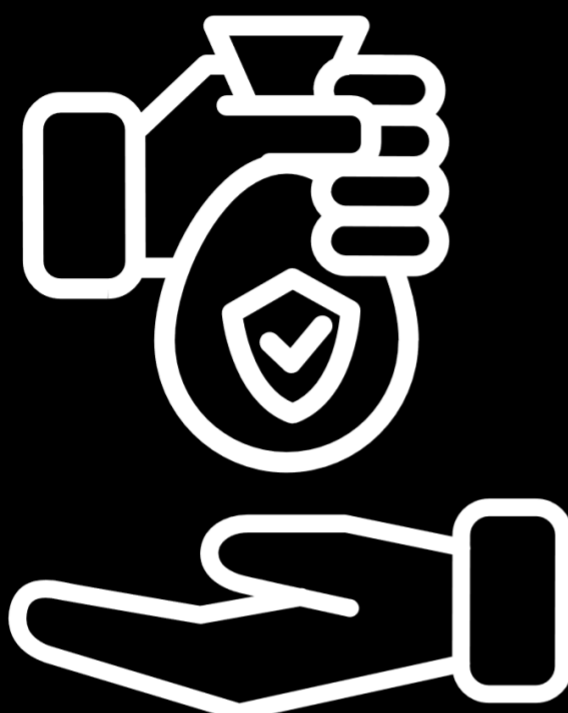
Secured Transactions

Quimbee® Outlines



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Secured Transactions

Quimbee Outlines

Table of Contents

I. Introduction to Article 9: The Law of Secured Transactions

Revised Article 9 of the Uniform Commercial Code (UCC) governs *secured transactions*, in which a consensual security interest in personal property arises in a creditor's favor to secure payment or performance of an obligation.

II. General Terminology Defined

A fundamental step to mastering Article 9 is the understanding of secured-transactions terminology.

A. Collateral

Collateral is personal property that is subject to a *security interest* or *agricultural lien*.

B. Security Interest

A security interest is a right, or interest, in personal property or fixtures. A security interest is not ownership. Rather, a security interest is a *consensual encumbrance* that secures an obligation's payment or performance, similar in concept to a mortgage on real property.

C. Purchase-Money Security Interest

A *purchase-money security interest* (PMSI) arises if the underlying obligation is incurred (1) as some or all of the *purchase price* of collateral constituting goods or software or (2) to supply value to enable the debtor to acquire rights in that collateral, if the debtor *in fact uses the value* for that purpose.

D. Debtor

A *debtor* is someone with an *interest in the collateral* other than a security interest.

E. Obligor

An *obligor* is someone who owes payment or performance of an obligation subject to a security interest in collateral. Debtors are commonly obligors.

F. Creditor

A creditor is someone to whom an obligor owes *payment or performance of an obligation*.

G. Insolvent

An obligor is insolvent if the obligor has generally *ceased to pay* or is *unable to pay* his obligations as they come due.

H. Organization

An organization is any legal or business entity other than a natural person, such as a corporation, a limited partnership, or a government agency.

I. Person

A person is either a *natural person* or an *organization*.

J. Record

A record is information either written on a physical or tangible medium, or stored electronically in such a way that one can pull it up in a perceptible form.

K. Money

Money is the actual *medium of exchange*, or currency, adopted by a domestic or foreign government.

L. Bank

A bank is a person engaged in the business of banking, such as a savings bank, a credit union, a savings-and-loan association, or a trust company.

III. Title to Collateral as Immaterial

The rights of the debtor, any obligors, the secured party, and third parties are generally the same under Article 9 regardless of whether title purportedly rests in the debtor, the secured party, or another.

IV. Subject Matter of Article 9

In general, secured-transactions law under Article 9 applies to:

- *consensual security interests* in personal property and fixtures;
- *consignments*;
- security interests in movable goods arising under *Article 2 or Article 2A* of the UCC;

- *agricultural liens*; and
- the *sale* of accounts, chattel paper, payment intangibles, and promissory notes.

A. Consensual Security Interests

A *mutually consensual* commercial transaction creating a security interest in personal property is the most common transaction subject to Article 9.

