negotiable instrument, a holder to which a negotiable document of title has been duly negotiated or a protected purchaser of a security. These holders or purchasers take priority over an earlier security interest, even if perfected, to the extent provided in Divisions 3 (relating to negotiable instruments), 7 (relating to warehouse receipts, bills of lading and other documents of title) and 8 (relating to investment securities).

(b) Protection under Division 8. This division does not limit the rights of or impose liability on a person to the extent that the person is protected against the assertion of a claim under Division 8.

(c) Filing not notice. Filing under this division does not constitute notice of a claim or defense to the holders, purchasers or persons described in subsections (a) and (b).

Official Comment

§ 9332. Transfer of money; transfer of funds from deposit account.

(a) Transferee of money. A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(b) Transferee of funds from deposit account. A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

Official Comment

§ 9333. Priority of certain liens arising by operation of law.

(a) Possessory lien. As used in this section, the term "possessory lien" means an interest, other than a security interest or an agricultural lien:

- (1) which secures payment or performance of an obligation for services or materials furnished with respect to goods by a person in the ordinary course of the person's business;
- (2) which is created by statute or rule of law in favor of the person; and
- (3) whose effectiveness depends on the person's possession of the goods.

(b) Priority of possessory lien. A possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute which expressly provides otherwise.

Official Comment

§ 9334. Priority of security interests in fixtures and crops.

(a) Security interest in fixtures under this division. A security interest under this division may be created in goods which are fixtures or may continue in goods which become fixtures. A security interest does not exist under this division in ordinary building materials incorporated into an improvement on land.

(b) Security interest in fixtures under real property law. This division does not prevent creation of an encumbrance upon fixtures under real property law.

(c) General rule: subordination of security interest in fixtures. In cases not governed by subsections (d) through (h), a security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property other than the debtor.

(d) Fixtures purchase-money priority. Except as otherwise provided in subsection (h), a perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property and:

- (1) the security interest is a purchase-money security interest;

(2) the interest of the encumbrancer or owner arises before the goods become fixtures; and

(3) the security interest is perfected by a fixture filing before the goods become fixtures or within 20 days thereafter.

(e) Priority of security interest in fixtures over interests in real property. A perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if any of the following paragraphs apply:

(1) The debtor has an interest of record in the real property or is in possession of the real property and the security interest:

(i) is perfected by a fixture filing before the interest of the encumbrancer or owner is of record; and

(ii) has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner.

(2) Before the goods become fixtures, the security interest is perfected by any method permitted by this division and the fixtures are readily removable:

(i) factory or office machines;

(ii) equipment which is not primarily used or leased for use in the operation of the real property; or

(iii) replacements of domestic appliances which are consumer goods.

(3) The conflicting interest is a lien on the real property obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this division.

(4) The security interest is:

(i) created in a manufactured home in a manufactured-home transaction; and

(ii) perfected pursuant to a statute described in section 9311(a)(2) (relating to perfection of security interests in property subject to certain statutes, regulations and treaties).

(f) Priority based on consent, disclaimer or right to remove. A security interest in fixtures, whether or not perfected, has priority over a conflicting interest of an encumbrancer or owner of the real property if:

(1) the encumbrancer or owner has, in an authenticated record, consented to the security interest or disclaimed an interest in the goods as fixtures; or

(2) the debtor has a right to remove the goods as against the encumbrancer or owner.

(g) Continuation of subsection (f)(2) priority. The priority of the security interest under subsection (f)(2) continues for a reasonable time if the debtor's right to remove the goods as against the encumbrancer or owner terminates.

(h) Priority of construction mortgage. A mortgage is a construction mortgage to the extent that it secures an obligation incurred for the construction of an improvement on land, including the acquisition cost of the land, if a recorded record of the mortgage so indicates. Except as otherwise provided in subsections (e) and (f), a security interest in fixtures is subordinate to a construction mortgage if a record of the mortgage is recorded before the goods become fixtures and the goods become fixtures before the completion of the construction. A mortgage has this priority to the same extent as a construction mortgage to the extent that it is given to refinance a construction mortgage.

(i) Priority of security interest in crops. A perfected security interest in crops growing on real property has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property.

Official Comment

§ 9335. Accessions.

(a) Creation of security interest in accession. A security interest may be created in an accession and continues in collateral which becomes an accession.

(b) Perfection of security interest. If a security interest is perfected when the collateral becomes an accession, the security interest remains perfected in the collateral.

(c) Priority of security interest. Except as otherwise provided in subsection (d), the other provisions of this chapter determine the priority of a security interest in an accession.

(d) Compliance with certificate-of-title statute. A security interest in an accession is subordinate to a security interest in the whole which is perfected by compliance with the requirements of a certificate-of-title statute under section 9311(b) (relating to perfection of security interests in property subject to certain statutes, regulations and treaties).

(e) Removal of accession after default. After default, subject to Chapter 96 (relating to default), a secured party may remove an accession from other goods if the security interest in the accession has priority over the claims of every person having an interest in the whole.

(f) Reimbursement following removal. A secured party that removes an accession from other goods under subsection (e) shall promptly reimburse any holder of a security interest or other

lien on, or owner of, the whole or of the other goods, other than the debtor, for the cost of repair of any physical injury to the whole or the other goods. The secured party need not reimburse the holder or owner for any diminution in value of the whole or the other goods caused by the absence of the accession removed or by any necessity for replacing it. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse.

Official Comment

§ 9336. Commingled goods.

(a) Commingled goods. As used in this section, the term "commingled goods" means goods which are physically united with other goods in such a manner that their identity is lost in a product or mass.

(b) No security interest in commingled goods as such. A security interest does not exist in commingled goods as such. However, a security interest may attach to a product or mass which results when goods become commingled goods.

(c) Attachment of security interest to product or mass. If collateral becomes commingled goods, a security interest attaches to the product or mass.

(d) Perfection of security interest. If a security interest in collateral is perfected before the collateral becomes commingled goods, the security interest which attaches to the product or mass under subsection (c) is perfected.

(e) Priority of security interest. Except as otherwise provided in subsection (f), the other provisions of this chapter determine the priority of a security interest which attaches to the product or mass under subsection (c).

(f) Conflicting security interests in product or mass. If more than one security interest attaches to the product or mass under subsection (c), the following rules determine priority:

(1) A security interest which is perfected under subsection (d) has priority over a security interest which is unperfected at the time the collateral becomes commingled goods.

(2) If more than one security interest is perfected under subsection (d), the security interests rank equally in proportion to the value of the collateral at the time it became commingled goods.

Official Comment

§ 9337. Priority of security interests in goods covered by certificate of title.

If, while a security interest in goods is perfected by any method under the law of another jurisdiction, the Commonwealth issues a certificate of title which does not show that the goods

are subject to the security interest or contain a statement that they may be subject to security interests not shown on the certificate:

- (1) a buyer of the goods, other than a person in the business of selling goods of that kind, takes free of the security interest if the buyer gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest; and
- (2) the security interest is subordinate to a conflicting security interest in the goods which attaches, and is perfected under section 9311(b) (relating to perfection of security interests in property subject to certain statutes, regulations and treaties), after issuance of the certificate and without the conflicting secured party's knowledge of the security interest.

Official Comment

§ 9338. Priority of security interest or agricultural lien perfected by filed financing statement providing certain incorrect information.

If a security interest or agricultural lien is perfected by a filed financing statement providing information described in section 9516(b)(5) (relating to what constitutes filing; effectiveness of filing) which is incorrect at the time the financing statement is filed:

- (1) the security interest or agricultural lien is subordinate to a conflicting perfected security interest in the collateral to the extent that the holder of the conflicting security interest gives value in reasonable reliance upon the incorrect information; and
- (2) a purchaser, other than a secured party, of the collateral takes free of the security interest or agricultural lien to the extent that, in reasonable reliance upon the incorrect information, the purchaser gives value and, in the case of tangible chattel paper, tangible documents, goods, instruments or a security certificate, receives delivery of the collateral.

Official Comment

§ 9339. Priority subject to subordination.

This division does not preclude subordination by agreement by a person entitled to priority.

Official Comment

Subchapter D. Rights of Bank.

§ 9340. Effectiveness of right of recoupment or set-off against deposit account.

(a) Exercise of recoupment or set-off. Except as otherwise provided in subsection (c), a bank with which a deposit account is maintained may exercise any right of recoupment or set-off against a secured party that holds a security interest in the deposit account.

(b) Recoupment or set-off not affected by security interest. Except as otherwise provided in subsection (c), the application of this division to a security interest in a deposit account does not affect a right of recoupment or set-off of the secured party as to a deposit account maintained with the secured party.

(c) When set-off ineffective. The exercise by a bank of a set-off against a deposit account is ineffective against a secured party that holds a security interest in the deposit account which is perfected by control under section 9104(a)(3) (relating to requirements for control) if the set-off is based on a claim against the debtor.

Official Comment

§ 9341. Bank's rights and duties with respect to deposit account.

Except as otherwise provided in section 9340(c) (relating to when set-off ineffective) and unless the bank otherwise agrees in an authenticated record, a bank's rights and duties with respect to a deposit account maintained with the bank are not terminated, suspended or modified by:

- (1) the creation, attachment or perfection of a security interest in the deposit account;
- (2) the bank's knowledge of the security interest; or
- (3) the bank's receipt of instructions from the secured party.

Official Comment

§ 9342. Bank's right to refuse to enter into or disclose existence of control agreement.

This division does not require a bank to enter into an agreement of the kind described in section 9104(a)(2) (relating to requirements for control) even if its customer so requests or directs. A bank which has entered into such an agreement is not required to confirm the existence of the agreement to another person unless requested to do so by its customer.

Official Comment

Chapter 94. Rights of Third Parties.

§ 9401. Alienability of debtor's rights.

(a) Other law governs alienability; exceptions. Except as otherwise provided in subsections (b) and (c), whether a debtor's rights in collateral may be voluntarily or involuntarily transferred is governed by law other than this division.

(b) Agreement does not prevent transfer. An agreement between the debtor and secured party which prohibits a transfer of the debtor's rights in collateral or makes the transfer a default does not prevent the transfer from taking effect.

(c) Exceptions. Subsection (a) is also subject to the following:

- (1) section 9406 (relating to discharge of account debtor; notification of assignment; identification and proof of assignment; restrictions on assignment of accounts, chattel paper, payment intangibles and promissory notes ineffective);
- (2) section 9407 (relating to restrictions on creation or enforcement of security interest in leasehold interest or in lessor's residual interest);
- (3) section 9408 (relating to restrictions on assignment of promissory notes, health-care-insurance receivables and certain general intangibles ineffective); and
- (4) section 9409 (relating to restrictions on assignment of letter-of-credit rights ineffective).

Official Comment

§ 9402. Secured party not obligated on contract of debtor or in tort.

The existence of a security interest, agricultural lien or authority given to a debtor to dispose of or use collateral, without more, does not subject a secured party to liability in contract or tort for the debtor's acts or omissions.

Official Comment

§ 9403. Agreement not to assert defenses against assignee.

(a) Value. As used in this section, the term "value" has the meaning provided in section 3303(a) (relating to value).

(b) Agreement not to assert claim or defense. Except as otherwise provided in this section, an agreement between an account debtor and an assignor not to assert against an assignee any claim or defense which the account debtor may have against the assignor is enforceable by an assignee that takes an assignment:

- (1) for value;
- (2) in good faith;
- (3) without notice of a claim of a property or possessory right to the property assigned; and
- (4) without notice of a defense or claim in recoupment of the type which may be asserted against a person entitled to enforce a negotiable instrument under section 3305(a) (relating to defenses and claims in recoupment).

(c) When subsection (b) not applicable. Subsection (b) does not apply to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under section 3305(b).

(d) Omission of required statement in consumer transaction. In a consumer transaction, if a record evidences the account debtor's obligation, law other than this division requires that the record include a statement to the effect that the rights of an assignee are subject to claims or defenses which the account debtor could assert against the original obligee and the record does not include such a statement:

- (1) the record has the same effect as if the record included such a statement; and
- (2) the account debtor may assert against an assignee those claims and defenses which would have been available if the record included such a statement.

(e) Rule for individual under other law. This section is subject to law other than this division which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family or household purposes.

(f) Other law not displaced. Except as otherwise provided in subsection (d), this section does not displace law other than this division which gives effect to an agreement by an account debtor not to assert a claim or defense against an assignee.

Official Comment

§ 9404. Rights acquired by assignee; claims and defenses against assignee.

(a) Assignee's rights subject to terms, claims and defenses; exceptions. Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections (b) through (e), the rights of an assignee are subject to:

- (1) all terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction which gave rise to the contract; and
- (2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.

(b) Account debtor's claim reduces amount owed to assignee. Subject to subsection (c) and except as otherwise provided in subsection (d), the claim of an account debtor against an assignor may be asserted against an assignee under subsection (a) only to reduce the amount the account debtor owes.

(c) Rule for individual under other law. This section is subject to law other than this division which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family or household purposes.

(d) Omission of required statement in consumer transaction. In a consumer transaction, if a record evidences the account debtor's obligation, law other than this division requires that the record include a statement to the effect that the account debtor's recovery against an assignee with respect to claims and defenses against the assignor may not exceed amounts paid by the account debtor under the record, and the record does not include such a statement, the extent to which a claim of an account debtor against the assignor may be asserted against an assignee is determined as if the record included such a statement.

(e) Inapplicability to health-care-insurance receivable. This section does not apply to an assignment of a health-care-insurance receivable.

Official Comment

§ 9405. Modification of assigned contract.

(a) Effect of modification on assignee. A modification of or substitution for an assigned contract is effective against an assignee if made in good faith. The assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that the modification or substitution is a breach of contract by the assignor. This subsection is subject to subsections (b) through (d).

(b) Applicability of subsection (a). Subsection (a) applies to the extent that:

- (1) the right to payment or a part thereof under an assigned contract has not been fully earned by performance; or
- (2) the right to payment or a part thereof has been fully earned by performance and the account debtor has not received notification of the assignment under section 9406(a) (relating to discharge of account debtor; effect of notification).

(c) Rule for individual under other law. This section is subject to law other than this division which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family or household purposes.

(d) Inapplicability to health-care-insurance receivable. This section does not apply to an assignment of a health-care-insurance receivable.

Official Comment

§ 9406. Discharge of account debtor; notification of assignment; identification and proof of assignment; restrictions on assignment of accounts, chattel paper, payment intangibles and promissory notes ineffective.

(a) Discharge of account debtor; effect of notification. Subject to subsections (b) through (i), an account debtor on an account, chattel paper or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.

(b) When notification ineffective. Subject to subsection (h), notification is ineffective under subsection (a):

- (1) If it does not reasonably identify the rights assigned.
- (2) To the extent that an agreement between an account debtor and a seller of a payment intangible limits the account debtor's duty to pay a person other than the seller and the limitation is effective under law other than this division.
- (3) At the option of an account debtor, if the notification notifies the account debtor to make less than the full amount of any installment or other periodic payment to the assignee even if:
 - (i) only a portion of the account, chattel paper or payment intangible has been assigned to that assignee;
 - (ii) a portion has been assigned to another assignee; or
 - (iii) the account debtor knows that the assignment to that assignee is limited.

(c) Proof of assignment. Subject to subsection (h), if requested by the account debtor, an assignee shall seasonably furnish reasonable proof that the assignment has been made. Unless the assignee complies, the account debtor may discharge its obligation by paying the assignor even if the account debtor has received a notification under subsection (a).

(d) Term restricting assignment generally ineffective. Except as otherwise provided in subsections (e) and (j) and sections 2A303 (relating to alienability of party's interest under lease contract or of lessor's residual interest in goods; delegation of performance; transfer of rights) and 9407 (relating to restrictions on creation or enforcement of security interest in leasehold interest or in lessor's residual interest) and subject to subsection (h), a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:

- (1) prohibits, restricts or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection or enforcement of a security interest in, the account, chattel paper, payment intangible or promissory note; or

(2) provides that the assignment or transfer or the creation, attachment, perfection or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination or remedy under the account, chattel paper, payment intangible or promissory note.

(e) Inapplicability of subsection (d) to certain sales. Subsection (d) does not apply to the sale of a payment intangible or promissory note, other than a sale pursuant to a disposition under section 9610 (relating to disposition of collateral after default) or an acceptance of collateral under section 9620 (relating to acceptance of collateral in full or partial satisfaction of obligation; compulsory disposition of collateral).

(f) Legal restrictions on assignment generally ineffective. Except as otherwise provided in subsection (j) and sections 2A303 and 9407 and subject to subsections (h) and (i), a rule of law, statute or regulation which prohibits, restricts or requires the consent of a government, governmental body or official or account debtor to the assignment or transfer of, or creation of a security interest in, an account or chattel paper is ineffective to the extent that the rule of law, statute or regulation:

(1) prohibits, restricts or requires the consent of the government, governmental body or official or account debtor to the assignment or transfer of, or the creation, attachment, perfection or enforcement of a security interest in, the account or chattel paper; or

(2) provides that the assignment or transfer or the creation, attachment, perfection or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination or remedy under the account or chattel paper.

(g) Subsection (b)(3) not waivable. Subject to subsection (h), an account debtor may not waive or vary its option under subsection (b)(3).

(h) Rule for individual under other law. This section is subject to law other than this division which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family or household purposes.

(i) Inapplicability to health-care-insurance receivable. This section does not apply to an assignment of a health-care-insurance receivable.

(j) Section prevails over inconsistent law.

(1) Except as set forth in paragraphs (2), (3), (4) and (5), this section prevails over any inconsistent provision of any existing or future statute or regulation of the Commonwealth unless the provision is contained in a statute of the Commonwealth, refers expressly to this section and states that the provision prevails over this section.

(2) Subsection (f) does not apply to an account or chattel paper if the account debtor is the Commonwealth.

(3) Subsection (f) does not apply to the following:

(i) A claim or right to receive benefits under a workers' compensation act as compensation for personal injury or sickness, including a claim or right to receive benefits under the act of June 2, 1915 (P.L.736, No.338), known as the Workers' Compensation Act.

(ii) The act of June 21, 1939 (P.L.566, No.284), known as The Pennsylvania Occupational Disease Act.

(iii) Section 306 of the act of August 26, 1971 (P.L.351, No.91), known as the State Lottery Law.

(4) Subsections (d) and (f) do not apply to a claim or right to receive benefits from a special needs trust described in section 1917(d)(4) of the Social Security Act (49 Stat. 620, 42 U.S.C. § 1396p(d)(4)).

(5) The limitations on restrictions of assignments contained in this section are inapplicable to transfers of structured settlement payment rights pursuant to the act of February 11, 2000 (P.L.1, No.1), known as the Structured Settlement Protection Act.

Official Comment

§ 9407. Restrictions on creation or enforcement of security interest in leasehold interest or in lessor's residual interest.

(a) Term restricting assignment generally ineffective. Except as otherwise provided in subsection (b), a term in a lease agreement is ineffective to the extent that it:

(1) prohibits, restricts or requires the consent of a party to the lease to the assignment or transfer of, or the creation, attachment, perfection or enforcement of a security interest in, an interest of a party under the lease contract or in the lessor's residual interest in the goods; or

(2) provides that the assignment or transfer or the creation, attachment, perfection or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination or remedy under the lease.

(b) Effectiveness of certain terms. Except as otherwise provided in section 2A303(g) (relating to requirements for prohibition of transfer in consumer lease), a term described in subsection (a)(2) is effective to the extent that there is:

- (1) a transfer by the lessee of the lessee's right of possession or use of the goods in violation of the term; or
- (2) a delegation of a material performance of either party to the lease contract in violation of the term.

(c) Security interest not material impairment. The creation, attachment, perfection or enforcement of a security interest in the lessor's interest under the lease contract or the lessor's residual interest in the goods is not a transfer which materially impairs the lessee's prospect of obtaining return performance or materially changes the duty of or materially increases the burden or risk imposed on the lessee within the purview of section 2A303(d) (relating to certain rights and remedies) unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the lessor.

Official Comment

§ 9408. Restrictions on assignment of promissory notes, health-care-insurance receivables and certain general intangibles ineffective.

(a) Term restricting assignment generally ineffective. Except as otherwise provided in subsections (b) and (e), a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or a general intangible, including a contract, permit, license or franchise, and which term prohibits, restricts or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment or perfection of a security interest in, the promissory note, health-care-insurance receivable or general intangible, is ineffective to the extent that the term:

- (1) would impair the creation, attachment or perfection of a security interest; or
- (2) provides that the assignment or transfer or the creation, attachment or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination or remedy under the promissory note, health-care-insurance receivable or general intangible.

(b) Applicability of subsection (a) to sales of certain rights to payment. Subsection (a) applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note, other than a sale pursuant to a disposition under section 9610 (relating to disposition of collateral after default) or an acceptance of collateral under section 9620 (relating to acceptance of collateral in full or partial satisfaction of obligation; compulsory disposition of collateral).

(c) Legal restrictions on assignment generally ineffective. Except as otherwise provided in subsection (e), a rule of law, statute or regulation which prohibits, restricts or requires the consent of a government, governmental body or official, person obligated on a promissory note or account debtor to the assignment or transfer of, or creation of a security interest in, a

promissory note, health-care-insurance receivable or general intangible, including a contract, permit, license or franchise between an account debtor and a debtor, is ineffective to the extent that the rule of law, statute or regulation:

- (1) would impair the creation, attachment or perfection of a security interest; or
- (2) provides that the assignment or transfer or the creation, attachment or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination or remedy under the promissory note, health-care-insurance receivable or general intangible.

(d) Limitation on ineffectiveness under subsections (a) and (c). To the extent that a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or general intangible or a rule of law, statute or regulation described in subsection (c) would be effective under law other than this division but is ineffective under subsection (a) or (c), the creation, attachment or perfection of a security interest in the promissory note, health-care-insurance receivable or general intangible:

- (1) is not enforceable against the person obligated on the promissory note or the account debtor;
- (2) does not impose a duty or obligation on the person obligated on the promissory note or the account debtor;
- (3) does not require the person obligated on the promissory note or the account debtor to recognize the security interest, pay or render performance to the secured party or accept payment or performance from the secured party;
- (4) does not entitle the secured party to use or assign the debtor's rights under the promissory note, health-care-insurance receivable or general intangible, including any related information or materials furnished to the debtor in the transaction giving rise to the promissory note, health-care-insurance receivable or general intangible;
- (5) does not entitle the secured party to use, assign, possess or have access to any trade secrets or confidential information of the person obligated on the promissory note or the account debtor; and
- (6) does not entitle the secured party to enforce the security interest in the promissory note, health-care-insurance receivable or general intangible.

(e) Section prevails over inconsistent law.

- (1) Except as set forth in paragraphs (2), (3) and (4), this section prevails over any inconsistent provision of any existing or future statute or regulation of the Commonwealth unless the provision is contained in a statute of the Commonwealth, refers expressly to this section and states that the provision prevails over this section.

(2) Subsection (c) does not apply to the provisions, claims and rights listed in section 9406(j)(3) (relating to discharge of account debtor; notification of assignment; identification and proof of assignment; restrictions on assignment of accounts, chattel paper, payment intangibles and promissory notes ineffective).

(3) Subsections (a) and (c) do not apply to the claims and rights described in section 9406(j)(4).

(4) The limitations on restrictions of assignments contained in this section are inapplicable to transfers of structured settlement payment rights pursuant to the act of February 11, 2000 (P.L.1, No.1), known as the Structured Settlement Protection Act.

Official Comment

§ 9409. Restrictions on assignment of letter-of-credit rights ineffective.

(a) Term or law restricting assignment generally ineffective. A term in a letter of credit or a rule of law, statute, regulation, custom or practice applicable to the letter of credit which prohibits, restricts or requires the consent of an applicant, issuer or nominated person to a beneficiary's assignment of or creation of a security interest in a letter-of-credit right is ineffective to the extent that the term or rule of law, statute, regulation, custom or practice:

(1) would impair the creation, attachment or perfection of a security interest in the letter-of-credit right; or

(2) provides that the assignment or the creation, attachment or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination or remedy under the letter-of-credit right.

(b) Limitation on ineffectiveness under subsection (a). To the extent that a term in a letter of credit is ineffective under subsection (a) but would be effective under law other than this division or a custom or practice applicable to the letter of credit, to the transfer of a right to draw or otherwise demand performance under the letter of credit or to the assignment of a right to proceeds of the letter of credit, the creation, attachment or perfection of a security interest in the letter-of-credit right:

(1) is not enforceable against the applicant, issuer, nominated person or transferee beneficiary;

(2) imposes no duties or obligations on the applicant, issuer, nominated person or transferee beneficiary; and

(3) does not require the applicant, issuer, nominated person or transferee beneficiary to recognize the security interest, pay or render performance to the secured party or accept payment or other performance from the secured party.

Official Comment

Chapter 95. Filing.

Subchapter A. Filing Office; Contents and Effectiveness of Financing Statement.

§ 9501. Filing office.

(a) Filing offices. Except as otherwise provided in subsection (b), if the local law of this Commonwealth governs perfection of a security interest or agricultural lien, the office in which to file a financing statement to perfect the security interest or agricultural lien is one of the following:

- (1) The office designated for the filing or recording of a record of a mortgage on the related real property if:
 - (i) the collateral is as-extracted collateral or timber to be cut; or
 - (ii) the financing statement is filed as a fixture filing and the collateral is goods which are or are to become fixtures.
- (2) The office of the Secretary of the Commonwealth in all other cases, including a case in which the collateral is goods which are or are to become fixtures and the financing statement is not filed as a fixture filing.

(b) Filing office for transmitting utilities. The office in which to file a financing statement to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of the Secretary of the Commonwealth. The financing statement also constitutes a fixture filing as to the collateral indicated in the financing statement which is or is to become fixtures.

Official Comment

§ 9502. Contents of financing statement; record of mortgage as financing statement; time of filing financing statement.

(a) Sufficiency of financing statement. Subject to subsection (b), a financing statement is sufficient only if it:

- (1) provides the name of the debtor;
- (2) provides the name of the secured party or a representative of the secured party; and
- (3) indicates the collateral covered by the financing statement.

(b) Real-property-related financing statements. Except as otherwise provided in section 9501(b) (relating to filing office for transmitting utilities), to be sufficient, a financing statement which covers as-extracted collateral or timber to be cut or which is filed as a fixture filing and covers goods which are or are to become fixtures must satisfy subsection (a) and also:

- (1) indicate that it covers this type of collateral;
- (2) indicate that it is to be filed in the real property records;
- (3) provide a description of the real property to which the collateral is related; and
- (4) if the debtor does not have an interest of record in the real property, provide the name of a record owner.

(c) Record of mortgage as financing statement. A record of a mortgage is effective, from the date of recording, as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut only if all of the following apply:

- (1) The record indicates the goods or accounts which it covers.
- (2) The goods are or are to become fixtures related to the real property described in the record, or the collateral is related to the real property described in the record and is as-extracted collateral or timber to be cut.
- (3) The record satisfies the requirements for a financing statement in this section subject to the following:
 - (i) The record need not indicate that it is to be filed in the real property records.
 - (ii) The record sufficiently provides the name of a debtor who is an individual if it provides the individual name of the debtor or the surname and first personal name of the debtor, even if the debtor is an individual to whom section 9503(a)(4) (relating to name of debtor and secured party) applies.
- (4) The record is duly recorded.

(d) Filing before security agreement or attachment. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.

Official Comment

§ 9503. Name of debtor and secured party.

(a) Sufficiency of debtor's name. A financing statement sufficiently provides the name of the debtor:

- (1) Except as otherwise provided in paragraph (3), if the debtor is a registered organization or the collateral is held in a trust that is a registered organization, only if the financing statement provides the name that is stated to be the registered organization's name on the public organic record most recently filed with or issued or enacted by the registered organization's jurisdiction of organization which purports to state, amend or restate the registered organization's name.
- (2) Subject to subsection (f), if the collateral is being administered by the personal representative of a decedent, only if the financing statement provides, as the name of the debtor, the name of the decedent and, in a separate part of the financing statement, indicates that the collateral is being administered by a personal representative.
- (3) If the collateral is held in a trust that is not a registered organization, only if the financing statement:
 - (i) provides, as the name of the debtor:
 - (A) if the organic record of the trust specifies a name for the trust, the name specified; or
 - (B) if the organic record of the trust does not specify a name for the trust, the name of the settlor or testator; and
 - (ii) in a separate part of the financing statement:
 - (A) if the name is provided under subparagraph (i)(A), indicates that the collateral is held in a trust; or
 - (B) if the name is provided under subparagraph (i)(B), provides additional information sufficient to distinguish the trust from other trusts having one or more of the same settlors or the same testator and indicates that the collateral is held in a trust, unless the additional information so indicates.
- (4) Subject to subsection (g), if the debtor is an individual to whom the Department of Transportation has issued a driver's license which has not expired under 75 Pa.C.S. § 1510(a) (relating to issuance and content of driver's license) or an identification card under 75 Pa.C.S. § 1510(b), only if the financing statement provides the name of the individual which is indicated on:
 - (i) except as set forth in subparagraph (ii), the driver's license; or
 - (ii) if there is no driver's license, the identification card.

(5) If the debtor is an individual to whom paragraph (4) does not apply, only if the financing statement provides the individual name of the debtor or the surname and first personal name of the debtor.

(6) In other cases:

(i) if the debtor has a name, only if the financing statement provides the organizational name of the debtor; and

(ii) if the debtor does not have a name, only if the financing statement provides the names of the partners, members, associates or other persons comprising the debtor, in a manner that each name provided would be sufficient if the person named were the debtor.

(b) Additional debtor-related information. A financing statement which provides the name of the debtor in accordance with subsection (a) is not rendered ineffective by the absence of:

(1) a trade name or other name of the debtor; or

(2) unless required under subsection (a)(6)(ii), names of partners, members, associates or other persons comprising the debtor.

(c) Debtor's trade name insufficient. A financing statement which provides only the debtor's trade name does not sufficiently provide the name of the debtor.

(d) Representative capacity. Failure to indicate the representative capacity of a secured party or representative of a secured party does not affect the sufficiency of a financing statement.

(e) Multiple debtors and secured parties. A financing statement may provide the name of more than one debtor and the name of more than one secured party.

(f) Name of decedent. The name of the decedent indicated on the order appointing the personal representative of the decedent issued by the court having jurisdiction over the collateral is sufficient as the name of the decedent under subsection (a)(2).

(g) Multiple driver's licenses. If the department has issued to an individual more than one driver's license or identification card of a kind described in subsection (a)(4), the one that was issued most recently is the one to which subsection (a)(4) refers.

(h) Definition. As used in this section, the term "name of the settlor or testator" means:

(1) if the settlor is a registered organization, the name that is stated to be the settlor's name on the public organic record most recently filed with or issued or enacted by the settlor's jurisdiction of organization which purports to state, amend or restate the settlor's name; or

(2) in other cases, the name of the settlor or testator indicated in the trust's organic record.

(June 27, 2013, P.L.154, No.30, eff. July 1, 2013) 2013 Amendment. Act 30 amended subsecs. (a) and (b)(2) and added subsecs. (f), (g) and (h). Section 12 of Act 30 provided that, in order to implement the amendment of section 9503, the Department of State and the Department of Transportation shall coordinate development and maintenance of electronic systems for entering and searching data.

[Official Comment](#)

§ 9504. Indication of collateral.

A financing statement sufficiently indicates the collateral which it covers if the financing statement provides:

- (1) a description of the collateral pursuant to section 9108 (relating to sufficiency of description); or
- (2) an indication that the financing statement covers all assets or all personal property.

[Official Comment](#)

§ 9505. Filing and compliance with other statutes and treaties for consignments, leases, other bailments and other transactions.

(a) Use of terms other than "debtor" and "secured party". A consignor, lessor or other bailor of goods, a licensor or a buyer of a payment intangible or promissory note may file a financing statement or may comply with a statute or treaty described in section 9311(a) (relating to perfection of security interests in property subject to certain statutes, regulations and treaties), using the terms "consignor," "consignee," "lessor," "lessee," "bailor," "bailee," "licensor," "licensee," "owner," "registered owner," "buyer," "seller" or words of similar import, instead of the terms "secured party" and "debtor."

(b) Effect of financing statement under subsection (a). This chapter applies to the filing of a financing statement under subsection (a) and, as appropriate, to compliance which is equivalent to filing a financing statement under section 9311(b), but the filing or compliance is not of itself a factor in determining whether the collateral secures an obligation. If it is determined for another reason that the collateral secures an obligation, a security interest held by the consignor, lessor, bailor, licensor, owner or buyer which attaches to the collateral is perfected by the filing or compliance.

[Official Comment](#)

§ 9506. Effect of errors or omissions.

(a) Minor errors and omissions. A financing statement substantially satisfying the requirements of this chapter is effective even if it has minor errors or omissions unless the errors or omissions make the financing statement seriously misleading.

(b) Financing statement seriously misleading. Except as otherwise provided in subsection (c), a financing statement which fails sufficiently to provide the name of the debtor in accordance with section 9503(a) (relating to sufficiency of debtor's name) is seriously misleading.

(c) Financing statement not seriously misleading. If a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement which fails sufficiently to provide the name of the debtor in accordance with section 9503(a), the name provided does not make the financing statement seriously misleading.

(d) Debtor's correct name. For purposes of section 9508(b) (relating to effectiveness of financing statement if new debtor becomes bound by security agreement), the "debtor's correct name" in subsection (c) means the correct name of the new debtor.

Official Comment

§ 9507. Effect of certain events on effectiveness of financing statement.

(a) Disposition. A filed financing statement remains effective with respect to collateral which is sold, exchanged, leased, licensed or otherwise disposed of and in which a security interest or agricultural lien continues even if the secured party knows of or consents to the disposition.

(b) Information becoming seriously misleading. Except as otherwise provided in subsection (c) and section 9508 (relating to effectiveness of financing statement if new debtor becomes bound by security agreement), a financing statement is not rendered ineffective if, after the financing statement is filed, the information provided in the financing statement becomes seriously misleading under section 9506 (relating to effect of errors or omissions).

(c) Change in debtor's name. If the name that a filed financing statement provides for a debtor becomes insufficient as the name of the debtor under section 9503(a) (relating to name of debtor and secured party) so that the financing statement becomes seriously misleading under section 9506:

(1) the financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the filed financing statement becomes seriously misleading; and

(2) the financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the filed financing statement becomes seriously misleading, unless an amendment to the financing statement which renders the financing statement not seriously misleading is filed within four months after the financing statement became seriously misleading.

Official Comment

§ 9508. Effectiveness of financing statement if new debtor becomes bound by security agreement.

(a) Financing statement naming original debtor. Except as otherwise provided in this section, a filed financing statement naming an original debtor is effective to perfect a security interest in collateral in which a new debtor has or acquires rights to the extent that the financing statement would have been effective had the original debtor acquired rights in the collateral.

(b) Financing statement becoming seriously misleading. If the difference between the name of the original debtor and that of the new debtor causes a filed financing statement which is effective under subsection (a) to be seriously misleading under section 9506 (relating to effect of errors or omissions):

- (1) the financing statement is effective to perfect a security interest in collateral acquired by the new debtor before and within four months after the new debtor becomes bound under section 9203(d) (relating to when person becomes bound by another person's security agreement); and
- (2) the financing statement is not effective to perfect a security interest in collateral acquired by the new debtor more than four months after the new debtor becomes bound under section 9203(d) unless an initial financing statement providing the name of the new debtor is filed before the expiration of that time.

(c) When section not applicable. This section does not apply to collateral as to which a filed financing statement remains effective against the new debtor under section 9507(a) (relating to disposition).

Official Comment

§ 9509. Persons entitled to file a record.

(a) Person entitled to file record. A person may file an initial financing statement, amendment which adds collateral covered by a financing statement or amendment which adds a debtor to a financing statement only if:

- (1) the debtor authorizes the filing in an authenticated record or pursuant to subsection (b) or (c); or
- (2) the person holds an agricultural lien which has become effective at the time of filing and the financing statement covers only collateral in which the person holds an agricultural lien.

(b) Security agreement as authorization. By authenticating or becoming bound as debtor by a security agreement, a debtor or new debtor authorizes the filing of an initial financing statement and an amendment covering:

- (1) the collateral described in the security agreement; and
- (2) property which becomes collateral under section 9315(a)(2) (relating to secured party's rights on disposition of collateral and in proceeds), whether or not the security agreement expressly covers proceeds.

(c) Acquisition of collateral as authorization. By acquiring collateral in which a security interest or agricultural lien continues under section 9315(a)(1), a debtor authorizes the filing of an initial financing statement and an amendment covering the collateral and property which becomes collateral under section 9315(a)(2).

(d) Person entitled to file certain amendments. A person may file an amendment other than an amendment which adds collateral covered by a financing statement or an amendment which adds a debtor to a financing statement only if:

- (1) the secured party of record authorizes the filing; or
- (2) the amendment is a termination statement for a financing statement as to which the secured party of record has failed to file or send a termination statement as required by section 9513(a) or (c) (relating to termination statement), the debtor authorizes the filing and the termination statement indicates that the debtor authorized it to be filed.

(e) Multiple secured parties of record. If there is more than one secured party of record for a financing statement, each secured party of record may authorize the filing of an amendment under subsection (d).

Official Comment

§ 9510. Effectiveness of filed record.

(a) Filed record effective if authorized. A filed record is effective only to the extent that it was filed by a person that may file it under section 9509 (relating to persons entitled to file a record).

(b) Authorization by one secured party of record. A record authorized by one secured party of record does not affect the financing statement with respect to another secured party of record.

(c) Continuation statement not timely filed. A continuation statement which is not filed within the six-month period prescribed by section 9515(d) (relating to when continuation statement may be filed) is ineffective.

Official Comment

§ 9511. Secured party of record.

(a) Secured party of record. A secured party of record with respect to a financing statement is a person whose name is provided as the name of the secured party or a representative of the secured party in an initial financing statement which has been filed. If an initial financing statement is filed under section 9514(a) (relating to assignment reflected on initial financing statement), the assignee named in the initial financing statement is the secured party of record with respect to the financing statement.

(b) Amendment naming secured party of record. If an amendment of a financing statement which provides the name of a person as a secured party or a representative of a secured party is filed, the person named in the amendment is a secured party of record. If an amendment is filed under section 9514(b), the assignee named in the amendment is a secured party of record.

(c) Amendment deleting secured party of record. A person remains a secured party of record until the filing of an amendment of the financing statement which deletes the person.

Official Comment

§ 9512. Amendment of financing statement.

(a) Amendment of information in financing statement. Subject to section 9509 (relating to persons entitled to file a record), a person may add or delete collateral covered by, continue or terminate the effectiveness of or, subject to subsection (e), otherwise amend the information provided in a financing statement by filing an amendment which:

- (1) identifies by its file number the initial financing statement to which the amendment relates; and
- (2) if the amendment relates to an initial financing statement filed in a filing office described in section 9501(a)(1) (relating to filing offices), provides the information specified in section 9502(b) (relating to real-property-related financing statements).

(b) Period of effectiveness not affected. Except as otherwise provided in section 9515 (relating to duration and effectiveness of financing statement; effect of lapsed financing statement), the filing of an amendment does not extend the period of effectiveness of the financing statement.

(c) Effectiveness of amendment adding collateral. A financing statement which is amended by an amendment which adds collateral is effective as to the added collateral only from the date of the filing of the amendment.

(d) Effectiveness of amendment adding debtor. A financing statement which is amended by an amendment which adds a debtor is effective as to the added debtor only from the date of the filing of the amendment.

(e) Certain amendments ineffective. An amendment is ineffective to the extent it:

(1) purports to delete all debtors and fails to provide the name of a debtor to be covered by the financing statement; or

(2) purports to delete all secured parties of record and fails to provide the name of a new secured party of record.

Official Comment

§ 9513. Termination statement.

(a) Consumer goods. A secured party shall cause the secured party of record for a financing statement to file a termination statement for the financing statement if the financing statement covers consumer goods and:

(1) there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation or otherwise give value; or

(2) the debtor did not authorize the filing of the initial financing statement.

(b) Time for compliance with subsection (a). To comply with subsection (a), a secured party shall cause the secured party of record to file the termination statement:

(1) within one month after there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation or otherwise give value; or

(2) if earlier, within 20 days after the secured party receives an authenticated demand from a debtor.

(c) Other collateral. In cases not governed by subsection (a), within 20 days after a secured party receives an authenticated demand from a debtor, the secured party shall cause the secured party of record for a financing statement to send to the debtor a termination statement for the financing statement or file the termination statement in the filing office if:

(1) except in the case of a financing statement covering accounts or chattel paper which has been sold or goods which are the subject of a consignment, there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation or otherwise give value;

(2) the financing statement covers accounts or chattel paper which has been sold but as to which the account debtor or other person obligated has discharged its obligation;

(3) the financing statement covers goods which were the subject of a consignment to the debtor but are not in the debtor's possession; or

(4) the debtor did not authorize the filing of the initial financing statement.

(d) Effect of filing termination statement. Except as otherwise provided in section 9510 (relating to effectiveness of filed record), upon the filing of a termination statement with the filing office, the financing statement to which the termination statement relates ceases to be effective. Except as otherwise provided in section 9510, for purposes of sections 9519(g) (relating to removal of debtor's name), 9522(a) (relating to post-lapse maintenance and retrieval of information) and 9523(c) (relating to communication of requested information), the filing with the filing office of a termination statement relating to a financing statement which indicates that the debtor is a transmitting utility also causes the effectiveness of the financing statement to lapse.