B. Fixtures

Fixtures are tangible goods that have become so integrated into real property that an interest in them arises under real-property law, *e.g.*, furnaces, central air-conditioning systems, or escalators in buildings. To determine whether something qualifies as a fixture, courts consider:

- the *intent* of the person affixing the collateral to the realty,
- the extent to which the good is *physically affixed* to the realty, and
- the degree to which the collateral has been *adapted* to the particular characteristics of the realty.

C. Consignment

A consignment is a marketing procedure by which the owner of movable goods, the *consignor*, turns the goods over to a retailer, the *consignee*, for sale to the public. Under Article 9, to qualify as a consignment:

- the consignor must deliver the goods to the consignee,
- the consignee must a *merchant* normally dealing in goods of that kind,
- the consignee must not be an auctioneer or generally known by creditors to sell others' goods,
- each delivery of goods must have an aggregate value of *$1,000 or more*,
- the goods must not be classified as consumer goods, and
- the transaction must not create a security interest securing an obligation.

D. Agricultural Liens

An agricultural lien is a *statutory, non-possessory interest* in farm products such as crops and livestock. Generally, an agricultural lien secures payment or performance of an obligation relating to goods or services provided in connection with a debtor's *farming operation*.

V. Transactions outside the Scope of Article 9

Many transactions, all of them *nonconsensual*, are outside the scope of Article 9:

- leases under UCC *Article 2A*,
- most *statutory liens* (except agricultural liens),
- transactions implicated in *federal statutes* that preempt Article 9,
- *landlord's liens*, and
- the creation or transfer of an interest in or lien on *real property* (although Article 9 does address security interests in fixtures).

VI. Classifying Collateral

Any type of personal property may be used as collateral. Article 9 breaks collateral into three broad categories:

- goods,
- quasi-tangible property, and
- intangible property.

A. Goods

Goods are tangible things *capable of moving*, including:

- consumer goods,
- farm products,
- inventory, and
- equipment.

B. Quasi-Tangible Property: Important Records

Quasi-tangible property includes:

- instruments,
- chattel paper,
- documents,
- investment property, and
- letter-of-credit rights.

C. Intangible Property

Intangible property is personal property that is *impossible to touch and move*, including:

- Accounts;
- deposit accounts;
- commercial tort claims; and
- general intangibles, such as software, causes of action, or patent rights.

VII. Attachment

Attachment means that an enforceable security interest has come to exist in the debtor's personal property, or that the creditor holding the security interest is a secured creditor with rights in the debtor's personal property. For a security interest to attach:

- the creditor must provide some *value* to the debtor;
- the debtor must have *rights* in the collateral or the power to transfer rights in the collateral to a third party; and
- in most cases, the debtor must authenticate a *written agreement* that grants the creditor rights in specific collateral and reasonably describes the collateral.

VIII. Ongoing Financial Relationships

Article 9 accommodates ongoing financial relationships by permitting the original secured transaction to cover subsequent transactions without the need to amend the security agreement. The most important of these cases are *after-acquired collateral* and *future advances.*

A. After-Acquired Collateral

Article 9 permits so-called floating liens. A floating lien is a security interest in property acquired after the security interest takes effect, typically created by an *after-acquired-property clause*.

B. Future Advances

A security agreement may contain a *future-advance clause* providing that the collateral will secure later extensions of credit, regardless of whether the secured party is obligated to extend future credit.

C. Debtor's Use of Collateral

A debtor may generally use or deal with with the collateral in any lawful manner. A secured party need not monitor the collateral or the debtor's use or movement of it.

D. Debtor's Right to Clarify the Secured Obligation

A debtor may confirm or clarify the scope of the secured obligation by sending the secured creditor a request:

- for an accounting,
- regarding a list of collateral, or
- regarding a statement of account.

IX. Perfection

Perfecting a security interest provides notice to third parties that the perfecting secured creditor has or claims an enforceable security interest in the debtor's personal property. There are five main ways for a secured party to perfect its security interest:

- the secured party may file a properly completed *financing statement* or *fixture filing* with the appropriate office;
- the secured party may *take possession* of the collateral;
- the secured party may *take control* of the collateral;
- in some cases, the secured party may be *automatically perfected* upon attachment, without further action; and
- to perfect specific types of collateral, the secured party must use the state's *certificate-of-title* system.