Official Comment

§ 9514. Assignment of powers of secured party of record.

(a) Assignment reflected on initial financing statement. Except as otherwise provided in subsection (c), an initial financing statement may reflect an assignment of all of the secured party's power to authorize an amendment to the financing statement by providing the name and mailing address of the assignee as the name and address of the secured party.

(b) Assignment of filed financing statement. Except as otherwise provided in subsection (c), a secured party of record may assign of record all or part of its power to authorize an amendment to a financing statement by filing in the filing office an amendment of the financing statement which:

- (1) identifies by its file number the initial financing statement to which it relates;
- (2) provides the name of the assignor; and
- (3) provides the name and mailing address of the assignee.

(c) Assignment of record of mortgage. An assignment of record of a security interest in a fixture covered by a record of a mortgage which is effective as a financing statement filed as a fixture filing under section 9502(c) (relating to record of mortgage as financing statement) may be made only by an assignment of record of the mortgage in the manner provided by law of this Commonwealth other than this title.

Official Comment

§ 9515. Duration and effectiveness of financing statement; effect of lapsed financing statement.

(a) Five-year effectiveness. Except as otherwise provided in subsections (b), (e), (f) and (g), a filed financing statement is effective for a period of five years after the date of filing.

(b) Public-finance or manufactured-home transaction. Except as otherwise provided in subsections (e), (f) and (g), an initial financing statement filed in connection with a public-finance transaction or manufactured-home transaction is effective for a period of 30 years after the date of filing if it indicates that it is filed in connection with a public-finance transaction or manufactured-home transaction.

(c) Lapse and continuation of financing statement. The effectiveness of a filed financing statement lapses on the expiration of the period of its effectiveness unless before the lapse a continuation statement is filed pursuant to subsection (d). Upon lapse, a financing statement ceases to be effective and any security interest or agricultural lien which was perfected by the financing statement becomes unperfected unless the security interest is perfected otherwise. If the security interest or agricultural lien becomes unperfected upon lapse, it is deemed never to have been perfected as against a purchaser of the collateral for value.

(d) When continuation statement may be filed. A continuation statement may be filed only within six months before the expiration of the five-year period specified in subsection (a) or the 30-year period specified in subsection (b), whichever is applicable.

(e) Effect of filing continuation statement. Except as otherwise provided in section 9510 (relating to effectiveness of filed record), upon timely filing of a continuation statement, the effectiveness of the initial financing statement continues for a period of five years commencing on the day on which the financing statement would have become ineffective in the absence of the filing. Upon the expiration of the five-year period, the financing statement lapses in the same manner as provided in subsection (c) unless, before the lapse, another continuation statement is filed pursuant to subsection (d). Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the initial financing statement.

(f) Transmitting utility financing statement. If a debtor is a transmitting utility and a filed initial financing statement so indicates, the financing statement is effective until a termination statement is filed.

(g) Record of mortgage as financing statement. A record of a mortgage which is effective as a financing statement filed as a fixture filing under section 9502(c) (relating to record of mortgage as financing statement) remains effective as a financing statement filed as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real property.

Official Comment

§ 9516. What constitutes filing; effectiveness of filing.

(a) What constitutes filing. Except as otherwise provided in subsection (b), communication of a record to a filing office and tender of the filing fee or acceptance of the record by the filing office constitutes filing.

(b) Refusal to accept record; filing does not occur. Filing does not occur with respect to a record which a filing office refuses to accept because one of the following paragraphs applies:

- (1) The record is not communicated by a method or medium of communication authorized by the filing office.
- (2) An amount equal to or greater than the applicable filing fee is not tendered.
- (3) The filing office is unable to index the record because of a reason stated in one of the following subparagraphs:
 - (i) In the case of an initial financing statement, the record does not provide a name for the debtor.
 - (ii) In the case of an amendment or information statement, the record:
 - (A) does not identify the initial financing statement as required by section 9512 (relating to amendment of financing statement) or 9518 (relating to claim concerning inaccurate or wrongfully filed record), as applicable; or
 - (B) identifies an initial financing statement whose effectiveness has lapsed under section 9515 (relating to duration and effectiveness of financing statement; effect of lapsed financing statement).
 - (iii) In the case of an initial financing statement which provides the name of a debtor identified as an individual or an amendment which provides a name of a debtor identified as an individual which was not previously provided in the financing statement to which the record relates, the record does not identify the debtor's surname.
 - (iv) In the case of a record filed in the filing office described in section 9501(a)(1) (relating to filing offices), the record does not provide a sufficient description of the real property to which it relates.
- (4) In the case of an initial financing statement or an amendment which adds a secured party of record, the record does not provide a name and mailing address for the secured party of record.
- (5) In the case of an initial financing statement or an amendment which provides a name of a debtor which was not previously provided in the financing statement to which the amendment relates, the record does not do both of the following:
 - (i) Provide a mailing address for the debtor.
 - (ii) Indicate whether the name provided as the name of the debtor is the name of an individual or an organization.

(iii) (Deleted by amendment).

(6) In the case of an assignment reflected in an initial financing statement under section 9514(a) (relating to assignment reflected on initial financing statement) or an amendment filed under section 9514(b) (relating to assignment of filed financing statement), the record does not provide a name and mailing address for the assignee.

(7) In the case of a continuation statement, the record is not filed within the six-month period prescribed by section 9515(d) (relating to when continuation statement may be filed).

(c) Rules applicable to subsection (b). For purposes of subsection (b):

(1) a record does not provide information if the filing office is unable to read or decipher the information; and

(2) a record which does not indicate that it is an amendment or identify an initial financing statement to which it relates, as required by section 9512, 9514 or 9518, is an initial financing statement.

(d) Refusal to accept record; record effective as filed record. A record which is communicated to the filing office with tender of the filing fee, but which the filing office refuses to accept for a reason other than one set forth in subsection (b), is effective as a filed record except as against a purchaser of the collateral that gives value in reasonable reliance upon the absence of the record from the files.

Official Comment

§ 9517. Effect of indexing errors.

The failure of the filing office to index a record correctly does not affect the effectiveness of the filed record.

Official Comment

§ 9518. Claim concerning inaccurate or wrongfully filed record.

(a) Statement with respect to record indexed under person's name. A person may file in the filing office an information statement with respect to a record indexed there under the person's name if the person believes that the record is inaccurate or was wrongfully filed.

(b) Contents of statement under subsection (a). An information statement under subsection (a) must:

- (1) identify the record to which it relates by the file number assigned to the initial financing statement to which the record relates;
- (2) indicate that it is an information statement; and
- (3) provide the basis for the person's belief that the record is inaccurate and indicate the manner in which the person believes the record should be amended to cure any inaccuracy or provide the basis for the person's belief that the record was wrongfully filed.

(c) Statement by secured party of record. A person may file in the filing office an information statement with respect to a record filed there if the person is a secured party of record with respect to the financing statement to which the record relates and believes that the person that filed the record was not entitled to do so under section 9509(d) (relating to persons entitled to file a record).

(d) Contents of statement under subsection (c). An information statement under subsection (c) must:

- (1) identify the record to which it relates by the file number assigned to the initial financing statement to which the record relates;
- (2) indicate that it is an information statement; and
- (3) provide the basis for the person's belief that the person that filed the record was not entitled to do so under section 9509(d).

(e) Record not affected by information statement. Except as provided in subsection (f), the filing of an information statement does not affect the effectiveness of an initial financing statement or other filed record.

(f) Fraudulent financing statements.

- (1) The Department of State may conduct an administrative hearing to determine if an initial financing statement was fraudulently filed in accordance with the following:
 - (i) The hearing shall be conducted in accordance with 2 Pa.C.S. (relating to Administrative Law and Procedure). The department shall determine the initial financing statement to be fraudulently filed for purposes of this subsection if it determines that no rational basis exists under section 9509 entitling the person to file the initial financing statement and it appears that the person filed the initial financing statement with intent to annoy, harass or harm the debtor.
 - (ii) If the department determines that the initial financing statement was fraudulently filed and no timely appeal of the determination was filed, the department shall file an information statement with respect to the initial financing

statement indexed there. In addition to complying with the requirements of subsection (b), the information statement filed by the department under this paragraph shall state all of the following:

- (A) the correction statement was filed by the department under this subsection;
- (B) the department has determined that the initial financing statement was fraudulently filed and that the person had the right to appeal the decision to a court of competent jurisdiction;
- (C) the initial financing statement found to be fraudulently filed may be ineffective; and
- (D) the reasons why the department found the initial financing statement to have been fraudulently filed.

(iii) An information statement filed by the department in accordance with paragraph (ii) creates a rebuttable presumption that the initial financing statement found to be fraudulently filed is ineffective.

(iv) A person adversely affected by a determination of the department under paragraph (i) may appeal the determination in accordance with 2 Pa.C.S. § 702 (relating to appeals).

(v) If the department determines that the initial financing statement was fraudulently filed and the determination is appealed to Commonwealth Court, the department shall file an information statement with respect to the initial financing statement indexed there only upon affirmation by the court of its determination. In addition to complying with the requirements of subsection (b), the information statement shall state all of the following:

- (A) the information statement was filed by the department under this subsection;
- (B) the department has determined that the initial financing statement was fraudulently filed and that the person had the right to appeal the decision to a court of competent jurisdiction;
- (C) the initial financing statement found to be fraudulently filed is ineffective; and
- (D) the reasons why the department found the initial financing statement to have been fraudulently filed.

- (vi) If the department files an information statement with respect to the initial financing statement indexed there under this subsection, it shall refer the matter for criminal prosecution to the Office of Attorney General pursuant to 18 Pa.C.S. § 4911 (relating to tampering with public records or information).
- (2) Nothing in this subsection limits the rights or remedies the debtor may have with respect to an initial financing statement that has been fraudulently filed. Nothing in this subsection limits the effectiveness of any termination or information statement filed by a debtor under sections 9509(d)(2) and 9513 (relating to termination statement) or the rights of a debtor under section 9625 (relating to remedies for secured party's failure to comply with division).

Official Comment

Subchapter B. Duties and Operation of Filing Office.

§ 9519. Numbering, maintaining and indexing records; communicating information provided in records.

(a) Filing office duties. For each record filed in a filing office, the filing office shall:

- (1) assign a unique number to the filed record;
- (2) create a record which bears the number assigned to the filed record and the date and time of filing;
- (3) maintain the filed record for public inspection; and
- (4) index the filed record in accordance with subsections (c), (d) and (e).

(b) File number. Except as provided in subsection (i), a file number assigned after January 1, 2002, must include a digit which:

- (1) is mathematically derived from or related to the other digits of the file number; and
- (2) aids the filing office in determining whether a number communicated as the file number includes a single digit or transpositional error.

(c) Indexing: general. Except as otherwise provided in subsections (d) and (e), the filing office shall:

- (1) index an initial financing statement according to the name of the debtor and index all filed records relating to the initial financing statement in a manner which associates with one another an initial financing statement and all filed records relating to the initial financing statement; and

(2) index a record which provides a name of a debtor which was not previously provided in the financing statement to which the record relates also according to the name which was not previously provided.

(d) Indexing: real-property-related financing statement. If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, the filing office shall index it:

(1) under the names of the debtor and of each owner of record shown on the financing statement as if they were the mortgagors under a mortgage of the real property described; and

(2) to the extent that the law of this Commonwealth provides for indexing of records of mortgages under the name of the mortgagee, under the name of the secured party as if the secured party were the mortgagee thereunder or, if indexing is by description, as if the financing statement were a record of a mortgage of the real property described.

(e) Indexing: real-property-related assignment. If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, the filing office shall index an assignment filed under section 9514(a) (relating to assignment reflected on initial financing statement) or an amendment filed under section 9514(b) (relating to assignment of filed financing statement):

(1) under the name of the assignor as grantor; and

(2) to the extent that the law of this Commonwealth provides for indexing a record of the assignment of a mortgage under the name of the assignee, under the name of the assignee.

(f) Retrieval and association capability. The filing office shall maintain a capability:

(1) to retrieve a record by the name of the debtor and by the file number assigned to the initial financing statement to which the record relates; and

(2) to associate and retrieve with one another an initial financing statement and each filed record relating to the initial financing statement.

(g) Removal of debtor's name. The filing office may not remove a debtor's name from the index until one year after the effectiveness of a financing statement naming the debtor lapses under section 9515 (relating to duration and effectiveness of financing statement; effect of lapsed financing statement) with respect to all secured parties of record.

(h) Timeliness of filing office performance. Except as provided in subsection (i), the filing office shall perform the acts required by subsections (a) through (e) at the time and in the manner prescribed by filing-office rule but not later than five business days after the filing office receives the record in question.

(i) Inapplicability to real-property-related filing office. Subsections (b) and (h) do not apply to a filing office described in section 9501(a)(1) (relating to filing offices).

Official Comment

§ 9520. Acceptance and refusal to accept record.

(a) Mandatory refusal to accept record. A filing office shall refuse to accept a record for filing for a reason set forth in section 9516(b) (relating to refusal to accept record; filing does not occur) and may refuse to accept a record for filing only for a reason set forth in section 9516(b).

(b) Communication concerning refusal. If a filing office refuses to accept a record for filing, it shall communicate to the person that presented the record the fact of and reason for the refusal and the date and time the record would have been filed had the filing office accepted it. The communication must be made at the time and in the manner prescribed by filing-office rule but, in the case of a filing office described in section 9501(a)(2) (relating to filing offices), in no event more than five business days after the filing office receives the record.

(c) When filed financing statement effective. A filed financing statement satisfying section 9502(a) and (b) (relating to contents of financing statement; record of mortgage as financing statement; time of filing financing statement) is effective even if the filing office is required to refuse to accept it for filing under subsection (a). However, section 9338 (relating to priority of security interest or agricultural lien perfected by filed financing statement providing certain incorrect information) applies to a filed financing statement providing information described in section 9516(b)(5) which is incorrect at the time the financing statement is filed.

(d) Separate application to multiple debtors. If a record communicated to a filing office provides information which relates to more than one debtor, this chapter applies as to each debtor separately.

Official Comment

§ 9521. Uniform form of written financing statement and amendment.

(a) Initial financing statement form. A filing office which accepts written records may not refuse to accept a written initial financing statement in the form and format set forth in the final official text of the 1999 revisions to Article 9 of the Uniform Commercial Code promulgated by The American Law Institute and the National Conference of Commissioners on Uniform State Laws, except for a reason set forth in section 9516(b) (relating to refusal to accept record; filing does not occur).

(b) Amendment form. A filing office which accepts written records may not refuse to accept a written record in the form and format set forth in the final official text of the 1999 revisions to Article 9 of the Uniform Commercial Code promulgated by The American Law Institute and the

National Conference of Commissioners on Uniform State Laws, except for a reason set forth in section 9516(b).

[Official Comment](#)

§ 9522. Maintenance and destruction of records

(a) Post-lapse maintenance and retrieval of information. The filing office shall maintain a record of the information provided in a filed financing statement for at least one year after the effectiveness of the financing statement has lapsed under section 9515 (relating to duration and effectiveness of financing statement; effect of lapsed financing statement) with respect to all secured parties of record. The record must be retrievable by using the name of the debtor and by using the file number assigned to the initial financing statement to which the record relates.

(b) Destruction of written records. Except to the extent that a statute governing disposition of public records provides otherwise, the filing office immediately may destroy any written record evidencing a financing statement. However, if the filing office destroys a written record, it shall maintain another record of the financing statement which complies with subsection (a).

[Official Comment](#)

§ 9523. Information from filing office; sale or license of records.

(a) Acknowledgment of filing written record. If a person that files a written record requests an acknowledgment of the filing, the filing office shall send to the person an image of the record showing the number assigned to the record pursuant to section 9519(a)(1) (relating to numbering, maintaining and indexing records; communicating information provided in records) and the date and time of the filing of the record. However, if the person furnishes a copy of the record to the filing office, the filing office may instead:

- (1) note upon the copy the number assigned to the record pursuant to section 9519(a)(1) and the date and time of the filing of the record; and
- (2) send the copy to the person.

(b) Acknowledgment of filing other record. If a person files a record other than a written record, the filing office shall communicate to the person an acknowledgment which provides:

- (1) the information in the record;
- (2) the number assigned to the record pursuant to section 9519(a)(1); and
- (3) the date and time of the filing of the record.

(c) Communication of requested information. The filing office shall communicate or otherwise make available in a record the following information to any person that requests it:

(1) Whether there is on file on a date and time specified by the filing office, but not a date earlier than three business days before the filing office receives the request, any financing statement which:

- (i) designates a particular debtor or, if the request so states, designates a particular debtor at the address specified in the request;
- (ii) has not lapsed under section 9515 (relating to duration and effectiveness of financing statement; effect of lapsed financing statement) with respect to all secured parties of record; and
- (iii) if the request so states, has lapsed under section 9515 and a record of which is maintained by the filing office under section 9522(a) (relating to post-lapse maintenance and retrieval of information).

(2) The date and time of filing of each financing statement.

(3) The information provided in each financing statement.

(d) Medium for communicating information. In complying with its duty under subsection (c), the filing office may communicate information in any medium. However, if requested, the filing office shall communicate information by issuing its written certificate.

(e) Timeliness of filing office performance.

(1) Except as set forth in paragraph (2), the filing office shall perform the acts required by subsections (a) through (d) at the time and in the manner prescribed by filing-office rule.

(2) A filing office described in section 9501(a)(2) (relating to filing offices) shall perform the acts required by subsections (a) through (d) not later than five business days after the filing office receives the request.

(f) Public availability of records. At least weekly, the filing office described in section 9501(a)(2) shall offer to sell or license to the public on a nonexclusive basis, in bulk, copies of all records filed in it under this chapter in every medium from time to time available to the filing office.

Official Comment

§ 9524. Delay by filing office.

Delay by the filing office beyond a time limit prescribed by this chapter is excused if:

(1) the delay is caused by interruption of communication or computer facilities, war, emergency conditions, failure of equipment or other circumstances beyond control of the filing office; and

(2) the filing office exercises reasonable diligence under the circumstances.

Official Comment

§ 9525. Fees.

(a) Initial financing statement or other record. Except as otherwise provided in subsections (c) and (d):

(1) The fee for filing and indexing a record under this chapter shall be as follows:

(i) For a record communicated to a filing office described in section 9501(a)(1) (relating to filing office), \$48.

(ii) For a record communicated to a filing office described in section 9501(a)(2), \$12.

(2) The amount of the fee for filing and indexing the record is not affected by the number of names to be indexed or the number of pages in the record.

(b) Response to information request. Except as otherwise provided in subsection (d), the fee for responding to a request for information from the filing office, including for issuing a certificate showing whether there is on file any financing statement naming a particular debtor, shall be as follows:

(1) The basic charge is \$12.

(2) If the filing office responds to the request in writing, there is an additional charge of:

(i) no charge per record found;

(ii) \$2 per page of copies; and

(iii) if certification is requested, \$28.

(c) Record of mortgage. This section does not require a fee with respect to a record of a mortgage which is effective as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut under section 9502(c) (relating to record of mortgage as financing statement). However, the recording and satisfaction fees that otherwise would be applicable to the record of the mortgage apply.

(d) Variation by regulation. Within 90 days of the effective date of this subsection, the Department of State shall promulgate regulations regarding the fees required by subsections (a) and (b). The department shall establish fees required by subsection (a)(1)(i) that generate revenue equivalent to the amount collected from UCC filing fees by all counties during calendar year 2000. The department shall establish fees required by subsection (a)(1)(ii) which generate revenue equivalent to the amount collected from UCC filing fees and deposited in the General Fund and the Corporation Bureau Restricted Account during fiscal year 1999-2000. Changes in the fees shall be promulgated as a final-form regulation with proposed rulemaking omitted in accordance with the act of June 25, 1982 (P.L.633, No.181), known as the Regulatory Review Act. After July 1, 2001, the department may promulgate regulations in accordance with the Regulatory Review Act regarding the fees required by subsections (a) and (b) for services rendered by the department. Fee regulations promulgated by the department under this subsection shall supersede the fees listed in subsections (a) and (b).

Official Comment

§ 9526. Filing-office rules.

(a) Adoption of filing-office rules. The Department of State shall promulgate rules to implement this division. The filing-office rules must be consistent with this division.

(b) Harmonization of rules. To keep the filing-office rules and practices of the filing office in harmony with the rules and practices of filing offices in other jurisdictions which enact substantially this chapter and to keep the technology used by the filing office compatible with the technology used by filing offices in other jurisdictions which enact substantially this chapter, the department, so far as is consistent with the purposes, policies and provisions of this division, in promulgating filing-office rules, shall:

- (1) consult with filing offices in other jurisdictions which enact substantially this chapter;
- (2) consult the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators or any successor organization; and
- (3) take into consideration the rules and practices of and the technology used by filing offices in other jurisdictions which enact substantially this chapter. Cross References. Section 9526 is referred to in section 9102 of this title.

Official Comment

§ 9527. Duty to report.

The Department of State shall report by October 31 of every even-numbered year to the Governor and the General Assembly on the operation of the filing office. The report must contain a statement of the extent to which:

(1) the filing-office rules are not in harmony with the rules of filing offices in other jurisdictions which enact substantially this chapter and the reasons for these variations; and

(2) the filing-office rules are not in harmony with the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators or any successor organization and the reasons for these variations.

[Official Comment](#)

Chapter 96. Default.

Subchapter A. Default and Enforcement of Security Interest.

§ 9601. Rights after default; judicial enforcement; consignor or buyer of accounts, chattel paper, payment intangibles or promissory notes.

(a) Rights of secured party after default. After default, a secured party has the rights provided in this chapter and, except as otherwise provided in section 9602 (relating to waiver and variance of rights and duties), those provided by agreement of the parties. A secured party:

- (1) may reduce a claim to judgment, foreclose or otherwise enforce the claim, security interest or agricultural lien by any available judicial procedure; and
- (2) if the collateral is documents, may proceed either as to the documents or as to the goods they cover.

(b) Rights and duties of secured party in possession or control. A secured party in possession of collateral or control of collateral under section 7106 (relating to control of electronic document of title), 9104 (relating to control of deposit account), 9105 (relating to control of electronic chattel paper), 9106 (relating to control of investment property) or 9107 (relating to control of letter-of-credit right) has the rights and duties provided in section 9207 (relating to rights and duties of secured party having possession or control of collateral).

(c) Rights cumulative; simultaneous exercise. The rights under subsections (a) and (b) are cumulative and may be exercised simultaneously.

(d) Rights of debtor and obligor. Except as otherwise provided in subsection (g) and section 9605 (relating to unknown debtor or secondary obligor), after default, a debtor and an obligor have the rights provided in this chapter and by agreement of the parties.

(e) Lien of levy after judgment. If a secured party has reduced its claim to judgment, the lien of any levy which may be made upon the collateral by virtue of an execution based upon the judgment relates back to the earliest of:

- (1) the date of perfection of the security interest or agricultural lien in the collateral;

- (2) the date of filing a financing statement covering the collateral; or
- (3) any date specified in a statute under which the agricultural lien was created.

(f) Execution sale. A sale pursuant to an execution is a foreclosure of the security interest or agricultural lien by judicial procedure within the meaning of this section. A secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this division.

(g) Consignor or buyer of certain rights to payment. Except as otherwise provided in section 9607(c) (relating to commercially reasonable collection and enforcement), this chapter imposes no duties upon a secured party that is a consignor or is a buyer of accounts, chattel paper, payment intangibles or promissory notes.

Official Comment

§ 9602. Waiver and variance of rights and duties.

Except as otherwise provided in section 9624 (relating to waiver), to the extent that they give rights to a debtor or obligor and impose duties on a secured party, the debtor or obligor may not waive or vary the rules stated in:

- (1) section 9207(b)(4)(iii) (relating to expenses, risks, duties and rights when secured party in possession);
- (2) section 9210 (relating to request for accounting; request regarding list of collateral or statement of account);
- (3) section 9607(c) (relating to commercially reasonable collection and enforcement);
- (4) sections 9608(a) (relating to application of proceeds, surplus and deficiency if obligation secured) and 9615(c) (relating to application of noncash proceeds) to the extent that they deal with application or payment of noncash proceeds of collection, enforcement or disposition;
- (5) sections 9608(a) and 9615(d) (relating to surplus or deficiency if obligation secured) to the extent that they require accounting for or payment of surplus proceeds of collateral;
- (6) section 9609 (relating to secured party's right to take possession after default) to the extent that it imposes upon a secured party that takes possession of collateral without judicial process the duty to do so without breach of the peace;
- (7) sections 9610(b) (relating to commercially reasonable disposition), 9611 (relating to notification before disposition of collateral), 9613 (relating to contents and form of

notification before disposition of collateral: general) and 9614 (relating to contents and form of notification before disposition of collateral: consumer-goods transaction);

(8) section 9615(f) (relating to calculation of surplus or deficiency in disposition to person related to secured party);

(9) section 9616 (relating to explanation of calculation of surplus or deficiency);

(10) sections 9620 (relating to acceptance of collateral in full or partial satisfaction of obligation; compulsory disposition of collateral), 9621 (relating to notification of proposal to accept collateral) and 9622 (relating to effect of acceptance of collateral);

(11) section 9623 (relating to right to redeem collateral);

(12) section 9624 (relating to waiver); and

(13) sections 9625 (relating to remedies for secured party's failure to comply with division) and 9626 (relating to action in which deficiency or surplus is in issue).

[Official Comment](#)

§ 9603. Agreement on standards concerning rights and duties.

(a) Agreed standards. The parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party under a rule stated in section 9602 (relating to waiver and variance of rights and duties) if the standards are not manifestly unreasonable.

(b) Agreed standards inapplicable to breach of peace. Subsection (a) does not apply to the duty under section 9609 (relating to secured party's right to take possession after default) to refrain from breaching the peace.

[Official Comment](#)

§ 9604. Procedure if security agreement covers real property or fixtures.

(a) Enforcement: personal and real property. If a security agreement covers both personal and real property, a secured party may proceed:

(1) under this chapter as to the personal property without prejudicing any rights with respect to the real property; or

(2) as to both the personal property and the real property in accordance with the rights with respect to the real property, in which case the other provisions of this chapter do not apply.

(b) Enforcement: fixtures. Subject to subsection (c), if a security agreement covers goods which are or become fixtures, a secured party may proceed:

- (1) under this chapter; or
- (2) in accordance with the rights with respect to real property, in which case the other provisions of this chapter do not apply.

(c) Removal of fixtures. Subject to the other provisions of this chapter, if a secured party holding a security interest in fixtures has priority over all owners and encumbrancers of the real property, the secured party, after default, may remove the collateral from the real property.

(d) Injury caused by removal. A secured party that removes collateral shall promptly reimburse any encumbrancer or owner of the real property, other than the debtor, for the cost of repair of any physical injury caused by the removal. The secured party need not reimburse the encumbrancer or owner for any diminution in value of the real property caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse.

Official Comment

§ 9605. Unknown debtor or secondary obligor.

A secured party does not owe a duty based on its status as secured party to any of the following:

- (1) A person that is a debtor or obligor unless the secured party knows:
 - (i) that the person is a debtor or obligor;
 - (ii) the identity of the person; and
 - (iii) how to communicate with the person.
- (2) A secured party or lienholder that has filed a financing statement against a person unless the secured party knows:
 - (i) that the person is a debtor; and
 - (ii) the identity of the person.

Official Comment

§ 9606. Time of default for agricultural lien.

For purposes of this chapter, a default occurs in connection with an agricultural lien at the time the secured party becomes entitled to enforce the lien in accordance with the statute under which it was created.

Official Comment

§ 9607. Collection and enforcement by secured party.

(a) Collection and enforcement generally. If so agreed, and in any event after default, a secured party:

- (1) may notify an account debtor or other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party;
- (2) may take any proceeds to which the secured party is entitled under section 9315 (relating to secured party's rights on disposition of collateral and in proceeds);
- (3) may enforce the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor with respect to the obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor and with respect to any property which secures the obligations of the account debtor or other person obligated on the collateral;
- (4) if the secured party holds a security interest in a deposit account perfected by control under section 9104(a)(1) (relating to requirements for control), may apply the balance of the deposit account to the obligation secured by the deposit account; and
- (5) if the secured party holds a security interest in a deposit account perfected by control under section 9104(a)(2) or (3), may instruct the bank to pay the balance of the deposit account to or for the benefit of the secured party.

(b) Nonjudicial enforcement of mortgage. If necessary to enable a secured party to exercise under subsection (a)(3) the right of a debtor to enforce a mortgage nonjudicially, the secured party may record in the office in which a record of the mortgage is recorded:

- (1) A copy of the security agreement which creates or provides for a security interest in the obligation secured by the mortgage.
- (2) The secured party's sworn affidavit in recordable form stating that:
 - (i) a default has occurred with respect to the obligation secured by the mortgage; and
 - (ii) the secured party is entitled to enforce the mortgage nonjudicially.

(c) Commercially reasonable collection and enforcement. A secured party shall proceed in a commercially reasonable manner if the secured party:

- (1) undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral; and
- (2) is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or a secondary obligor.

(d) Expenses of collection and enforcement. A secured party may deduct from the collections made pursuant to subsection (c) reasonable expenses of collection and enforcement, including reasonable attorney fees and legal expenses incurred by the secured party.

(e) Duties to secured party not affected. This section does not determine whether an account debtor, bank or other person obligated on collateral owes a duty to a secured party.

Official Comment

§ 9608. Application of proceeds of collection or enforcement; liability for deficiency and right to surplus.

(a) Application of proceeds, surplus and deficiency if obligation secured. If a security interest or agricultural lien secures payment or performance of an obligation, the following rules apply:

- (1) A secured party shall apply or pay over for application the cash proceeds of collection or enforcement under section 9607 (relating to collection and enforcement by secured party) in the following order to:
 - (i) the reasonable expenses of collection and enforcement and, to the extent provided for by agreement and not prohibited by law, reasonable attorney fees and legal expenses incurred by the secured party;
 - (ii) the satisfaction of obligations secured by the security interest or agricultural lien under which the collection or enforcement is made; and
 - (iii) the satisfaction of obligations secured by any subordinate security interest in or other lien on the collateral subject to the security interest or agricultural lien under which the collection or enforcement is made if the secured party receives an authenticated demand for proceeds before distribution of the proceeds is completed.
- (2) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder complies, the secured party need not comply with the holder's demand under paragraph (1)(iii).

(3) A secured party need not apply or pay over for application noncash proceeds of collection and enforcement under section 9607 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(4) A secured party shall account to and pay a debtor for any surplus, and the obligor is liable for any deficiency.

(b) No surplus or deficiency in sales of certain rights to payment. If the underlying transaction is a sale of accounts, chattel paper, payment intangibles or promissory notes, the debtor is not entitled to any surplus and the obligor is not liable for any deficiency.

Official Comment

§ 9609. Secured party's right to take possession after default.

(a) Possession; rendering equipment unusable; disposition on debtor's premises. After default, a secured party:

- (1) may take possession of the collateral; and
- (2) without removal, may render equipment unusable and dispose of collateral on a debtor's premises under section 9610 (relating to disposition of collateral after default).

(b) Judicial and nonjudicial process. A secured party may proceed under subsection (a):

- (1) pursuant to judicial process; or
- (2) without judicial process if it proceeds without breach of the peace.

(c) Assembly of collateral. If so agreed, and in any event after default, a secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties.

Official Comment

§ 9610. Disposition of collateral after default.

(a) Disposition after default. After default, a secured party may sell, lease, license or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.

(b) Commercially reasonable disposition. Every aspect of a disposition of collateral, including the method, manner, time, place and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private

proceedings, by one or more contracts, as a unit or in parcels and at any time and place and on any terms.

(c) Purchase by secured party. A secured party may purchase collateral:

- (1) at a public disposition; or
- (2) at a private disposition only if the collateral is of a kind which is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

(d) Warranties on disposition. A contract for sale, lease, license or other disposition includes the warranties relating to title, possession, quiet enjoyment and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.

(e) Disclaimer of warranties. A secured party may disclaim or modify warranties under subsection (d):

- (1) in a manner which would be effective to disclaim or modify the warranties in a voluntary disposition of property of the kind subject to the contract of disposition; or
- (2) by communicating to the purchaser a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.

(f) Record sufficient to disclaim warranties. A record is sufficient to disclaim warranties under subsection (e) if it indicates "There is no warranty relating to title, possession, quiet enjoyment or the like in this disposition" or uses words of similar import.

Official Comment

§ 9611. Notification before disposition of collateral.

(a) Notification date. As used in this section, the term "notification date" means the earlier of the date on which:

- (1) a secured party sends to the debtor and any secondary obligor an authenticated notification of disposition; or
- (2) the debtor and any secondary obligor waive the right to notification.

(b) Notification of disposition required. Except as otherwise provided in subsection (d), a secured party that disposes of collateral under section 9610 (relating to disposition of collateral after default) shall send to the persons specified in subsection (c) a reasonable authenticated notification of disposition.

(c) Persons to be notified. To comply with subsection (b), the secured party shall send an authenticated notification of disposition to all of the following:

- (1) The debtor.
 - (2) Any secondary obligor.
 - (3) If the collateral is other than consumer goods, all of the following:
 - (i) Any other person from which the secured party has received, before the notification date, an authenticated notification of a claim of an interest in the collateral.
 - (ii) Any other secured party or lienholder that, ten days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement which:
 - (A) identified the collateral;
 - (B) was indexed under the debtor's name as of that date; and
 - (C) was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date.
 - (iii) Any other secured party that, ten days before the notification date, held a security interest in the collateral perfected by compliance with a statute, regulation or treaty described in section 9311(a) (relating to security interest subject to other law).
- (d) Subsection (b) inapplicable: perishable collateral; recognized market.** Subsection (b) does not apply if the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.
- (e) Compliance with subsection (c)(3)(ii).** A secured party complies with the requirement for notification prescribed by subsection (c)(3)(ii) if both of the following paragraphs apply:
- (1) Not later than 20 days or earlier than 30 days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the office indicated in subsection (c)(3)(ii).
 - (2) Before the notification date, the secured party:
 - (i) did not receive a response to the request for information; or
 - (ii) received a response to the request for information and sent an authenticated notification of disposition to each secured party or other lienholder named in that response whose financing statement covered the collateral.

Official Comment

§ 9612. Timeliness of notification before disposition of collateral.

(a) Reasonable time is question of fact. Except as otherwise provided in subsection (b), whether a notification is sent within a reasonable time is a question of fact.

(b) Ten-day period sufficient in nonconsumer transaction. In a transaction other than a consumer transaction, a notification of disposition sent after default and ten days or more before the earliest time of disposition set forth in the notification is sent within a reasonable time before the disposition.

Official Comment

§ 9613. Contents and form of notification before disposition of collateral: general.

Except in a consumer-goods transaction, the following rules apply:

(1) The contents of a notification of disposition are sufficient if the notification:

- (i) describes the debtor and the secured party;
- (ii) describes the collateral which is the subject of the intended disposition;
- (iii) states the method of intended disposition;
- (iv) states that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting; and
- (v) states the time and place of a public disposition or the time after which any other disposition is to be made.

(2) Whether the contents of a notification which lacks any of the information specified in paragraph (1) are nevertheless sufficient is a question of fact.

(3) The contents of a notification providing substantially the information specified in paragraph (1) are sufficient even if the notification includes:

- (i) information not specified by that paragraph; or
- (ii) minor errors which are not seriously misleading.

(4) A particular phrasing of the notification is not required.

(5) The following form of notification and the form appearing in section 9614(3) (relating to contents and form of notification before disposition of collateral: consumer-goods transaction), when completed, each provides sufficient information:

NOTIFICATION OF DISPOSITION OF COLLATERAL

To: _____ (Name of debtor, obligor or other person to which the notification is sent)

From: _____ (Name, address and telephone number of secured party)

Name of Debtor(s): _____ (include only if debtor(s) are not an addressee)

(For a public disposition:)

We will sell (or lease or license, as applicable) the _____ (describe collateral) (to the highest qualified bidder) in public as follows:

Day and Date: _____

Time: _____

Place: _____

(For a private disposition:)

We will sell (or lease or license, as applicable) the _____ (describe collateral) privately sometime after _____ (day and date).

You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell (or lease or license, as applicable) (for a charge of \$______). You may request an accounting by calling us at _____ (telephone number).

(End of Form)

Official Comment

§ 9614. Contents and form of notification before disposition of collateral: consumer-goods transaction.

In a consumer-goods transaction, the following rules apply:

(1) A notification of disposition must provide the following information:

- (i) the information specified in section 9613(1) (relating to contents and form of notification before disposition of collateral: general);
- (ii) a description of any liability for a deficiency of the person to which the notification is sent;
- (iii) a telephone number from which the amount which must be paid to the secured party to redeem the collateral under section 9623 (relating to right to redeem collateral) is available; and
- (iv) a telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

(2) A particular phrasing of the notification is not required.

(3) The following form of notification, when completed, provides sufficient information:

_____ (Name and address of secured party)

_____ (Date)

NOTICE OF OUR PLAN TO SELL PROPERTY

_____ (Name and address of any obligor who is also a debtor)

Subject: _____ (Identification of transaction)

We have your _____ (describe collateral) because you broke promises in our agreement.

(For a public disposition:)

We will sell _____ (describe collateral) at public sale. A sale could include a lease or license. The sale will be held as follows:

Date: _____

Time: _____

Place: _____

You may attend the sale and bring bidders if you want.

(For a private disposition:)

We will sell _____ (describe collateral) at private sale sometime after _____ (date). A sale could include a lease or license. The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you (will or will not, as applicable) still owe us the difference. If we get more money than you owe, you will get the extra money unless we must pay it to someone else. You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at _____ (telephone number). If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at

_____ (telephone number) (or write us at _____ (secured party's address)) and request a written explanation. (We will charge you \$ _____ for the explanation if we sent you another written explanation of the amount you owe us within the last six months.) If you need more information about the sale, call us at _____ (telephone number) (or write us at _____ (secured party's address)). We are sending this notice to the following other people who have an interest in

_____ (describe collateral) or who owe money under your agreement:

_____ (Names of all other debtors and obligors, if any)

(End of Form)

(4) A notification in the form of paragraph (3) is sufficient even if additional information appears at the end of the form.

(5) A notification in the form of paragraph (3) is sufficient even if it includes errors in information not required by paragraph (1) unless the error is misleading with respect to rights arising under this division.

(6) If a notification under this section is not in the form of paragraph (3), law other than this division determines the effect of including information not required by paragraph (1).

Official Comment

§ 9615. Application of proceeds of disposition; liability for deficiency and right to surplus.

(a) Application of proceeds. A secured party shall apply or pay over for application the cash proceeds of disposition under section 9610 (relating to disposition of collateral after default) in the following order to:

- (1) The reasonable expenses of retaking, holding, preparing for disposition, processing and disposing and, to the extent provided for by agreement and not prohibited by law, reasonable attorney fees and legal expenses incurred by the secured party.
- (2) The satisfaction of obligations secured by the security interest or agricultural lien under which the disposition is made.
- (3) The satisfaction of obligations secured by any subordinate security interest in or other subordinate lien on the collateral if:
 - (i) the secured party receives from the holder of the subordinate security interest or other lien an authenticated demand for proceeds before distribution of the proceeds is completed; and
 - (ii) in a case in which a consignor has an interest in the collateral, the subordinate security interest or other lien is senior to the interest of the consignor.
- (4) A secured party that is a consignor of the collateral if the secured party receives from the consignor an authenticated demand for proceeds before distribution of the proceeds is completed.

(b) Proof of subordinate interest. If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder does so, the secured party need not comply with the holder's demand under subsection (a)(3).

(c) Application of noncash proceeds. A secured party need not apply or pay over for application noncash proceeds of disposition under section 9610 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(d) Surplus or deficiency if obligation secured. If the security interest under which a disposition is made secures payment or performance of an obligation, after making the payments and applications required by subsection (a) and permitted by subsection (c):

- (1) unless subsection (a)(4) requires the secured party to apply or pay over cash proceeds to a consignor, the secured party shall account to and pay a debtor for any surplus; and
- (2) the obligor is liable for any deficiency.

(e) No surplus or deficiency in sales of certain rights to payment. If the underlying transaction is a sale of accounts, chattel paper, payment intangibles or promissory notes:

- (1) the debtor is not entitled to any surplus; and
- (2) the obligor is not liable for any deficiency.

(f) Calculation of surplus or deficiency in disposition to person related to secured party.

The surplus or deficiency following a disposition is calculated based on the amount of proceeds which would have been realized in a disposition complying with this chapter to a transferee other than the secured party, a person related to the secured party or a secondary obligor if:

- (1) the transferee in the disposition is the secured party, a person related to the secured party or a secondary obligor; and
- (2) the amount of proceeds of the disposition is significantly below the range of proceeds which a complying disposition to a person other than the secured party, a person related to the secured party or a secondary obligor would have brought.

(g) Cash proceeds received by junior secured party. A secured party that receives cash proceeds of a disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien which is not subordinate to the security interest or agricultural lien under which the disposition is made:

- (1) takes the cash proceeds free of the security interest or other lien;
- (2) is not obligated to apply the proceeds of the disposition to the satisfaction of obligations secured by the security interest or other lien; and
- (3) is not obligated to account to or pay the holder of the security interest or other lien for any surplus.

Official Comment

§ 9616. Explanation of calculation of surplus or deficiency.