A. Perfection by Filing

For a financing statement to perfect a security interest, it must be (1) filed in the *appropriate office*, often the office of the secretary of state, and (2) *properly completed*, setting forth:

- the debtor's complete and correct name and mailing address,
- the name of the secured party or its representative, and
- an indication of the collateral covered by the financing statement.

A *fixture filing* includes additional information.

B. Perfection by Possession

The secured party may perfect by *taking possession* of the collateral. Possession is the *only* way to perfect a security interest in money. Other types of collateral *may* be perfected through possession.

C. Perfection by Control

If the collateral is quasi-intangible or intangible, a secured party may perfect a security interest by *taking control* of the collateral. Control is the only legitimate method to perfect a security interest in *deposit accounts* or letter-of-credit rights.

D. Automatic Perfection upon Attachment

Automatic perfection can occur on attachment with:

- a purchase-money security interest in consumer goods,
- a sale of a payment intangible or promissory note,
- an assignment of accounts or payment intangibles, or
- the proceeds of collateral.

E. Certificate-of-Title Systems

Generally, the only way to perfect a security interest in collateral subject to a certificate-of-title system (notably vehicles) is to ensure that a notation is made, or a lien is placed, on the title document for each piece of collateral.

X. Multistate Transactions, Changes

A security interest can remain perfected despite multistate transactions and changes to the debtor's name, capital structure, and other attributes.

A. Article 9 Choice-of-Law Rules

The general choice-of-law rule under Article 9 is that if the debtor is located in a particular jurisdiction, that jurisdiction's laws govern perfection and the priority of the security interest. There are many exceptions.

B. Debtors

A debtor's location may be a business's state of registration, place of business, location of executive offices, or an individual's principal residence. A security interest may lapse if the debtor changes location or name unless the secured creditor takes certain steps to continue perfection. A new debtor will often be bound by an original debtor's security agreement.

XI. Priority

Article 9's *priority rules* determine the order in which competing claimants may satisfy their claims against the *same collateral*. In general:

- the claimant with the *earlier priority date* wins (first in time, first in line);
- a secured creditor has priority over a general unsecured creditor who has not acquired a lien;
- among perfected security interests, the first to file or perfect wins;
- between two secured but unperfected creditors, the *first secured creditor to attach* its security interest has top priority;
- holders of PMSIs may have superpriority; and
- for security interests perfected by control, the secured party with control of the collateral has priority.

XII. The Possessory-Lien Creditor

A possessory lien secures an obligation for *services or materials* furnished concerning goods. A possessory lien has priority over a *prior or subsequent* security interest in the goods, unless the statute creating the lien explicitly alters this priority rule.

XIII. Purchasers v. Perfected and Unperfected Secured Parties

In general, a security interest continues to exist even if the collateral is sold, leased, exchanged, licensed, or otherwise disposed of. Exceptions include:

- buyers in the ordinary course of business,
- buyers of consumer goods from consumers,
- purchasers of chattel paper not constituting proceeds of inventory collateral, and
- purchasers of instruments.

XIV. Priority of Security Interests in Transferred Collateral

In general, a security interest created by a debtor is subordinate to a security interest created by another person if:

- the debtor acquired the collateral *subject to* the security interest that the other person created,
- that security interest *was perfected* when the debtor acquired the collateral, and
- there is *no later period* when the security interest is unperfected. [U.C.C. § 9-325(a).]

A. Fixtures, Accessions, and Commingled Goods

Goods subject to a security interest can be united with either real property or other goods in such a way that the goods change into another type of collateral if the goods become *fixtures*, *accessions*, or *commingled goods*.

B. Subordination Agreements

A party entitled to superior priority may *subordinate*, or give up, its position to another.

XV. Particular Rights and Responsibilities of Secured Creditor in Possession or Control of Collateral

A secured party in possession or control of collateral:

- must exercise reasonable care in preserving collateral in her possession;
- must keep the collateral *identifiable*;
- may hold proceeds, except money or funds, from any collateral it possesses or controls as *additional security*; and
- may generally create a *security interest* in collateral it controls or possesses.