(a) Definitions. As used in this section, the following words and phrases shall have the meanings given to them in this subsection:

"Explanation." A writing which:

- (1) states the amount of the surplus or deficiency;
- (2) provides an explanation in accordance with subsection (c) of how the secured party calculated the surplus or deficiency;

(3) states, if applicable, that future debits, credits, charges, including additional credit service charges or interest, rebates and expenses may affect the amount of the surplus or deficiency; and

(4) provides a telephone number or mailing address from which additional information concerning the transaction is available.

"Request." A record:

- (1) authenticated by a debtor or consumer obligor;
- (2) requesting that the recipient provide an explanation; and
- (3) sent after disposition of the collateral under section 9610 (relating to disposition of collateral after default).

(b) Explanation of calculation. In a consumer-goods transaction in which the debtor is entitled to a surplus or a consumer obligor is liable for a deficiency under section 9615 (relating to application of proceeds of disposition; liability for deficiency and right to surplus), the secured party shall comply with one of the following paragraphs:

- (1) Send an explanation to the debtor or consumer obligor, as applicable, after the disposition and:
 - (i) before or when the secured party accounts to the debtor and pays any surplus or first makes written demand on the consumer obligor after the disposition for payment of the deficiency; and
 - (ii) within 14 days after receipt of a request.
- (2) In the case of a consumer obligor who is liable for a deficiency, within 14 days after receipt of a request, send to the consumer obligor a record waiving the secured party's right to a deficiency.

(c) Required information. To comply with paragraph (2) of the definition of the term "explanation" in subsection (a), a writing must provide the following information in the following order:

- (1) The aggregate amount of obligations secured by the security interest under which the disposition was made and, if the amount reflects a rebate of unearned interest or credit service charge, an indication of that fact, calculated as of a specified date:
 - (i) if the secured party takes or receives possession of the collateral after default, not more than 35 days before the secured party takes or receives possession; or

- (ii) if the secured party takes or receives possession of the collateral before default or does not take possession of the collateral, not more than 35 days before the disposition.
- (2) The amount of proceeds of the disposition.
- (3) The aggregate amount of the obligations after deducting the amount of proceeds.
- (4) The amount, in the aggregate or by type, and types of expenses, including expenses of retaking, holding, preparing for disposition, processing and disposing of the collateral and attorney fees secured by the collateral which are known to the secured party and relate to the current disposition.
- (5) The amount, in the aggregate or by type and types of credits, including rebates of interest or credit service charges, to which the obligor is known to be entitled and which are not reflected in the amount in paragraph (1).
- (6) The amount of the surplus or deficiency.

(d) Substantial compliance. A particular phrasing of the explanation is not required. An explanation complying substantially with the requirements of subsection (a) is sufficient even if it includes minor errors which are not seriously misleading.

(e) Charges for responses. A debtor or consumer obligor is entitled without charge to one response to a request under this section during any six-month period in which the secured party did not send to the debtor or consumer obligor an explanation pursuant to subsection (b)(1). The secured party may require payment of a charge not exceeding \$25 for each additional response.

Official Comment

§ 9617. Rights of transferee of collateral.

(a) Effects of disposition. A secured party's disposition of collateral after default:

- (1) transfers to a transferee for value all of the debtor's rights in the collateral;
- (2) discharges the security interest under which the disposition is made; and
- (3) discharges any subordinate security interest or other subordinate lien.

(b) Rights of good-faith transferee. A transferee that acts in good faith takes free of the rights and interests described in subsection (a) even if the secured party fails to comply with this division or the requirements of any judicial proceeding.

(c) Rights of other transferee. If a transferee does not take free of the rights and interests described in subsection (a), the transferee takes the collateral subject to:

- (1) the debtor's rights in the collateral;
- (2) the security interest or agricultural lien under which the disposition is made; and
- (3) any other security interest or other lien.

Official Comment

§ 9618. Rights and duties of certain secondary obligors.

(a) Rights and duties of secondary obligor. A secondary obligor acquires the rights and becomes obligated to perform the duties of the secured party after the secondary obligor:

- (1) receives an assignment of a secured obligation from the secured party;
- (2) receives a transfer of collateral from the secured party and agrees to accept the rights and assume the duties of the secured party; or
- (3) is subrogated to the rights of a secured party with respect to collateral.

(b) Effect of assignment, transfer or subrogation. An assignment, transfer or subrogation described in subsection (a):

- (1) is not a disposition of collateral under section 9610 (relating to disposition of collateral after default); and
- (2) relieves the secured party of further duties under this division.

Official Comment

§ 9619. Transfer of record or legal title.

(a) Transfer statement. As used in this section, the term "transfer statement" means a record authenticated by a secured party stating:

- (1) that the debtor has defaulted in connection with an obligation secured by specified collateral;
- (2) that the secured party has exercised its postdefault remedies with respect to the collateral;
- (3) that, by reason of the exercise, a transferee has acquired the rights of the debtor in the collateral; and
- (4) the name and mailing address of the secured party, debtor and transferee.

(b) Effect of transfer statement. A transfer statement entitles the transferee to the transfer of record of all rights of the debtor in the collateral specified in the statement in any official filing, recording, registration or certificate-of-title system covering the collateral. If a transfer statement is presented with the applicable fee and request form to the official or office responsible for maintaining the system, the official or office shall:

- (1) accept the transfer statement;
- (2) promptly amend its records to reflect the transfer; And
- (3) if applicable, issue a new appropriate certificate of title in the name of the transferee.

(c) Transfer not a disposition; no relief of secured party's duties. A transfer of the record or legal title to collateral to a secured party under subsection (b) or otherwise is not of itself a disposition of collateral under this division and does not of itself relieve the secured party of its duties under this division.

Official Comment

§ 9620. Acceptance of collateral in full or partial satisfaction of obligation; compulsory disposition of collateral.

(a) Conditions to acceptance in satisfaction. Except as otherwise provided in subsection (g), a secured party may accept collateral in full or partial satisfaction of the obligation it secures only if all of the following paragraphs apply:

- (1) The debtor consents to the acceptance under subsection (c).
- (2) The secured party does not receive, within the time set forth in subsection (d), a notification of objection to the proposal authenticated by:
 - (i) a person to which the secured party was required to send a proposal under section 9621 (relating to notification of proposal to accept collateral); or
 - (ii) any other person, other than the debtor, holding an interest in the collateral subordinate to the security interest which is the subject of the proposal.
- (3) If the collateral is consumer goods, the collateral is not in the possession of the debtor when the debtor consents to the acceptance.
- (4) Subsection (e) does not require the secured party to dispose of the collateral or the debtor waives the requirement pursuant to section 9624 (relating to waiver).

(b) Purported acceptance ineffective. A purported or apparent acceptance of collateral under this section is ineffective unless:

(1) the secured party consents to the acceptance in an authenticated record or sends a proposal to the debtor; and

(2) the conditions of subsection (a) are met.

(c) Debtor's consent. For purposes of this section:

(1) A debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default.

(2) A debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default or the secured party:

(i) sends to the debtor after default a proposal which is unconditional or subject only to a condition that collateral not in the possession of the secured party be preserved or maintained;

(ii) in the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and

(iii) does not receive a notification of objection authenticated by the debtor within 20 days after the proposal is sent.

(d) Effectiveness of notification. To be effective under subsection (a)(2), a notification of objection must be received by the secured party:

(1) In the case of a person to which the proposal was sent pursuant to section 9621, within 20 days after notification was sent to that person.

(2) In other cases:

(i) within 20 days after the last notification was sent pursuant to section 9621; or

(ii) if a notification was not sent, before the debtor consents to the acceptance under subsection (c).

(e) Mandatory disposition of consumer goods. A secured party that has taken possession of collateral shall dispose of the collateral pursuant to section 9610 (relating to disposition of collateral after default) within the time specified in subsection (f) if:

(1) 60% of the cash price has been paid in the case of a purchase-money security interest in consumer goods; or

(2) 60% of the principal amount of the obligation secured has been paid in the case of a nonpurchase-money security interest in consumer goods.

(f) Compliance with mandatory disposition requirement. To comply with subsection (e), the secured party shall dispose of the collateral:

(1) within 90 days after taking possession; or

(2) within any longer period to which the debtor and all secondary obligors have agreed in an agreement to that effect entered into and authenticated after default.

(g) No partial satisfaction in consumer transaction. In a consumer transaction, a secured party may not accept collateral in partial satisfaction of the obligation it secures.

Official Comment

§ 9621. Notification of proposal to accept collateral.

(a) Persons to which proposal to be sent. A secured party that desires to accept collateral in full or partial satisfaction of the obligation it secures shall send its proposal to all of the following:

(1) Any person from which the secured party has received, before the debtor consented to the acceptance, an authenticated notification of a claim of an interest in the collateral.

(2) Any other secured party or lienholder that, ten days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected by the filing of a financing statement which:

(i) identified the collateral;

(ii) was indexed under the debtor's name as of that date; and

(iii) was filed in the office or offices in which to file a financing statement against the debtor covering the collateral as of that date.

(3) Any other secured party that, ten days before the debtor consented to the acceptance, held a security interest in the collateral perfected by compliance with a statute, regulation or treaty described in section 9311(a) (relating to security interest subject to other law).

(b) Proposal to be sent to secondary obligor in partial satisfaction. A secured party that desires to accept collateral in partial satisfaction of the obligation it secures shall send its proposal to any secondary obligor in addition to the persons described in subsection (a).

Official Comment

§ 9622. Effect of acceptance of collateral.

(a) Effect of acceptance. A secured party's acceptance of collateral in full or partial satisfaction of the obligation it secures:

- (1) discharges the obligation to the extent consented to by the debtor;
- (2) transfers to the secured party all of a debtor's rights in the collateral;
- (3) discharges the security interest or agricultural lien which is the subject of the debtor's consent and any subordinate security interest or other subordinate lien; and
- (4) terminates any other subordinate interest.

(b) Discharge of subordinate interest notwithstanding noncompliance. A subordinate interest is discharged or terminated under subsection (a) even if the secured party fails to comply with this division.

Official Comment

§ 9623. Right to redeem collateral.

(a) Persons that may redeem. A debtor, any secondary obligor or any other secured party or lienholder may redeem collateral.

(b) Requirements for redemption. To redeem collateral, a person shall tender:

- (1) fulfillment of all obligations secured by the collateral; and
- (2) the reasonable expenses and attorney fees described in section 9615(a)(1) (relating to application of proceeds).

(c) When redemption may occur. A redemption may occur at any time before a secured party:

- (1) has collected collateral under section 9607 (relating to collection and enforcement by secured party);
- (2) has disposed of collateral or entered into a contract for its disposition under section 9610 (relating to disposition of collateral after default); or
- (3) has accepted collateral in full or partial satisfaction of the obligation it secures under section 9622 (relating to effect of acceptance of collateral).

Official Comment

§ 9624. Waiver.

(a) Waiver of disposition notification. A debtor or secondary obligor may waive the right to notification of disposition of collateral under section 9611 (relating to notification before disposition of collateral) only by an agreement to that effect entered into and authenticated after default.

(b) Waiver of mandatory disposition. A debtor may waive the right to require disposition of collateral under section 9620(e) (relating to mandatory disposition of consumer goods) only by an agreement to that effect entered into and authenticated after default.

(c) Waiver of redemption right. Except in a consumer-goods transaction, a debtor or secondary obligor may waive the right to redeem collateral under section 9623 (relating to right to redeem collateral) only by an agreement to that effect entered into and authenticated after default.

Official Comment

Subchapter B. Noncompliance with Division.

§ 9625. Remedies for secured party's failure to comply with division.

(a) Judicial orders concerning noncompliance. If it is established that a secured party is not proceeding in accordance with this division, a court may order or restrain collection, enforcement or disposition of collateral on appropriate terms and conditions.

(b) Damages for noncompliance. Subject to subsections (c), (d) and (f), a person is liable for damages in the amount of any loss caused by a failure to comply with this division. Loss caused by a failure to comply may include loss resulting from the debtor's inability to obtain or increased costs of alternative financing.

(c) Persons entitled to recover damages; statutory damages in consumer-goods transaction. Except as otherwise provided in section 9628 (relating to nonliability and limitation on liability of secured party; liability of secondary obligor):

(1) a person that, at the time of the failure, was a debtor, was an obligor or held a security interest in or other lien on the collateral may recover damages under subsection (b) for its loss; and

(2) if the collateral is consumer goods, a person that was a debtor or a secondary obligor at the time a secured party failed to comply with this chapter may recover for that failure in any event an amount not less than the credit service charge plus 10% of the principal amount of the obligation or the time price differential plus 10% of the cash price.

(d) Recovery when deficiency eliminated or reduced. A debtor whose deficiency is eliminated under section 9626 (relating to action in which deficiency or surplus is in issue) may recover damages for the loss of any surplus. However, a debtor or secondary obligor whose deficiency is eliminated or reduced under section 9626 may not otherwise recover under subsection (b) for

noncompliance with the provisions of this chapter relating to collection, enforcement, disposition or acceptance.

(e) Statutory damages: noncompliance with specified provisions. In addition to any damages recoverable under subsection (b), the debtor, consumer obligor or person named as a debtor in a filed record, as applicable, may recover \$500 from a person that:

- (1) fails to comply with section 9208 (relating to additional duties of secured party having control of collateral);
- (2) fails to comply with section 9209 (relating to duties of secured party if account debtor has been notified of assignment);
- (3) files a record which the person is not entitled to file under section 9509(a) (relating to person entitled to file record);
- (4) fails to cause the secured party of record to file or send a termination statement as required by section 9513(a) or (c) (relating to termination statement);
- (5) fails to comply with section 9616(b)(1) (relating to explanation of calculation of surplus or deficiency), and the failure is part of a pattern or consistent with a practice of noncompliance; or
- (6) fails to comply with section 9616(b)(2).

(f) Statutory damages: noncompliance with section 9210. A debtor or consumer obligor may recover damages under subsection (b) and, in addition, \$500 in each case from a person that, without reasonable cause, fails to comply with a request under section 9210. A recipient of a request under section 9210 which never claimed an interest in the collateral or obligations which are the subject of a request under that section has a reasonable excuse for failure to comply with the request within the meaning of this subsection.

(g) Limitation of security interest: noncompliance with section 9210. If a secured party fails to comply with a request regarding a list of collateral or a statement of account under section 9210, the secured party may claim a security interest only as shown in the list or statement included in the request as against a person that is reasonably misled by the failure.

Official Comment

§ 9626. Action in which deficiency or surplus is in issue.

(a) Applicable rules if amount of deficiency or surplus in issue. In an action arising from a transaction, other than a consumer transaction, in which the amount of a deficiency or surplus is in issue, the following rules apply:

- (1) A secured party need not prove compliance with the provisions of this chapter relating to collection, enforcement, disposition or acceptance unless the debtor or a secondary obligor places the secured party's compliance in issue.
- (2) If the secured party's compliance is placed in issue, the secured party has the burden of establishing that the collection, enforcement, disposition or acceptance was conducted in accordance with this chapter.
- (3) Except as otherwise provided in section 9628 (relating to nonliability and limitation on liability of secured party; liability of secondary obligor), if a secured party fails to prove that the collection, enforcement, disposition or acceptance was conducted in accordance with the provisions of this chapter relating to collection, enforcement, disposition or acceptance, the liability of a debtor or a secondary obligor for a deficiency is limited to an amount by which the sum of the secured obligation, expenses and attorney fees exceeds the greater of:
 - (i) the proceeds of the collection, enforcement, disposition or acceptance; or
 - (ii) the amount of proceeds which would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this chapter relating to collection, enforcement, disposition or acceptance.
- (4) For purposes of paragraph (3)(ii), the amount of proceeds which would have been realized is equal to the sum of the secured obligation, expenses and attorney fees unless the secured party proves that the amount is less than that sum.
- (5) If a deficiency or surplus is calculated under section 9615(f) (relating to calculation of surplus or deficiency in disposition to person related to secured party), the debtor or obligor has the burden of establishing that the amount of proceeds of the disposition is significantly below the range of prices which a complying disposition to a person other than the secured party, a person related to the secured party or a secondary obligor would have brought.

(b) Nonconsumer transactions; no inference. The limitation of the rules in subsection (a) to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. The court may not infer from that limitation the nature of the proper rule in consumer transactions and may continue to apply established approaches.

Official Comment

§ 9627. Determination of whether conduct was commercially reasonable.

(a) Greater amount obtainable under other circumstances; no preclusion of commercial reasonableness. The fact that a greater amount could have been obtained by a collection, enforcement, disposition or acceptance at a different time or in a different method from that

selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition or acceptance was made in a commercially reasonable manner.

(b) Dispositions which are commercially reasonable. A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

- (1) in the usual manner on any recognized market;
- (2) at the price current in any recognized market at the time of the disposition; or
- (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property which was the subject of the disposition.

(c) Approval by court or on behalf of creditors. A collection, enforcement, disposition or acceptance is commercially reasonable if it has been approved:

- (1) in a judicial proceeding;
- (2) by a bona fide creditors' committee;
- (3) by a representative of creditors; or
- (4) by an assignee for the benefit of creditors.

(d) Approval under subsection (c) not necessary; absence of approval has no effect.

Approval under subsection (c) need not be obtained, and lack of approval does not mean that the collection, enforcement, disposition or acceptance is not commercially reasonable.

Official Comment

§ 9628. Nonliability and limitation on liability of secured party; liability of secondary obligor.

(a) Limitation of liability of secured party for noncompliance with division. Unless a secured party knows that a person is a debtor or obligor, knows the identity of the person and knows how to communicate with the person:

- (1) the secured party is not liable to the person or to a secured party or lienholder that has filed a financing statement against the person for failure to comply with this division; and
- (2) the secured party's failure to comply with this division does not affect the liability of the person for a deficiency.

(b) Limitation of liability based on status as secured party. A secured party is not liable because of its status as secured party to any of the following:

(1) A person that is a debtor or obligor unless the secured party knows:

- (i) that the person is a debtor or obligor;
- (ii) the identity of the person; and
- (iii) how to communicate with the person.

(2) A secured party or lienholder that has filed a financing statement against a person unless the secured party knows:

- (i) that the person is a debtor; and
- (ii) the identity of the person.

(c) Limitation of liability if reasonable belief that transaction not a consumer-goods transaction or consumer transaction. A secured party is not liable to any person, and a person's liability for a deficiency is not affected, because of any act or omission arising out of the secured party's reasonable belief that a transaction is not a consumer-goods transaction or a consumer transaction or that goods are not consumer goods if the secured party's belief is based on its reasonable reliance on:

- (1) a debtor's representation concerning the purpose for which collateral was to be used, acquired or held; or
- (2) an obligor's representation concerning the purpose for which a secured obligation was incurred.

(d) Limitation of liability for statutory damages. A secured party is not liable to any person under section 9625(c)(2) (relating to remedies for secured party's failure to comply with division) for its failure to comply with section 9616 (relating to explanation of calculation of surplus or deficiency).

(e) Limitation of multiple liability for statutory damages. A secured party is not liable under section 9625(c)(2) more than once with respect to any one secured obligation.

Official Comment

Chapter 97. Transition Provisions.

§ 9700. Definitions.

The following words and terms when used in this chapter shall have the meanings given to them in this section:

"Former Division 9." The provisions of this title, other than Division 5 (relating to letters of credit), as in effect before the effective date of Revised Division 9.

"Revised Division 9." The provisions of this title, other than sections 5101 (relating to short title of division) through 5117 (relating to subrogation of issuer, applicant and nominated person), as amended by the Uniform Commercial Code Modernization Act of 2001 and as they may be further amended.

§ 9701. Effective date.

Revised Division 9 takes effect on July 1, 2001.

§ 9702. Savings clause.

(a) Pre-effective-date transactions or liens. Except as otherwise provided in this chapter, Revised Division 9 applies to a transaction or lien within its scope even if the transaction or lien was entered into or created before the effective date of Revised Division 9.

(b) Continuing validity. Except as otherwise provided in subsection (c) and sections 9703 (relating to security interest perfected before effective date) through 9709 (relating to priority) of Revised Division 9:

(1) transactions and liens which were not governed by Former Division 9, were validly entered into or created before the effective date of Revised Division 9 and would be subject to Revised Division 9 if they had been entered into or created after the effective date of Revised Division 9 and the rights, duties and interests flowing from those transactions and liens remain valid after the effective date of Revised Division 9; and

(2) transactions and liens may be terminated, completed, consummated and enforced as required or permitted by Revised Division 9 or by the law which otherwise would apply if Revised Division 9 had not taken effect.

(c) Pre-effective-date proceedings. Revised Division 9 does not affect an action, case or proceeding commenced before the effective date of Revised Division 9.

§ 9703. Security interest perfected before effective date.

(a) Continuing priority over lien creditor: perfection requirements satisfied. A security interest which is enforceable immediately before the effective date of Revised Division 9 and would have priority over the rights of a person that becomes a lien creditor at that time is a perfected security interest under Revised Division 9 if, when Revised Division 9 takes effect, the applicable requirements for enforceability and perfection under Revised Division 9 are satisfied without further action.

(b) Continuing priority over lien creditor: perfection requirements not satisfied. Except as otherwise provided in section 9705 of Revised Division 9 (relating to effectiveness of action

taken before effective date), if, immediately before Revised Division 9 takes effect, a security interest is enforceable and would have priority over the rights of a person that becomes a lien creditor at that time, but the applicable requirements for enforceability or perfection under Revised Division 9 are not satisfied when Revised Division 9 takes effect, the security interest:

- (1) is a perfected security interest for one year after Revised Division 9 takes effect;
- (2) remains enforceable thereafter only if the security interest becomes enforceable under section 9203 of Revised Division 9 (relating to attachment and enforceability of security interest; proceeds; supporting obligations; formal requisites) before the year expires; and
- (3) remains perfected thereafter only if the applicable requirements for perfection under Revised Division 9 are satisfied before the year expires.

§ 9704. Security interest unperfected before effective date.

A security interest which is enforceable immediately before Revised Division 9 takes effect but which would be subordinate to the rights of a person that becomes a lien creditor at that time:

- (1) Remains an enforceable security interest for one year after Revised Division 9 takes effect.
- (2) Remains enforceable thereafter if the security interest becomes enforceable under section 9203 of Revised Division 9 (relating to attachment and enforceability of security interest; proceeds; supporting obligations; formal requisites) when Revised Division 9 takes effect or within one year thereafter.
- (3) Becomes perfected:
 - (i) without further action when Revised Division 9 takes effect if the applicable requirements for perfection under Revised Division 9 are satisfied before or at that time; or
 - (ii) when the applicable requirements for perfection are satisfied if the requirements are satisfied after that time.

§ 9705. Effectiveness of action taken before effective date.

(a) Pre-effective-date action; one-year perfection period unless reperfected. If action, other than the filing of a financing statement, is taken before Revised Division 9 takes effect and the action would have resulted in priority of a security interest over the rights of a person that becomes a lien creditor had the security interest become enforceable before Revised Division 9 takes effect, the action is effective to perfect a security interest which attaches under Revised Division 9 within one year after Revised Division 9 takes effect. An attached security interest becomes unperfected one year after Revised Division 9 takes effect unless the security interest

becomes a perfected security interest under Revised Division 9 before the expiration of that period.

(b) Pre-effective-date filing. The filing of a financing statement before July 1, 2001, is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under Revised Division 9, and the effectiveness of such a financing statement shall not be affected by subsection (c).

(c) Pre-effective-date filing in jurisdiction formerly governing perfection. Revised Division 9 does not render ineffective an effective financing statement which, before Revised Division 9 takes effect, is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in section 9103 of Former Division 9 (relating to perfection of security interests in multiple state transactions). However, except as otherwise provided in subsections (d) and (e) and section 9706 of Revised Division 9 (relating to when initial financing statement suffices to continue effectiveness of financing statement), the financing statement ceases to be effective at the earlier of:

- (1) the time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed; or
- (2) June 30, 2006.

(d) Continuation statement.

(1) Except as set forth in paragraph (2), the filing of a continuation statement after Revised Division 9 takes effect does not continue the effectiveness of the financing statement filed before Revised Division 9 takes effect.

(2) Notwithstanding paragraph (1), upon the timely filing of a continuation statement after Revised Division 9 takes effect and in accordance with the law of the jurisdiction governing perfection as provided in Chapter 93 of Revised Division 9 (relating to perfection and priority), the effectiveness of a financing statement filed in the same office in that jurisdiction before Revised Division 9 takes effect continues for the period provided by the law of that jurisdiction. Filing of a continuation statement shall be timely under this paragraph if the filing occurs before the financing statement ceases to be effective but not before the earlier of:

- (i) December 30, 2005; or
- (ii) six months before the financing statement ceases to be effective.

(e) Application of subsection (c)(2) to transmitting utility financing statement. Subsection (c)(2) applies to a financing statement which, before Revised Division 9 takes effect, is filed against a transmitting utility and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in section 9103 of Former Division 9 only to the extent that Chapter 93 of Revised Division 9 provides that the law of a jurisdiction

other than the jurisdiction in which the financing statement is filed governs perfection of a security interest in collateral covered by the financing statement.

(f) Application of Chapter 95. A financing statement which includes a financing statement filed before Revised Division 9 takes effect and a continuation statement filed after Revised Division 9 takes effect is effective only to the extent that it satisfies the requirements of Chapter 95 of Revised Division 9 (relating to filing) for an initial financing statement.

(June 30, 2006, P.L.290, No.64, eff. imd.) 2006 Amendment. Act 64 amended subsecs. (b) and (d). Section 2 of Act 64 provided that nothing in the amendment of subsecs. (b) or (d) shall render ineffective a continuation statement that was filed prior to the effective date of section 2.

§ 9706. When initial financing statement suffices to continue effectiveness of financing statement.

(a) Initial financing statement in lieu of continuation statement. The filing of an initial financing statement in the office specified in section 9501 of Revised Division 9 (relating to filing office) continues the effectiveness of a financing statement filed before Revised Division 9 takes effect if:

- (1) the filing of an initial financing statement in that office would be effective to perfect a security interest under Revised Division 9;
- (2) the pre-effective-date financing statement was filed in an office in another state or another office in this Commonwealth;
- (3) the initial financing statement satisfies subsection (c); and
- (4) with respect to a pre-effective-date financing statement which, but for section 9705(c)(2) (relating to effectiveness of action taken before effective date), would cease to be effective after June 30, 2006, the initial financing statement is filed:
 - (i) after December 29, 2005; and
 - (ii) before July 1, 2006.

(b) Period of continued effectiveness. The filing of an initial financing statement under subsection (a) continues the effectiveness of the pre-effective-date financing statement:

- (1) if the initial financing statement is filed before Revised Division 9 takes effect, for the period provided in section 9403 of Former Division 9 (relating to what constitutes filing; duration of filing; effect of lapsed filing; duties of filing officer) with respect to a financing statement; and
- (2) if the initial financing statement is filed after Revised Division 9 takes effect, for the period provided in section 9515 of Revised Division 9 (relating to duration and

effectiveness of financing statement; effect of lapsed financing statement) with respect to an initial financing statement.

(c) Requirements for initial financing statement under subsection (a). To be effective for purposes of subsection (a), an initial financing statement must:

- (1) satisfy the requirements of Chapter 95 of Revised Division 9 (relating to filing) for an initial financing statement;
- (2) identify the pre-effective-date financing statement by indicating the office in which the financing statement was filed and providing the dates of filing and file numbers, if any, of the financing statement and of the most recent continuation statement filed with respect to the financing statement; and
- (3) indicate that the pre-effective-date financing statement remains effective.

(June 30, 2006, P.L.290, No.64, eff. imd.) 2006 Amendment. Act 64 amended subsec. (a). Section 2 of Act 64 provided that nothing in the amendment of subsec. (a) shall render ineffective a continuation statement that was filed prior to the effective date of section 2.

§ 9707. Amendment of pre-effective-date financing statement.

(a) Pre-effective-date financing statement. In this section, "pre-effective-date financing statement" means a financing statement filed before Revised Division 9 takes effect.

(b) Applicable law. After Revised Division 9 takes effect, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or otherwise amend the information provided in, a pre-effective-date financing statement only in accordance with the law of the jurisdiction governing perfection as provided in Chapter 93 of Revised Division 9 (relating to perfection and priority). However, the effectiveness of a pre-effective-date financing statement also may be terminated in accordance with the law of the jurisdiction in which the financing statement is filed.

(c) Method of amending: general rule. Except as otherwise provided in subsection (d), if the law of this Commonwealth governs perfection of a security interest, the information in a pre-effective-date financing statement may be amended after Revised Division 9 takes effect only if:

- (1) the pre-effective-date financing statement and an amendment are filed in the office specified in section 9501 of Revised Division 9 (relating to filing office);
- (2) an amendment is filed in the office specified in section 9501 of Revised Division 9 concurrently with, or after the filing in that office of, an initial financing statement that satisfies section 9706(c) of Revised Division 9 (relating to when initial financing statement suffices to continue effectiveness of financing statement); or

(3) an initial financing statement that provides the information as amended and satisfies section 9706(c) of Revised Division 9 is filed in the office specified in section 9501 of Revised Division 9.

(d) Method of amending: continuation. If the law of this Commonwealth governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement may be continued only under section 9705(d) and (f) of Revised Division 9 (relating to effectiveness of action taken before effective date) or section 9706 of Revised Division 9.

(e) Methods of amending: additional termination rule. Whether or not the law of this Commonwealth governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement filed in this Commonwealth may be terminated after Revised Division 9 takes effect by filing a termination statement in the office in which the pre-effective-date financing statement is filed unless one or both of the following conditions apply:

(1) An initial financing statement that satisfies section 9706(c) of Revised Division 9 has been filed in the office specified by the law of the jurisdiction governing perfection as provided in Chapter 93 of Revised Division 9 as the office in which to file a financing statement.

(2) The pre-effective-date financing statement is filed in the office of a prothonotary of a county of this Commonwealth.

§ 9708. Persons entitled to file initial financing statement or continuation statement.

A person may file an initial financing statement or a continuation statement under this chapter if all of the following paragraphs apply:

(1) The secured party of record authorizes the filing.

(2) The filing is necessary under this chapter:

(i) to continue the effectiveness of a financing statement filed before Revised Division 9 takes effect; or

(ii) to perfect or continue the perfection of a security interest.

§ 9709. Priority.

(a) Law governing priority. Revised Division 9 determines the priority of conflicting claims to collateral. However, if the relative priorities of the claims were established before Revised Division 9 takes effect, Former Division 9 determines priority.

(b) Priority if security interest becomes enforceable under section 9203 of Revised Division 9. For purposes of section 9322(a) of Revised Division 9 (relating to general priority rules), the priority of a security interest which becomes enforceable under section 9203 of Revised Division

9 (relating to attachment and enforceability of security interest; proceeds; supporting obligations; formal requisites) dates from the time Revised Division 9 takes effect if the security interest is perfected under Revised Division 9 by the filing of a financing statement before Revised Division 9 takes effect which financing statement would not have been effective to perfect the security interest under Former Division 9. This subsection does not apply to conflicting security interests each of which is perfected by the filing of such a financing statement.

§ 9710. Operations of prothonotaries' offices after effective date.

(a) Definitions. As used in this section, the following words and phrases shall have the meanings given to them in this subsection:

"Former Division 9 records." The following records:

- (1) Financing statements and other records that have been filed in a prothonotary's office pursuant to Former Division 9 before July 1, 2001, and that are, or upon processing and indexing will be, reflected in the index maintained as of June 30, 2001, by the prothonotary's office for financing statements and other records filed in the prothonotary's office before July 1, 2001.
- (2) The index as of June 30, 2001.

The term does not include records presented to a prothonotary's office for filing after June 30, 2001, whether or not the records relate to financing statements filed in the prothonotary's office before July 1, 2001.

"Prothonotary's office." The office of a prothonotary of a county of this Commonwealth.

(b) No records to be accepted after June 30, 2001. A prothonotary's office must not accept for filing a record presented after June 30, 2001, whether or not the record relates to a financing statement filed in the prothonotary's office before July 1, 2001.

(c) Maintenance of Former Division 9 records. Until July 1, 2008, each prothonotary's office must maintain all Former Division 9 records in accordance with Former Division 9. A Former Division 9 record that is not reflected on the index maintained at June 30, 2001, by the prothonotary's office must be processed and indexed and reflected on the index as of June 30, 2001, as soon as practicable but in any event no later than July 30, 2001.

(d) Response to information requests. Until June 30, 2008, each prothonotary's office shall respond to requests for information with respect to Former Division 9 records relating to a debtor and issue certificates in accordance with Former Division 9. The fees charged for responding to requests for information relating to a debtor and issuing certificates with respect to Former Division 9 records must be the fees in effect under Former Division 9 on June 30, 2001, unless a different fee is established by regulation issued by the Department of State pursuant to section 9525 of Revised Division 9 (relating to fees).

(e) Removal and destruction of Former Division 9 records. After June 30, 2008, each prothonotary's office may remove and destroy, in accordance with any then applicable record retention law of this Commonwealth, all Former Division 9 records, including the related index.

Chapter 98. Transition Provisions for 2013 Amendments.

§ 9800. Definitions.

The following words and phrases when used in this chapter shall have the meanings given to them in this section unless the context clearly indicates otherwise:

"2013 Revision." The amendments which:

(1) affect this division; and

(2) are made by the act of June 27, 2013 (P.L.154, No.30), entitled "An act amending Titles 13 (Commercial Code), 30 (Fish) and 75 (Vehicles) of the Pennsylvania Consolidated Statutes, revising secured transaction provisions relating to definitions, to control of electronic chattel paper, to location of debtor, to perfection of security interests in property subject to certain statutes, regulations and treaties, to continued perfection of security interest following change in governing law, to interests which take priority over or take free of security interest or agricultural lien, to priority of security interests created by new debtor, to discharge of account debtor, notification of assignment, identification and proof of assignment, restrictions on assignment of accounts, chattel paper, payment intangibles and promissory notes ineffective, to restrictions on assignment of promissory notes, health-care-insurance receivables and certain general intangibles ineffective, to contents of financing statement, record of mortgage as financing statement, time of filing financing statement, to name of debtor and secured party, to effect of certain events on effectiveness of financing statement, to duration and effectiveness of financing statement, effect of lapsed financing statement, to what constitutes filing, effectiveness of filing, to claim concerning inaccurate or wrongfully filed record and to collection and enforcement by secured party; providing for transition provisions for 2013 amendments; imposing duties upon the Department of State and the Department of Transportation; and making editorial changes."

§ 9801. Effective date.

The 2013 Revision takes effect July 1, 2013.

§ 9802. Savings clause.

(a) Pre-effective-date transactions or liens. Except as otherwise provided in this division, the 2013 Revision applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before the 2013 Revision takes effect.

(b) Pre-effective-date proceedings. The 2013 Revision does not affect an action, case or proceeding commenced before the 2013 Revision takes effect.

§ 9803. Security interest perfected before effective date.

(a) Continuing perfection; perfection requirements satisfied. A security interest that is a perfected security interest immediately before the 2013 Revision takes effect is a perfected security interest under this division as amended by the 2013 Revision if, when the 2013 Revision takes effect, the applicable requirements for attachment and perfection under this division as amended by the 2013 Revision are satisfied without further action.

(b) Continuing perfection; perfection requirements not satisfied. Except as otherwise provided in section 9805 (relating to effectiveness of action taken before effective date), if, immediately before the 2013 Revision takes effect, a security interest is a perfected security interest, but the applicable requirements for perfection under this division as amended by the 2013 Revision are not satisfied when the 2013 Revision takes effect, the security interest remains perfected thereafter only if the applicable requirements for perfection under this division as amended by the 2013 Revision are satisfied within one year after the 2013 Revision takes effect.

§ 9804. Security interest unperfected before effective date.

A security interest that is an unperfected security interest immediately before the 2013 Revision takes effect becomes a perfected security interest:

- (1) without further action when the 2013 Revision takes effect if the applicable requirements for perfection under this division as amended by the 2013 Revision are satisfied before or at that time; or
- (2) when the applicable requirements for perfection are satisfied if the requirements are satisfied after that time.

§ 9805. Effectiveness of action taken before effective date.

(a) Pre-effective-date filing effective. The filing of a financing statement before the 2013 Revision takes effect is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under this division as amended by the 2013 Revision.

(b) When pre-effective-date filing becomes ineffective. The 2013 Revision does not render ineffective an effective financing statement that, before the 2013 Revision takes effect, is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in this division as it existed before amendment by the 2013 Revision. However, except as otherwise provided in subsections (c) and (d) and section 9806 (relating to when initial financing statement suffices to continue effectiveness of financing statement), the financing statement ceases to be effective:

- (1) if the financing statement is filed in this Commonwealth, at the time the financing statement would have ceased to be effective had the 2013 Revision not taken effect; or

(2) if the financing statement is filed in another jurisdiction, at the earlier of:

- (i) the time the financing statement would have ceased to be effective under the law of that jurisdiction; or
- (ii) June 30, 2018.

(c) Continuation statement. The filing of a continuation statement after the 2013 Revision takes effect does not continue the effectiveness of a financing statement filed before the 2013 Revision takes effect. However, upon the timely filing of a continuation statement after the 2013 Revision takes effect and in accordance with the law of the jurisdiction governing perfection as provided in this division as amended by the 2013 Revision, the effectiveness of a financing statement filed in the same office in that jurisdiction before the 2013 Revision takes effect continues for the period provided by the law of that jurisdiction.

(d) Application of subsection (b)(2)(ii) to transmitting utility financing statement.

Subsection (b)(2)(ii) applies to a financing statement that, before the 2013 Revision takes effect, is filed against a transmitting utility and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in this division as it existed before amendment by the 2013 Revision, only to the extent that this division as amended by the 2013 Revision provides that the law of a jurisdiction other than the jurisdiction in which the financing statement is filed governs perfection of a security interest in collateral covered by the financing statement.

(e) Application of Chapter 95. A financing statement that includes a financing statement filed before the 2013 Revision takes effect and a continuation statement filed after the 2013 Revision takes effect is effective only to the extent that it satisfies the requirements of Chapter 95 (relating to filing) as amended by the 2013 Revision for an initial financing statement. A financing statement that indicates that the debtor is a decedent's estate indicates that the collateral is being administered by a personal representative within the meaning of section 9503(a)(2) (relating to name of debtor and secured party) as amended by the 2013 Revision. A financing statement that indicates that the debtor is a trust or is a trustee acting with respect to property held in trust indicates that the collateral is held in a trust within the meaning of section 9503(a)(3) as amended by the 2013 Revision.

§ 9806. When initial financing statement suffices to continue effectiveness of financing statement.

(a) Initial financing statement in lieu of continuation statement. The filing of an initial financing statement in the office specified in section 9501 (relating to filing office) continues the effectiveness of a financing statement filed before the 2013 Revision takes effect if:

- (1) the filing of an initial financing statement in that office would be effective to perfect a security interest under this division as amended by the 2013 Revision;

- (2) the pre-effective-date financing statement was filed in an office in another state; and
- (3) the initial financing statement satisfies subsection (c).

(b) Period of continued effectiveness. The filing of an initial financing statement under subsection (a) continues the effectiveness of the pre-effective-date financing statement:

- (1) if the initial financing statement is filed before the 2013 Revision takes effect, for the period provided in section 9515(a), (b), (c), (d), (e) and (g) (relating to duration and effectiveness of financing statement; effect of lapsed financing statement) with respect to an initial financing statement; and
- (2) if the initial financing statement is filed after the 2013 Revision takes effect, for the period provided in section 9515(f) as amended by the 2013 Revision with respect to an initial financing statement.

(c) Requirements for initial financing statement under subsection (a). To be effective for purposes of subsection (a), an initial financing statement must:

- (1) satisfy the requirements of Chapter 95 (relating to filing) as amended by the 2013 Revision for an initial financing statement;
- (2) identify the pre-effective-date financing statement by indicating the office in which the financing statement was filed and providing the dates of filing and file numbers, if any, of the financing statement and of the most recent continuation statement filed with respect to the financing statement; and
- (3) indicate that the pre-effective-date financing statement remains effective.

§ 9807. Amendment of pre-effective-date financing statement.

(a) Definitions. Refer to subsection (f).

(b) Applicable law. After the 2013 Revision takes effect, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or otherwise amend the information provided in, a pre-effective-date financing statement only in accordance with the law of the jurisdiction governing perfection as provided in this division as amended by the 2013 Revision. However, the effectiveness of a pre-effective-date financing statement also may be terminated in accordance with the law of the jurisdiction in which the financing statement is filed.

(c) Method of amending: general rule. Except as otherwise provided in subsection (d), if the law of this Commonwealth governs perfection of a security interest, the information in a pre-effective-date financing statement may be amended after the 2013 Revision takes effect only if:

- (1) the pre-effective-date financing statement and an amendment are filed in the office specified in section 9501 (relating to filing office);

(2) an amendment is filed in the office specified in section 9501 concurrently with, or after the filing in that office of, an initial financing statement that satisfies section 9806(c) (relating to when initial financing statement suffices to continue effectiveness of financing statement); or

(3) an initial financing statement that provides the information as amended and satisfies section 9806(c) is filed in the office specified in section 9501.

(d) Method of amending: continuation. If the law of this Commonwealth governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement may be continued only under section 9805(c) and (e) (relating to effectiveness of action taken before effective date) or 9806.