XVI. Default

The parties themselves may agree on what constitutes default, limited only by the UCC's good-faith requirement and the general rules of contract law. After default, the secured party has these general remedies against the collateral:

- repossession,
- disposition of collateral (simple foreclosure),
- foreclosure on intangible assets, and
- strict foreclosure.

A. Repossession

A secured party is entitled to exercise self-help and take possession of tangible collateral, or disable collateral that is too heavy to move, provided that this is done without a *breach of the peace*. Best practices to avoid breaching the peace include:

- providing the debtor *notice* before the repossession,
- repossessing during *daylight hours* and on *public property*, and
- notifying the *local police* that the collateral has been lawfully repossessed.

The secured party is generally liable for any damages arising from the repossession.

B. Simple Foreclosure

Simple foreclosure means to dispose of the collateral by sale, lease, license, or other means. The terms of the simple foreclosure must be *commercially reasonable*; the secured party must take adequate steps to assure that the disposition yields a *fair price* for the collateral. The secured party may dispose of the collateral by *public or private sale*, including sale over the Internet.

C. Foreclosure on Intangible Assets

If the collateral consists of intangible assets, such as accounts, investment property, or chattel paper, the secured party may take steps to collect, from the account debtor, amounts due on the account to the debtor. Foreclosure on accounts is often done by *notification lending*, in which the secured creditor *notifies* the account debtor to pay the secured party directly. The notification serves to effectuate, and to alert the account debtor to, an *assignment* of the debtor's rights to the secured party.

D. Strict Foreclosure

Strict foreclosure occurs when a secured creditor simply *accepts the collateral* as full or partial satisfaction of the secured obligation. Strict foreclosure extinguishes the foreclosed security interest and transfers to the secured party all the debtor's rights in the collateral.

E. Redemption

The debtor, a secondary obligor, or a secured party or lienholder other than the one foreclosing may redeem the collateral. The redeeming party must tender full payment of all obligations secured by the collateral that are then due and owing, along with the reasonable expenses of foreclosure, including attorney's fees.

XVII. Assignment of Rights and Duties to Secondary Obligors

A secondary obligor may become obligated to perform the secured party's duties, and the secured party may correspondingly be relieved of those duties, if:

- the secured party *assigns its rights* to the secondary obligor,
- the secured party *transfers the collateral* to the secondary obligor, or
- the secured party *subrogates* its rights to the collateral to the secondary obligor.

I. Introduction to Article 9: The Law of Secured Transactions

Revised Article 9 of the Uniform Commercial Code (UCC) governs *secured transactions* in which, typically, a consensual security interest in personal property arises in a creditor's favor to secure payment or performance of an obligation. Personal property is any property other than real property, including movable goods used as equipment or sold as inventory, and intangible property such as patents and accounts.

II. General Terminology Defined

A fundamental step to mastering Article 9 is the understanding and proper use of secured-transactions terminology.

A. Collateral

Collateral is personal property that is subject to a *security interest* or *agricultural lien*. [*See* U.C.C. § 9-102(a)(12); Agricultural Liens, *infra*.]

B. Security Interest

A security interest is a right, or interest, in personal property or fixtures. A security interest is not ownership. Rather, a security interest is a *consensual encumbrance* that secures an obligation's payment or performance, similar in concept to a mortgage on real property. The underlying obligation is almost always to pay money; a security interest protects the creditor, in case the debt is not paid when due, by allowing the creditor to foreclose on the property, sell it, and apply the proceeds to the debt. [U.C.C. § 1-201(b)(35).]

C. Purchase-Money Security Interest

Generally, a *purchase-money security interest* (PMSI) arises if the underlying obligation is incurred (1) as some or all of the *purchase price* of collateral constituting goods or software or (2) to supply value to enable the debtor to acquire rights in (usually, to purchase) that collateral, if the debtor *in fact uses the value* for that purpose. [*See* U.C.C. § 9-103.]

Example:

A debtor needed a new computer, but she lacked either the cash to buy the computer outright or any credit card with sufficient available credit to purchase it. An electronics store offered the debtor an interest-free, two-year loan to purchase the computer. The debtor accepted the loan. The electronics store took a security interest in the computer, a movable good. That interest was a purchase-money security interest. The store extended value, by way of credit, for the debtor to use to purchase the computer, and the debtor used that value to acquire the computer. [*See* U.C.C. § 9-103.]

D. Debtor

Under Article 9, a *debtor* is someone with an *interest in the collateral other than a security interest*. This is a technical meaning that differs from the word's meaning in common parlance, in which the term typically refers to someone who owes a binding obligation to another, especially to pay money. A debtor under Article 9 need not necessarily owe any binding obligation to another. For purposes of Article 9, a debtor may also be someone selling accounts, chattel paper, payment intangibles, or promissory notes, as well as a consignee. [U.C.C. § 9-102(a)(28)(A)-(C); Consignment, *infra*.]

E. Obligor

The term *obligor*, as used in Article 9, is someone who owes payment or performance of an obligation subject to a security interest in collateral. An obligor also may be someone who has furnished property other than the collateral to secure an obligation, or someone wholly or partially accountable to pay or perform the obligation. In other words, the obligor must repay the debt owed to the creditor. Debtors are very commonly obligors, so much so that the terms are often, though incorrectly, used interchangeably. [U.C.C. § 9-102(a)(59).]

F. Creditor

A creditor is one to whom an obligor owes *payment or performance of an obligation*. A creditor may be a general unsecured creditor; a secured creditor; a lien creditor; or any representative of creditors, such as a bankruptcy trustee or an assignee for the benefit of creditors. [U.C.C. § 1-201(b)(13).]

G. Insolvent

An obligor is insolvent if the obligor (1) has generally *ceased to pay* his obligations as they come due (except insofar as the failure to pay is the result of a good-faith dispute about the obligations) or (2) is *unable to pay* his obligations as they come due. Alternatively, an obligor is insolvent under the UCC if he qualifies as insolvent under federal bankruptcy law. [U.C.C. § 1-201(b)(23).]

1. Insolvency under Federal Bankruptcy Law, Most Entities

Under federal bankruptcy law, individuals, corporations, and most unincorporated business associations are *insolvent* if the sum of their liabilities is greater than the aggregate fair value of all their property, excluding (1) property transferred, removed, or concealed with intent to defraud creditors and (2) specific types of property exempted from the claims of general creditors under state law or federal bankruptcy law (for instance, many states exempt a certain dollar value of the debtor's home's equity from general creditors' claims). [*See* 11 U.S.C. §§ 101(32)(A), 522.]

2. Insolvency under Federal Bankruptcy Law, Common-Law General Partnerships

Under federal bankruptcy law, a partnership in which the general partners are personally liable for the partnership's obligations is insolvent if the sum of the partnership's liabilities is greater than (1) the aggregate fair value of all the partnership's property (excluding fraudulently concealed, removed, or transferred property), (2) plus the amount by which the aggregate fair value of each partner's personal property (excluding exempt property and fraudulently concealed, transferred, or removed property) exceeds her personal debts. [*See* 11 U.S.C. § 101(32)(B); *Jacobs v. Altorelli (In re Dewey & LeBoeuf, LLP)*, 518 B.R. 766 (Bankr. S.D.N.Y. 2014) (defining "partnership" as used in Bankruptcy Code).]

3. Insolvency under Federal Bankruptcy Law, Municipality

Under federal bankruptcy law, a municipality is insolvent if (1) it has ceased to pay its debts as they come due (except insofar as the debts are subject to a good-faith dispute), or (2) it is unable to pay its debts as they become due. [11 U.S.C. § 101(32)(C).]

H. Organization

An organization is any legal or business entity other than a natural person. An organization may, but need not, be formally organized under any jurisdiction's laws. Examples of organizations include corporations, limited liability companies, limited partnerships, limited liability partnerships, general partnerships, joint ventures, trusts, business trusts, and government agencies. [*See* U.C.C. § 1-201(25), (27).]

I. Person

A person is either (1) a *natural person* or (2) an *organization*. [U.C.C. § 1-201(25), (27).]