(e) Method of amending: additional termination rule. Whether or not the law of this Commonwealth governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement filed in this Commonwealth may be terminated after the 2013 Revision takes effect by filing a termination statement in the office in which the pre-effective-date financing statement is filed, unless an initial financing statement that satisfies section 9806(c) has been filed in the office specified by the law of the jurisdiction governing perfection as provided in this division as amended by the 2013 Revision as the office in which to file a financing statement.

(f) Definition. As used in this section, the term "pre-effective-date financing statement" means a financing statement filed before the 2013 Revision takes effect.

§ 9808. Person entitled to file initial financing statement or continuation statement.

A person may file an initial financing statement or a continuation statement under this part if:

(1) the secured party of record authorizes the filing; And

(2) the filing is necessary under this part:

(i) to continue the effectiveness of a financing statement filed before the 2013 Revision takes effect; or

(ii) to perfect or continue the perfection of a security interest.

§ 9809. Priority.

The 2013 Revision determines the priority of conflicting claims to collateral. However, if the relative priorities of the claims were established before the 2013 Revision takes effect, this division as it existed before amendment determines priority.

Bankruptcy Reform Act, Automatic Stay and Avoidance Powers, 11 U.S.C. § 101 et seq.

§ 101(31). Insider.

The term “insider” includes

(A) if the debtor is an individual

- (i) relative of the debtor or of a general partner of the debtor;
- (ii) partnership in which the debtor is a general partner;
- (iii) general partner of the debtor; or
- (iv) corporation of which the debtor is a director, officer, or person in control;

(B) if the debtor is a corporation

- (i) director of the debtor;
- (ii) officer of the debtor;
- (iii) person in control of the debtor;
- (iv) partnership in which the debtor is a general partner;
- (v) general partner of the debtor; or
- (vi) relative of a general partner, director, officer, or person in control of the debtor;

(C) if the debtor is a partnership

- (i) general partner in the debtor;
- (ii) relative of a general partner in, general partner of, or person in control of the debtor;
- (iii) partnership in which the debtor is a general partner;
- (iv) general partner of the debtor; or
- (v) person in control of the debtor;

(D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;

(E) affiliate, or insider of an affiliate as if such affiliate were the debtor; and

(F) managing agent of the debtor.

§ 101(32). Insolvent.

The term “insolvent” means –

(A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity’s debts is greater than all of such entity’s property, at a fair valuation, exclusive of—

- (i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity’s creditors; and
- (ii) property that may be exempted from property of the estate under section 522 of this title

§ 101(37). Lien.

The term “lien” means charge against or interest in property to secure payment of a debt or performance of an obligation.

§ 101(54). Transfer.

The term “transfer” means –

- (A) the creation of a lien;
- (B) the retention of title as a security interest;
- (C) the foreclosure of a debtor’s equity of redemption; or
- (D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with –
 - (i) property; or
 - (ii) an interest in property.

§ 361. Adequate protection.

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by

- (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
- (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
- (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

§ 362. Automatic Stay (subsections (a) and (d)(1) and (2)).

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of

- (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
- (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
- (4) any act to create, perfect, or enforce any lien against property of the estate;
- (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
- (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
- (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
- (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the

bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

- (1)** for cause, including the lack of adequate protection of an interest in property of such party in interest;
- (2)** with respect to a stay of an act against property under subsection (a) of this section, if—
 - (A)** the debtor does not have an equity in such property; and
 - (B)** such property is not necessary to an effective reorganization; ...

§ 544. Trustee as lien creditor and as successor to certain creditors and purchasers.

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by

- (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;
- (2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or
- (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

(b)

- (1) Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under

applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

(2) Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3)) that is not covered under section 548(a)(1)(B), by reason of section 548(a)(2). Any claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.

§ 545. Statutory Liens.

The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien

(1) first becomes effective against the debtor

- (A) when a case under this title concerning the debtor is commenced;
- (B) when an insolvency proceeding other than under this title concerning the debtor is commenced;
- (C) when a custodian is appointed or authorized to take or takes possession;
- (D) when the debtor becomes insolvent;
- (E) when the debtor's financial condition fails to meet a specified standard; or
- (F) at the time of an execution against property of the debtor levied at the instance of an entity other than the holder of such statutory lien;

(2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists, except in any case in which a purchaser is a purchaser described in section 6323 of the Internal Revenue Code of 1986, or in any other similar provision of State or local law;

(3) is for rent; or

(4) is a lien of distress for rent.

§ 546. Limitations on avoiding powers.

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of

- (1) the later of

- (A) 2 years after the entry of the order for relief; or
 - (B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or
- (2) the time the case is closed or dismissed.
- (b)
- (1) The rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that
 - (A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or
 - (B) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation.
- (2) If—
- (A) a law described in paragraph (1) requires seizure of such property or commencement of an action to accomplish such perfection, or maintenance or continuation of perfection of an interest in property; and
 - (B) such property has not been seized or such an action has not been commenced before the date of the filing of the petition;
- such interest in such property shall be perfected, or perfection of such interest shall be maintained or continued, by giving notice within the time fixed by such law for such seizure or such commencement.
- (c)
- (1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—
 - (A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).

(d) In the case of a seller who is a producer of grain sold to a grain storage facility, owned or operated by the debtor, in the ordinary course of such seller's business (as such terms are defined in section 557 of this title) or in the case of a United States fisherman who has caught fish sold to a fish processing facility owned or operated by the debtor in the ordinary course of such fisherman's business, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common law right of such producer or fisherman to reclaim such grain or fish if the debtor has received such grain or fish while insolvent, but—

(1) such producer or fisherman may not reclaim any grain or fish unless such producer or fisherman demands, in writing, reclamation of such grain or fish before ten days after receipt thereof by the debtor; and

(2) the court may deny reclamation to such a producer or fisherman with a right of reclamation that has made such a demand only if the court secures such claim by a lien.

(e) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(f) Notwithstanding 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer made by or to (or for the benefit of) a repo participant or financial participant, in connection with a repurchase agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(g) Notwithstanding 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer, made by or to (or for the benefit of) a swap participant or financial participant, under or in connection with any swap agreement and that is made before the commencement of the case, except under 548(a)(1)(A) of this title.

(h) Notwithstanding the rights and powers of a trustee under sections 544(a), 545, 547, 549, and 553, if the court determines on a motion by the trustee made not later than 120 days after the date of the order for relief in a case under chapter 11 of this title and after notice and a hearing, that a return is in the best interests of the estate, the debtor, with the consent of a creditor and subject to the prior rights of holders of security interests in such goods or the proceeds of such goods, may

return goods shipped to the debtor by the creditor before the commencement of the case, and the creditor may offset the purchase price of such goods against any claim of the creditor against the debtor that arose before the commencement of the case.

(i)

- (1)** Notwithstanding paragraphs (2) and (3) of section 545, the trustee may not avoid a warehouseman's lien for storage, transportation, or other costs incidental to the storage and handling of goods.
- (2)** The prohibition under paragraph (1) shall be applied in a manner consistent with any State statute applicable to such lien that is similar to section 7-209 of the Uniform Commercial Code, as in effect on the date of enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, or any successor to such section 7-209.

(j) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) the trustee may not avoid a transfer made by or to (or for the benefit of) a master netting agreement participant under or in connection with any master netting agreement or any individual contract covered thereby that is made before the commencement of the case, except under section 548(a)(1)(A) and except to the extent that the trustee could otherwise avoid such a transfer made under an individual contract covered by such master netting agreement.

§ 547. Preferences

(a) In this section—

- (1)** “inventory” means personal property leased or furnished, held for sale or lease, or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business, including farm products such as crops or livestock, held for sale or lease;
- (2)** “new value” means money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation;
- (3)** “receivable” means right to payment, whether or not such right has been earned by performance; and
- (4)** a debt for a tax is incurred on the day when such tax is last payable without penalty, including any extension.

(b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

- (1)** to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(c) The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

(3) that creates a security interest in property acquired by the debtor—

(A) to the extent such security interest secures new value that was—

- (i) given at or after the signing of a security agreement that contains a description of such property as collateral;
 - (ii) given by or on behalf of the secured party under such agreement;
 - (iii) given to enable the debtor to acquire such property; and
 - (iv) in fact used by the debtor to acquire such property; and
- (B) that is perfected on or before 30 days after the debtor receives possession of such property;
- (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—
- (A) not secured by an otherwise unavoidable security interest; and
 - (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;
- (5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of—
- (A)
 - (i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or
 - (ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or
 - (B) the date on which new value was first given under the security agreement creating such security interest;
- (6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title;
- (7) to the extent such transfer was a bona fide payment of a debt for a domestic support obligation;
- (8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than \$600; or

(9) if, in a case filed by a debtor whose debts are not primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than \$6,425.

(d) The trustee may avoid a transfer of an interest in property of the debtor transferred to or for the benefit of a surety to secure reimbursement of such a surety that furnished a bond or other obligation to dissolve a judicial lien that would have been avoidable by the trustee under subsection (b) of this section. The liability of such surety under such bond or obligation shall be discharged to the extent of the value of such property recovered by the trustee or the amount paid to the trustee.

(e)

(1) For the purposes of this section—

(A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; and

(B) a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made—

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 30 days after, such time, except as provided in subsection (c)(3)(B);

(B) at the time such transfer is perfected, if such transfer is perfected after such 30 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—

(i) the commencement of the case; or

(ii) 30 days after such transfer takes effect between the transferor and the transferee.

(3) For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

(f) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

(g) For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section.

(h) The trustee may not avoid a transfer if such transfer was made as a part of an alternative repayment schedule between the debtor and any creditor of the debtor created by an approved nonprofit budget and credit counseling agency.

(i) If the trustee avoids under subsection (b) a transfer made between 90 days and 1 year before the date of the filing of the petition, by the debtor to an entity that is not an insider for the benefit of a creditor that is an insider, such transfer shall be considered to be avoided under this section only with respect to the creditor that is an insider.

§ 548. Fraudulent transfers and obligations.

(a)

(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(B)

(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)

(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

(2) A transfer of a charitable contribution to a qualified religious or charitable entity or organization shall not be considered to be a transfer covered under paragraph (1)(B) in any case in which—

(A) the amount of that contribution does not exceed 15 percent of the gross annual income of the debtor for the year in which the transfer of the contribution is made; or

(B) the contribution made by a debtor exceeded the percentage amount of gross annual income specified in subparagraph (A), if the transfer was consistent with the practices of the debtor in making charitable contributions.

(b) The trustee of a partnership debtor may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, to a general partner in the debtor, if the debtor was insolvent on the date such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

(d)

(1) For the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer is made immediately before the date of the filing of the petition.

(2) In this section

(A) “value” means property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor;

(B) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency that receives a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, takes for value to the extent of such payment;

(C) a repo participant or financial participant that receives a margin payment, as defined in section 741 or 761 of this title, or settlement payment, as defined in section 741 of this title, in connection with a repurchase agreement, takes for value to the extent of such payment;

(D) a swap participant or financial participant that receives a transfer in connection with a swap agreement takes for value to the extent of such transfer; and

(E) a master netting agreement participant that receives a transfer in connection with a master netting agreement or any individual contract covered thereby takes for value to the extent of such transfer, except that, with respect to a transfer under any individual contract covered thereby, to the extent that such master netting agreement participant otherwise did not take (or is otherwise not deemed to have taken) such transfer for value.

(3) In this section, the term “charitable contribution” means a charitable contribution, as that term is defined in section 170(c) of the Internal Revenue Code of 1986, if that contribution—

(A) is made by a natural person; and

(B) consists of—

(i) a financial instrument (as that term is defined in section 731(c)(2)(C) of the Internal Revenue Code of 1986); or

(ii) cash.

(4) In this section, the term “qualified religious or charitable entity or organization” means—

(A) an entity described in section 170(c)(1) of the Internal Revenue Code of 1986; or

(B) an entity or organization described in section 170(c)(2) of the Internal Revenue Code of 1986.

(e)

(1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—

- (A)** such transfer was made to a self-settled trust or similar device;
- (B)** such transfer was by the debtor;
- (C)** the debtor is a beneficiary of such trust or similar device; and
- (D)** the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.

(2) For the purposes of this subsection, a transfer includes a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by, or which the debtor believed would be incurred by—

- (A)** any violation of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws; or
- (B)** fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78l and 78o(d)) or under section 6 of the Securities Act of 1933 (15 U.S.C. 77f).

§ 558. Defenses of the estate.

The estate shall have the benefit of any defense available to the debtor as against any entity other than the estate, including statutes of limitation, statutes of frauds, usury, and other personal defenses. A waiver of any such defense by the debtor after the commencement of the case does not bind the estate.

Internal Revenue Code, Federal Tax Lien Act, 20 U.S.C.

§§ 6321, 6323

§ 6321. Lien for taxes.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

§ 6323. Validity and priority against certain persons.

(a) Purchasers, holders of security interests, mechanic's lienors, and judgment lien creditors. The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary.

(b) Protection for certain interests even though notice filed. Even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid

(1) Securities. With respect to a security (as defined in subsection (h)(4))

(A) as against a purchaser of such security who at the time of purchase did not have actual notice or knowledge of the existence of such lien; and

(B) as against a holder of a security interest in such security who, at the time such interest came into existence, did not have actual notice or knowledge of the existence of such lien.

(2) Motor vehicles. With respect to a motor vehicle (as defined in subsection (h)(3)), as against a purchaser of such motor vehicle, if

(A) at the time of the purchase such purchaser did not have actual notice or knowledge of the existence of such lien, and

(B) before the purchaser obtains such notice or knowledge, he has acquired possession of such motor vehicle and has not thereafter relinquished possession of such motor vehicle to the seller or his agent.

(3) Personal property purchased at retail. With respect to tangible personal property purchased at retail, as against a purchaser in the ordinary course of the seller's trade or business, unless at the time of such purchase such purchaser intends such purchase to (or knows such purchase will) hinder, evade, or defeat the collection of any tax under this title.

(4) Personal property purchased in casual sale. With respect to household goods, personal effects, or other tangible personal property described in section 6334(a) purchased (not for resale) in a casual sale for less than \$1,000, as against the purchaser, but only if such purchaser does not have actual notice or knowledge (A) of the existence of such lien, or (B) that this sale is one of a series of sales.

(5) Personal property subject to possessory lien. With respect to tangible personal property subject to a lien under local law securing the reasonable price of the repair or improvement of such property, as against a holder of such a lien, if such holder is, and has been, continuously in possession of such property from the time such lien arose.

(6) Real property tax and special assessment liens. With respect to real property, as against a holder of a lien upon such property, if such lien is entitled under local law to priority over security interests in such property which are prior in time, and such lien secures payment of

- (A)** a tax of general application levied by any taxing authority based upon the value of such property;
- (B)** a special assessment imposed directly upon such property by any taxing authority, if such assessment is imposed for the purpose of defraying the cost of any public improvement; or
- (C)** charges for utilities or public services furnished to such property by the United States, a State or political subdivision thereof, or an instrumentality of any one or more of the foregoing.

(7) Residential property subject to a mechanic's lien for certain repairs and improvements. With respect to real property subject to a lien for repair or improvement of a personal residence (containing not more than four dwelling units) occupied by the owner of such residence, as against a mechanic's lienor, but only if the contract price on the contract with the owner is not more than \$5,000.

(8) Attorneys' liens. With respect to a judgment or other amount in settlement of a claim or of a cause of action, as against an attorney who, under local law, holds a lien upon or a contract enforceable against such judgment or amount, to the extent of his reasonable compensation for obtaining such judgment or procuring such settlement, except that this paragraph shall not apply to any judgment or amount in settlement of a claim or of a cause of action against the United States to the extent that the United States offsets such judgment or amount against any liability of the taxpayer to the United States.

(9) Certain insurance contracts. With respect to a life insurance, endowment, or annuity contract, as against the organization which is the insurer under such contract, at any time

- (A) before such organization had actual notice or knowledge of the existence of such lien;
- (B) after such organization had such notice or knowledge, with respect to advances required to be made automatically to maintain such contract in force under an agreement entered into before such organization had such notice or knowledge; or
- (C) after satisfaction of a levy pursuant to section 6332(b), unless and until the Secretary delivers to such organization a notice, executed after the date of such satisfaction, of the existence of such lien.

(10) Deposit-secured loans. With respect to a savings deposit, share, or other account, with an institution described in section 581 or 591, to the extent of any loan made by such institution without actual notice or knowledge of the existence of such lien, as against such institution, if such loan is secured by such account.

(c) Protection for certain commercial transactions financing agreements, etc.

(1) In general. To the extent provided in this subsection, even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing but which

(A) is in qualified property covered by the terms of a written agreement entered into before tax lien filing and constituting

- (i) a commercial transactions financing agreement,
- (ii) a real property construction or improvement financing agreement, or
- (iii) an obligatory disbursement agreement, and

(B) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation.

(2) Commercial transactions financing agreement. For purposes of this subsection

(A) Definition. The term “commercial transactions financing agreement” means an agreement (entered into by a person in the course of his trade or business)

- (i) to make loans to the taxpayer to be secured by commercial financing security acquired by the taxpayer in the ordinary course of his trade or business, or
- (ii) to purchase commercial financing security (other than inventory) acquired by the taxpayer in the ordinary course of his trade or business;

but such an agreement shall be treated as coming within the term only to the extent that such loan or purchase is made before the 46th day after the date of tax lien filing or (if earlier) before the lender or purchaser had actual notice or knowledge of such tax lien filing.

(B) Limitation on qualified property. The term “qualified property”, when used with respect to a commercial transactions financing agreement, includes only commercial financing security acquired by the taxpayer before the 46th day after the date of tax lien filing.

(C) Commercial financing security defined. The term “commercial financing security” means (i) paper of a kind ordinarily arising in commercial transactions, (ii) accounts receivable, (iii) mortgages on real property, and (iv) inventory.

(D) Purchaser treated as acquiring security interest. A person who satisfies subparagraph (A) by reason of clause (ii) thereof shall be treated as having acquired a security interest in commercial financing security.

(3) Real property construction or improvement financing agreement. For purposes of this subsection

(A) Definition. The term “real property construction or improvement financing agreement” means an agreement to make cash disbursements to finance

- (i)** the construction or improvement of real property,
- (ii)** a contract to construct or improve real property, or
- (iii)** the raising or harvesting of a farm crop or the raising of livestock or other animals.

For purposes of clause (iii), the furnishing of goods and services shall be treated as the disbursement of cash.

(B) Limitation on qualified property. The term “qualified property”, when used with respect to a real property construction or improvement financing agreement, includes only

- (i)** in the case of subparagraph (A)(i), the real property with respect to which the construction or improvement has been or is to be made,
- (ii)** in the case of subparagraph (A)(ii), the proceeds of the contract described therein, and

(iii) in the case of subparagraph (A)(iii), property subject to the lien imposed by section 6321 at the time of tax lien filing and the crop or the livestock or other animals referred to in subparagraph (A)(iii).

(4) Obligatory disbursement agreement. For purposes of this subsection

(A) Definition. The term “obligatory disbursement agreement” means an agreement (entered into by a person in the course of his trade or business) to make disbursements, but such an agreement shall be treated as coming within the term only to the extent of disbursements which are required to be made by reason of the intervention of the rights of a person other than the taxpayer.

(B) Limitation on qualified property. The term “qualified property”, when used with respect to an obligatory disbursement agreement, means property subject to the lien imposed by section 6321 at the time of tax lien filing and (to the extent that the acquisition is directly traceable to the disbursements referred to in subparagraph (A)) property acquired by the taxpayer after tax lien filing.

(C) Special rules for surety agreements. Where the obligatory disbursement agreement is an agreement ensuring the performance of a contract between the taxpayer and another person

- (i) the term “qualified property” shall be treated as also including the proceeds of the contract the performance of which was ensured, and
- (ii) if the contract the performance of which was ensured was a contract to construct or improve real property, to produce goods, or to furnish services, the term “qualified property” shall be treated as also including any tangible personal property used by the taxpayer in the performance of such ensured contract.

(d) 45-day period for making disbursements. Even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing by reason of disbursements made before the 46th day after the date of tax lien filing, or (if earlier) before the person making such disbursements had actual notice or knowledge of tax lien filing, but only if such security interest

(1) is in property

- (A) subject, at the time of tax lien filing, to the lien imposed by section 6321, and
- (B) covered by the terms of a written agreement entered into before tax lien filing, and

(2) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation.

(e) Priority of interest and expenses. If the lien imposed by section 6321 is not valid as against a lien or security interest, the priority of such lien or security interest shall extend to

- (1) any interest or carrying charges upon the obligation secured,
- (2) the reasonable charges and expenses of an indenture trustee or agent holding the security interest for the benefit of the holder of the security interest,
- (3) the reasonable expenses, including reasonable compensation for attorneys, actually incurred in collecting or enforcing the obligation secured,
- (4) the reasonable costs of insuring, preserving, or repairing the property to which the lien or security interest relates,
- (5) the reasonable costs of insuring payment of the obligation secured, and
- (6) amounts paid to satisfy any lien on the property to which the lien or security interest relates, but only if the lien so satisfied is entitled to priority over the lien imposed by section 6321, to the extent that, under local law, any such item has the same priority as the lien or security interest to which it relates.