J. Record

A record is, in essence, any *writing*. More particularly, a record is information either (1) written on a physical or tangible medium or (2) stored electronically (or by some other means) in such a way that one can pull it up in a perceptible form. [*See* U.C.C. § 9-102(a)(70).]

K. Money

Money is the actual *medium of exchange*, or currency, adopted by a domestic or foreign government (*e.g.*, the U.S. or Canadian dollar). [U.C.C. § 1-201(b)(24).]

L. Bank

A bank is a person engaged in the business of banking—providing financial services such as lending, managing deposit accounts, and so on. Examples include a savings bank, a credit union, a savings-and-loan association, and a trust company. [U.C.C. § 1-201(b)(4).]

III. Title to Collateral as Immaterial

For most purposes under Article 9, the state of title to the collateral is immaterial. The rights of the debtor, any obligors, the secured party, and third parties are generally the same under Article 9 regardless of whether title purportedly rests in the debtor, the secured party, or another. [U.C.C. § 9-202.]

IV. Subject Matter of Article 9

In general, secured-transactions law under Article 9 applies to:

- *consensual security interests* in personal property and fixtures;
- *consignments*;
- security interests in movable goods arising under *Article 2 or Article 2A* of the UCC;
- *agricultural liens*; and
- the *sale* of accounts, chattel paper, payment intangibles, and promissory notes.

A. Consensual Security Interests

A *mutually consensual* commercial transaction creating a security interest in personal property is the most common transaction subject to the law of secured transactions under Article 9.

Example:

A car dealership sold a fleet of cars on credit to a taxi company for use in the company's business. The dealership itself provided the credit. To secure the ensuing repayment obligation, the dealership and the company signed a security agreement giving the dealership a security interest in the cars. The security interest gave the dealer the legal right to repossess the cars, sell them, and apply the proceeds toward the debt, should the company default on its obligations to the dealer.

B. Security Interests in Fixtures

Although real property is generally outside the scope of Article 9, that article does govern the relative priority of security interests in *fixtures*. Fixtures are tangible goods that have become so integrated into real property that an interest in them arises under real-property law. Examples of fixtures include furnaces, central air-conditioning systems, elevators, or escalators in buildings. Security interests in fixtures are often subject to special rules under Article 9. [*See* U.C.C. § 9-102(a)(41); Fixture Filing, *infra*.]

1. Test to Determine What Goods Constitute Fixtures

Generally, courts evaluate all the relevant circumstances to determine whether a particular good qualifies as a fixture, considering three basic factors:

- the *intent* of the person affixing the collateral to the realty (*i.e.*, intent to make the good a part of the realty);
- the extent to which the good is *physically affixed* to the realty and, hence, the degree of damage the realty would suffer if the good were removed; and
- the degree to which the collateral has been *adapted* to the particular characteristics of the realty.

Example:

A hotelier purchased hundreds of rose bushes to plant in a rose garden at his hotel. His intent was to affix the rose bushes to the land to create an attractive feature of the hotel. The bushes were arranged in a way that was pleasing to the eye and thus enhanced the land’s value. Once the bushes were fully grown, their roots reached deep into the soil, and removing them would have been expensive and damaging to the land. The rose bushes were therefore *fixtures*. [*Adapted from Flores de N.M. v. Banda Negra Int’l., Inc. (In re Flores de N.M.*), 151 B.R. 571 (Bankr. D. N.M. 1993).]

C. Consignment

A consignment, as defined by Article 9, is a marketing procedure by which the owner of movable goods, the *consignor*, turns the goods over to a retailer, the *consignee*, for sale to the public. The retailer does not buy the goods from the consignor. Instead, the retailer is essentially the agent selling the goods on the consignor's behalf. The goods are thus *consigned* to the retailer for sale. One advantage of this procedure is that the consignor retains control over the terms of the retail sale, such as the sale price.

1. Requirements for Consignment under Article 9

Any transaction must satisfy specific requirements to qualify as a consignment under Article 9. These requirements are very technical and particular; many transactions ordinarily thought of as consignments are not true consignments for purposes of Article 9.

a. Delivery to Merchant Dealing in Goods of the Kind

The consignor must deliver the goods to the consignee, and the consignee must a *merchant* normally dealing in goods of that kind. The merchant and the consignor must operate under substantially different names. [U.C.C. § 9-102(a)(20)(A)(i).]

i. Merchant Defined

Under Article 9, a merchant is someone who

- deals in goods of the relevant kind in the normal course of business;
- holds herself out by occupation as someone with knowledge or skill specific to the relevant goods or practices; or
- may be deemed to have knowledge or skill specific to the relevant goods or practices by virtue of employing someone, such as a broker, who holds himself out by occupation as having knowledge or skill specific to the relevant goods or practices.

[U.C.C. §§ 9-102(b) (incorporating the definition of "merchant" in U.C.C. § 2-104(1)).]

b. Not an Auctioneer or Generally Known by Creditors to Sell Others' Goods

The consignee must *not be an auctioneer*, and its creditors must not generally know it to substantially engage in selling others' goods. [U.C.C. § 9-102(a)(20)(A)(ii), (iii).]

Note: This means that ordinary so-called consignment shops cannot qualify to receive consignments under Article 9, because these shops are generally known to be substantially engaged in selling others' goods.

c. Minimum $1,000 Value per Delivery, No Security Interest

Each delivery of goods from the consignor to the consignee must have an aggregate value of *$1,000 or more* at the time of the delivery. The goods must not be classified as *consumer goods* before delivery, and the transaction must not create a security interest securing an obligation. [U.C.C. § 9-102(a)(20)(B), (C), (D); Consumer Goods, *infra*.]

Example:

A jeweler operated a high-end jewelry store. The jeweler owned most of the inventory she sold, but a friend owned some of it. The friend had his own jewelry store in another state. The name of the friend's business was totally different from that of the jeweler's. Each piece of jewelry inventory the jeweler sold for the friend was valued at between $5,000 and $10,000. The arrangement between the friend and the jeweler was a consignment under Article 9. The jeweler normally dealt in jewelry in the course of her business and not under the friend's business name. The jeweler was not an auctioneer, and she did not generally sell others' goods. The friend retained ownership of the jewelry. Each delivery was worth well over $1,000 and consisted of inventory, not consumer goods, when delivered.

D. Agricultural Liens

The scope of Article 9 generally *does not* include statutory liens, such as mechanics' liens or tax liens. This is because these liens are not consensual transactions; they arise by operation of law. The *agricultural lien* is an exception. Though an agricultural lien is a statutory lien, it qualifies as a secured transaction within the scope of Article 9.

1. Agricultural Lien Defined

An agricultural lien is a *statutory, non-possessory interest* in farm products. Functionally and conceptually, an agricultural lien operates very similarly to a security interest or a mortgage, except that it arises by operation of law. Generally, an agricultural lien secures payment or performance of an obligation relating to goods or services provided in connection with a debtor's *farming operation*, created in favor of one furnishing those goods or services in the ordinary course of business. An agricultural lien may also arise in favor of someone leasing real property to the debtor, in connection with the debtor's farming operations. [U.C.C. § 9-102(a)(5).]

2. Farm Products Defined

Farm products are any goods other than standing timber that are the subject of a debtor's farming operation, including

- any supplies the debtor uses in her farming operation,
- crops,
- livestock, and
- unmanufactured products of crops and livestock.

[U.C.C. § 9-102(34).]

E. Sale of Accounts, Chattel Paper, Payment Intangibles, or Promissory Notes

Sales of quasi-intangible and intangible property such as accounts, chattel paper, payment intangibles, and promissory notes are within the scope of Article 9. These sales are commonplace in many industries. For example, a car dealer might make car loans with security interests to consumer car buyers and then sell those loans to a finance company. This is the sale of chattel paper. Similarly, a bank might sell a bundle of promissory notes, and a credit-card company might sell a bundle of accounts. These sales within the scope of Article 9.

V. Transactions outside the Scope of Article 9

Many transactions are outside the scope of Article 9. One factor that most of these excluded transactions have in common is that they are *not consensual*. Except for the agricultural lien, every commercial transaction within the scope of Article 9 is a consensual transaction between the parties. Excluded transactions include:

- leases under UCC *Article 2A*,
- most *statutory liens* (except agricultural liens),
- transactions implicated in *federal statutes* that preempt Article 9,
- *landlord's liens*, and
- the creation or transfer of an interest in or lien on *real property* (although Article 9 does address security interests in fixtures).