(f) Place for filing notice; form.

(1) Place for filing. The notice referred to in subsection (a) shall be filed

(A) Under State laws.

(i) Real property. In the case of real property, in one office within the State (or the county, or other governmental subdivision), as designated by the laws of such State, in which the property subject to the lien is situated; and

(ii) Personal property. In the case of personal property, whether tangible or intangible, in one office within the State (or the county, or other governmental subdivision), as designated by the laws of such State, in which the property subject to the lien is situated, except that State law merely conforming to or reenacting Federal law establishing a national filing system does not constitute a second office for filing as designated by the laws of such State; or

(B) With clerk of district court. In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State has not by law designated one office which meets the requirements of subparagraph (A); or

(C) With Recorder of Deeds of the District of Columbia. In the office of the Recorder of Deeds of the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(2) Situs of property subject to lien. For purposes of paragraphs (1) and (4), property shall be deemed to be situated

(A) Real property. In the case of real property, at its physical location; or

(B) Personal property. In the case of personal property, whether tangible or intangible, at the residence of the taxpayer at the time the notice of lien is filed.

For purposes of paragraph (2)(B), the residence of a corporation or partnership shall be deemed to be the place at which the principal executive office of the business is located, and the residence of a taxpayer whose residence is without the United States shall be deemed to be in the District of Columbia.

(3) Form. The form and content of the notice referred to in subsection (a) shall be prescribed by the Secretary. Such notice shall be valid notwithstanding any other provision of law regarding the form or content of a notice of lien.

(4) Indexing required with respect to certain real property. In the case of real property, if

(A) under the laws of the State in which the real property is located, a deed is not valid as against a purchaser of the property who (at the time of purchase) does not have actual notice or knowledge of the existence of such deed unless the fact of filing of such deed has been entered and recorded in a public index at the place of filing in such a manner that a reasonable inspection of the index will reveal the existence of the deed, and

(B) there is maintained (at the applicable office under paragraph (1)) an adequate system for the public indexing of Federal tax liens, then the notice of lien referred to in subsection (a) shall not be treated as meeting the filing requirements under paragraph (1) unless the fact of filing is entered and recorded in the index referred to in subparagraph (B) in such a manner that a reasonable inspection of the index will reveal the existence of the lien.

(5) National filing systems.--The filing of a notice of lien shall be governed solely by this title and shall not be subject to any other Federal law establishing a place or places for the filing of liens or encumbrances under a national filing system.

(g) Refiling of notice. For purposes of this section

(1) General rule. Unless notice of lien is refiled in the manner prescribed in paragraph (2) during the required refiling period, such notice of lien shall be treated as filed on the

date on which it is filed (in accordance with subsection (f)) after the expiration of such refiling period.

(2) Place for filing. A notice of lien refiled during the required refiling period shall be effective only—

(A) if—

- (i) such notice of lien is refiled in the office in which the prior notice of lien was filed, and
- (ii) in the case of real property, the fact of refiling is entered and recorded in an index to the extent required by subsection (f)(4); and

(B) in any case in which, 90 days or more prior to the date of a refiling of notice of lien under subparagraph (A), the Secretary received written information (in the manner prescribed in regulations issued by the Secretary) concerning a change in the taxpayer's residence, if a notice of such lien is also filed in accordance with subsection (f) in the State in which such residence is located.

(3) Required refiling period. In the case of any notice of lien, the term “required refiling period” means

- (A) the one-year period ending 30 days after the expiration of 10 years after the date of the assessment of the tax, and
- (B) the one-year period ending with the expiration of 10 years after the close of the preceding required refiling period for such notice of lien.

(4) Transitional rule. Notwithstanding paragraph (3), if the assessment of the tax was made before January 1, 1962, the first required refiling period shall be the calendar year 1967.

(h) Definitions. For purposes of this section and section 6324

(1) Security interest. The term “security interest” means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth.

(2) Mechanic's lienor. The term “mechanic's lienor” means any person who under local law has a lien on real property (or on the proceeds of a contract relating to real property) for services, labor, or materials furnished in connection with the construction or improvement of such property. For purposes of the preceding sentence, a person has a

lien on the earliest date such lien becomes valid under local law against subsequent purchasers without actual notice, but not before he begins to furnish the services, labor, or materials.

(3) Motor vehicle. The term “motor vehicle” means a self-propelled vehicle which is registered for highway use under the laws of any State or foreign country.

(4) Security. The term “security” means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by a corporation or a government or political subdivision thereof, with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(5) Tax lien filing. The term “tax lien filing” means the filing of notice (referred to in subsection (a) of the lien imposed by section 6321.

(6) Purchaser. The term “purchaser” means a person who, for adequate and full consideration in money or money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice. In applying the preceding sentence for purposes of subsection (a) of this section, and for purposes of section 6324

- (A) a lease of property,
- (B) a written executory contract to purchase or lease property,
- (C) an option to purchase or lease property or any interest therein, or
- (D) an option to renew or extend a lease of property,

which is not a lien or security interest shall be treated as an interest in property.

(i) Special rules.

(1) Actual notice or knowledge. For purposes of this subchapter, an organization shall be deemed for purposes of a particular transaction to have actual notice or knowledge of any fact from the time such fact is brought to the attention of the individual conducting such transaction, and in any event from the time such fact would have been brought to such individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routine. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

(2) Subrogation. Where, under local law, one person is subrogated to the rights of another with respect to a lien or interest, such person shall be subrogated to such rights for purposes of any lien imposed by section 6321 or 6324.

(3) Forfeitures. For purposes of this subchapter, a forfeiture under local law of property seized by a law enforcement agency of a State, county, or other local governmental subdivision shall relate back to the time of seizure, except that this paragraph shall not apply to the extent that under local law the holder of an intervening claim or interest would have priority over the interest of the State, county, or other local governmental subdivision in the property.

(4) Cost-of-living adjustment. In the case of notices of liens imposed by section 6321 which are filed in any calendar year after 1998, each of the dollar amounts under paragraph (4) or (7) of subsection (b) shall be increased by an amount equal to

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year, determined by substituting “calendar year 1996” for “calendar year 1992” in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of \$10, such amount shall be rounded to the nearest multiple of \$10.

(j) Withdrawal of notice in certain circumstances.

(1) In general. The Secretary may withdraw a notice of a lien filed under this section and this chapter shall be applied as if the withdrawn notice had not been filed, if the Secretary determines that

(A) the filing of such notice was premature or otherwise not in accordance with administrative procedures of the Secretary,

(B) the taxpayer has entered into an agreement under section 6159 to satisfy the tax liability for which the lien was imposed by means of installment payments, unless such agreement provides otherwise,

(C) the withdrawal of such notice will facilitate the collection of the tax liability, or

(D) with the consent of the taxpayer or the National Taxpayer Advocate, the withdrawal of such notice would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.

Any such withdrawal shall be made by filing notice at the same office as the withdrawn notice. A copy of such notice of withdrawal shall be provided to the taxpayer.

(2) Notice to credit agencies, etc. Upon written request by the taxpayer with respect to whom a notice of a lien was withdrawn under paragraph (1), the Secretary shall promptly make reasonable efforts to notify credit reporting agencies, and any financial institution or creditor whose name and address is specified in such request, of the withdrawal of such notice. Any such request shall be in such form as the Secretary may prescribe.

Pennsylvania Uniform Voidable Transactions Act, 12 Pa.C.S. § 5101 et seq.

§ 5101. Short title of chapter and definitions

(a) Short title of chapter. This chapter, that was formerly cited as the Pennsylvania Uniform Fraudulent Transfer Act, shall be known and may be cited as the Pennsylvania Uniform Voidable Transactions Act.

(b) Definitions. The following words and phrases when used in this chapter shall have the meanings given to them in this subsection unless the context clearly indicates otherwise:

“Asset.” Property of a debtor. The term does not include:

- (1) property to the extent it is encumbered by a valid lien;
- (2) property to the extent it is generally exempt under nonbankruptcy law; or
- (3) an interest in property held in tenancy by the entireties to the extent it is not subject to process by a creditor holding a claim against only one tenant.

“Claim.” Except as used in “claim for relief,” a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured.

“Creditor.” A person that has a claim.

“Debt.” Liability on a claim.

“Debtor.” A person that is liable on a claim.

“Electronic.” Relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic or similar capabilities.

“Lien.” A charge against or an interest in property to secure payment of a debt or performance of an obligation. The term includes a security interest created by agreement, a judicial lien obtained by legal or equitable process or proceedings, a common law lien or a statutory lien.

“Organization.” A person other than an individual.

“Person.” An individual, partnership, estate, business or nonprofit entity, public corporation, government or governmental subdivision, agency, trust or instrumentality or other legal entity.

“Property.” Anything that may be the subject of ownership.

“Record.” Information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

“Sign.” With present intent to authenticate or adopt a record:

- (1) to execute or adopt a tangible symbol; or
- (2) to attach to or logically associate with the record an electronic symbol, sound or process.

“Transfer.” Every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset. The term includes payment of money, release, lease, license and creation of a lien or other encumbrance.

“Valid lien.” A lien that is effective against the holder of a judicial lien subsequently obtained by legal or equitable process or proceedings.

§ 5102. Insolvency

(a) General rule. A debtor is insolvent if, at fair valuation, the sum of the debtor's debts is greater than the sum of the debtor's assets.

(b) Presumption of insolvency. A debtor that is generally not paying the debtor's debts as they become due other than as a result of a bona fide dispute is presumed to be insolvent. The presumption imposes on the party against which the presumption is directed the burden of proving that the nonexistence of insolvency is more probable than its existence.

(c) Exclusion of certain assets. Assets under this section do not include property that has been transferred, concealed or removed with intent to hinder, delay or defraud creditors or that has been transferred in a manner making the transfer voidable under this chapter.

(d) Exclusion of certain debts. Debts under this section do not include an obligation to the extent it is secured by a valid lien on property of the debtor not included as an asset.

§ 5103. Value

(a) General rule. Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied, but value does not include an unperformed promise made otherwise than in the ordinary course of the promisor's business to furnish support to the debtor or another person.

(b) Reasonably equivalent value. For the purposes of sections 5104(a)(2) (relating to transfer or obligation voidable as to present or future creditor) and 5105 (relating to transfer or obligation voidable as to present creditor), a person gives reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, noncollusive foreclosure

sale or the exercise of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust or security agreement or pursuant to a regularly conducted, noncollusive execution sale.

§ 5104. Transfer or obligation voidable as to present or future creditor

(a) General rule. A transfer made or obligation incurred by a debtor is voidable as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

- (1) with actual intent to hinder, delay or defraud any creditor of the debtor; or
- (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
 - (i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
 - (ii) intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due.

(b) Certain factors. In determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether:

- (1) the transfer or obligation was to an insider;
- (2) the debtor retained possession or control of the property transferred after the transfer;
- (3) the transfer or obligation was disclosed or concealed;
- (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
- (5) the transfer was of substantially all the debtor's assets;
- (6) the debtor absconded;
- (7) the debtor removed or concealed assets;
- (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
- (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and

(11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

(c) Burden of proof. A creditor making a claim for relief under subsection (a) has the burden of proving the elements of the claim for relief by a preponderance of the evidence.

§ 5105. Transfer or obligation voidable as to present creditor

(a) General rule. A transfer made or obligation incurred by a debtor is voidable as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

(b) Burden of proof. Subject to section 5102(b) (relating to insolvency), a creditor making a claim for relief under subsection (a) has the burden of proving the elements of the claim for relief by a preponderance of the evidence.

§ 5106. When transfer is made or obligation is incurred

For the purposes of this chapter:

(1) A transfer is made:

(i) with respect to an asset that is real property other than a fixture, but including the interest of a seller or purchaser under a contract for the sale of the asset, when the transfer is so far perfected that a good faith purchaser of the asset from the debtor against which applicable law permits the transfer to be perfected cannot acquire an interest in the asset that is superior to the interest of the transferee; and

(ii) with respect to an asset that is not real property or that is a fixture, when the transfer is so far perfected that a creditor on a simple contract cannot acquire a judicial lien otherwise than under this chapter that is superior to the interest of the transferee.

(2) If applicable law permits the transfer to be perfected as provided in paragraph (1) and the transfer is not so perfected before the commencement of an action for relief under this chapter, the transfer is made immediately before the commencement of the action.

(3) If applicable law does not permit the transfer to be perfected as provided in paragraph (1), the transfer is made when it becomes effective between the debtor and the transferee.

(4) A transfer is not made until the debtor has acquired rights in the asset transferred.

(5) An obligation is incurred:

- (i) if oral, when it becomes effective between the parties; or
- (ii) if evidenced by a record, when the record signed by the obligor is delivered to or for the benefit of the obligee.

§ 5107. Remedies of creditor

(a) Available remedies. In an action for relief against a transfer or obligation under this chapter, a creditor, subject to the limitations in sections 5108 (relating to defenses, liability and protection of transferee or obligee) and 5109 (relating to extinguishment of claim for relief), may obtain:

- (1) Avoidance of the transfer or obligation to the extent necessary to satisfy the creditor's claim.
- (2) An attachment or other provisional remedy against the asset transferred or other property of the transferee if available under applicable law.
- (3) Subject to applicable principles of equity and in accordance with applicable rules of civil procedure:
 - (i) an injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property;
 - (ii) appointment of a receiver to take charge of the asset transferred or of other property of the transferee; or
 - (iii) any other relief the circumstances may require.

(b) Execution. If a creditor has obtained a judgment on a claim against the debtor, the creditor, if the court so orders, subject to the limitations of sections 5108 and 5109, may levy execution on the asset transferred or its proceeds.

§ 5108. Defenses, liability and protection of transferee or obligee

(a) Certain transfers or obligations not voidable. A transfer or obligation is not voidable under section 5104(a)(1) (relating to transfer or obligation voidable as to present or future creditor) against a person that took in good faith and for a reasonably equivalent value given the debtor or against any subsequent transferee or obligee.

(b) Judgment for certain voidable transfers. To the extent a transfer is avoidable in an action by a creditor under section 5107(a)(1)(relating to remedies of creditor), the following rules apply:

(1) Except as otherwise provided in this section, the creditor may recover judgment for the value of the asset transferred, as adjusted under subsection (c), or the amount necessary to satisfy the creditor's claim, whichever is less. The judgment may be entered against:

- (i) the first transferee of the asset or the person for whose benefit the transfer was made; or
- (ii) an immediate or mediate transferee of the first transferee, other than:
 - (A) a good faith transferee that took for value; or
 - (B) an immediate or mediate good faith transferee of a person described in clause (A).

(2) Recovery under section 5107(a)(1) or (b) of or from the asset transferred or its proceeds, by levy or otherwise, is available only against a person described in paragraph (1).

(c) Measure of recovery. If the judgment under subsection (b) is based upon the value of the asset transferred, the judgment must be for an amount equal to the value of the asset at the time of the transfer, subject to adjustment as the equities may require.

(d) Rights of good faith transferee or obligee. Notwithstanding voidability of a transfer or an obligation under this chapter, a good faith transferee or obligee is entitled, to the extent of the value given the debtor for the transfer or obligation, to:

- (1) a lien on or a right to retain an interest in the asset transferred;
- (2) enforcement of an obligation incurred; or
- (3) a reduction in the amount of the liability on the judgment.

(e) Certain transfers not voidable. A transfer is not voidable under section 5104(a)(2) or 5105 (relating to transfer or obligation voidable as to present creditor) if the transfer results from:

- (1) termination of a lease upon default by the debtor when the termination is pursuant to the lease and applicable law; or
- (2) enforcement of a security interest in compliance with 13 Pa.C.S. Div. 9 (relating to secured transactions), other than an acceptance of collateral in full or partial satisfaction of the obligations it secures under 13 Pa.C.S. § 9620 (relating to acceptance of collateral in full or partial satisfaction of obligation; compulsory disposition of collateral).

The references to 13 Pa.C.S. Div. 9 and 13 Pa.C.S. § 9620 in paragraph (2) shall also be deemed to refer to the corresponding provisions of the Uniform Commercial Code as in effect in any other jurisdiction.

(f) Burden of proof. The following rules determine the burden of proving matters referred to in this section:

- (1) A party that seeks to invoke subsection (a), (d) or (e) has the burden of proving the applicability of that subsection.
- (2) Except as otherwise provided in paragraphs (3) and (4), the creditor has the burden of proving each applicable element of subsection (b) or (c).
- (3) The transferee has the burden of proving the applicability to the transferee of subsection (b)(1)(ii)(A) or (B).
- (4) A party that seeks adjustment under subsection (c) has the burden of proving the adjustment.

(g) Standard of proof. The standard of proof required to establish matters referred to in this section is preponderance of the evidence.

§ 5109. Extinguishment of claim for relief

A claim for relief with respect to a transfer or obligation under this chapter is extinguished unless action is brought:

- (1) under section 5104(a)(1) (relating to transfer or obligation voidable as to present or future creditor), not later than four years after the transfer was made or the obligation was incurred or, if later, not later than one year after the transfer or obligation was or could reasonably have been discovered by the claimant; or
- (2) under section 5104(a)(2) or 5105(a) (relating to transfer or obligation voidable as to present creditor), not later than four years after the transfer was made or the obligation was incurred.

§ 5110. Governing law

(a) Location of debtor. In this section, the following rules determine a debtor's location:

- (1) A debtor who is an individual is located at the individual's principal residence.
- (2) A debtor that is an organization and has only one place of business is located at the organization's place of business.

(3) A debtor that is an organization and has more than one place of business is located at the organization's chief executive office.

(b) Governing law. A claim for relief in the nature of a claim for relief under this chapter is governed by the local law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred.

§ 5111. Application to series organization

(a) Separate person. A series organization and a protected series of the series organization is a separate person for purposes of this chapter, even if for other purposes a protected series is not a person separate from the series organization or other protected series of the series organization.

(b) Definitions. As used in this section, the following words and phrases shall have the meanings given to them in this subsection unless the context clearly indicates otherwise:

“Protected series.” An arrangement, however denominated, created by a series organization that, pursuant to the law under which the series organization is organized, has the characteristics specified for a series organization.

“Series organization.” An organization that, pursuant to the law under which the organization is organized, has the following characteristics:

(1) The organic record of the organization provides for creation by the organization of one or more protected series, however denominated, with respect to specified property of the organization, and for records to be maintained for each protected series that identifies the property of or associated with the protected series.

(2) Debt incurred or existing with respect to the activities of, or property of or associated with, a particular protected series is enforceable against the property of or associated with the protected series only, and not against the property of or associated with the organization or other protected series of the organization.

(3) Debt incurred or existing with respect to the activities or property of the organization is enforceable against the property of the organization only and not against the property of or associated with a protected series of the organization.

§ 5112. Supplementary provisions

Unless displaced by the provisions of this chapter, the principles of law and equity, including the law merchant and the law relating to principal and agent, estoppel, laches, fraud, misrepresentation, duress, coercion, mistake, insolvency or other validating or invalidating cause, supplement its provisions.

§ 5113. Uniformity of application and construction

This chapter shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this chapter among states enacting it.

§ 5114. Relation to Electronic Signatures in Global and National Commerce Act

This chapter modifies, limits or supersedes the Electronic Signatures in Global and National Commerce Act (Public Law 106-229, 15 U.S.C. § 7001 et seq.), but does not modify, limit or supersede section 101(c) of the Electronic Signatures in Global and National Commerce Act or authorize electronic delivery of a notice described in section 103(b) of the Electronic Signatures in Global and National Commerce Act.

Artisan's Lien Statute in Pennsylvania, 6 P.S. § 11

Hereafter where any person, corporation, firm, or copartnership may have what is known as a "common law lien" for work done or material furnished about the repair of any personal property belonging to another person, corporation, firm, or copartnership, it shall be lawful for such person, corporation, firm, or copartnership having said common law lien, while such property is in the hands of the said person, corporation, firm, or copartnership contributing such work and material, to give notice in writing to the owner of the amount of indebtedness for which said common law lien is claimed for the labor and material that has entered into the repair, alteration, improvement, or otherwise, done upon the said property. If the said claim for said work or material is not paid within thirty days the said person, corporation, firm, or copartnership to which said money is due, may proceed to sell the said property, as hereinafter provided: Provided, however, That the owner of said property, if he disputes said bill, may issue a writ of replevin, as provided by law, within the said thirty days, and the said dispute shall be settled in said action of replevin.

[Ed.- The highlighted portion of the statute dealing with disposition has been declared unconstitutional by the Pennsylvania Supreme Court.]