A. Article 2A Leases

A sale of goods on credit, in which the seller retains a security interest in the goods, is a secured transaction within the scope of Article 9. A *true lease* of goods under Article 2A is not. An example of a true lease is a situation in which a lessor leases a car to a consumer for a certain period, often three years, and the consumer then returns the car to the dealership or buys it at market value.

1. Distinguishing a Secured Transaction from a True Lease Generally

In general, the prime characteristic of a true lease is that the parties intended for the lessee to return the property to the lessor with some substantial useful life or value remaining in it. If it appears that the parties meant for the lessee to essentially purchase the property's remaining useful life, with the seller able to retake the goods in the event of a default, the arrangement is likely a secured sale on credit. A transaction is likely a *secured sale on credit* if:

- there is an option to purchase the goods for a nominal sum at the end of the lease term,
- the total rental payments approximately equal the goods' fair market value,
- the agreement gives the lessor remedies similar to those of a secured creditor, or
- the term of the lease is roughly equal to the remaining useful life of the goods.

[*See In re QDS Components, Inc.*, 292 B.R. 313 (Bankr. S.D. Ohio 2002).]

2. Distinguishing a Secured Transaction from a True Lease, Specific UCC Guidance

Under the UCC, a transaction taking the form of a lease will automatically be deemed a secured transaction, and not a true lease, if the lessee's payment obligation in exchange for using and possessing the goods persists for the whole lease term, the lessee cannot terminate the obligation, and:

- the lease's original term equals or exceeds the goods' remaining economic life;
- the lessee is obligated to either renew the lease for the goods' remaining economic life or buy the goods;
- the lessee has, at the end of the lease term (that is, upon fulfilling the lease agreement), the option either to renew the lease for the goods' remaining economic life or to buy them, for no additional consideration or for nominal consideration.

[*See* U.C.C. § 1-203(b).]

3. Nominal Consideration

Under the UCC, additional consideration to renew a lease agreement or purchase the leased goods is nominal if it is less than the lessee's reasonably predictable cost of performance under the lease, should the lessee not renew the lease or purchase the goods (as the case may be). Additional consideration is not nominal if the lease agreement states it to be the fair rental value of the goods over the renewal period or the goods' fair market value, determined as of the time the lessee exercises the option to renew or purchase. [*See* U.C.C. § 1-203.]

VI. Classifying Collateral

Any type of personal property may be used as collateral, assuming a creditor is willing to accept it. However, under Article 9, different rules apply depending on the classification of the collateral. Thus, properly classifying collateral is a crucial step in analyzing secured-transactions problems. Article 9 recognizes many discrete types of collateral. Three broad categories help organize the types of collateral into a coherent conceptual framework:

- goods,
- quasi-tangible property, and
- intangible property.

A. Goods

The UCC generally defines goods as all things that are *movable* at the time the security interest attaches to the goods. In other words, goods must be *tangible things capable of moving*, even if special equipment is needed. Examples include cars, furniture, electronics, produce, and heavy equipment. [U.C.C. § 9-102(a)(44); Attachment, *infra*.]

1. Classifying Goods

To classify particular goods, Article 9 always looks to the *debtor's use of the collateral*, not the creditor's or a third party's use. For that reason, the classification of goods may change if the debtor's use of them changes. Article 9 divides goods into four subcategories:

- consumer goods,
- farm products,
- inventory, and
- equipment.

a. Consumer Goods

Consumer goods are goods that the debtor uses or buys not mainly for business purposes, but mainly for the personal needs or wants of the debtor or the debtor's family or household. Examples include home furniture, a personal vehicle (including one used to commute to work), and personal clothing. [U.C.C. § 9-102(a)(23).]

b. Farm Products

Farm products embrace any goods other than standing timber that are the subject of a debtor's farming operation, including

- any supplies the debtor uses in the farming operation,
- crops,
- livestock, and
- unmanufactured products of crops and livestock.

[U.C.C. § 9-102(a)(34).]

c. Inventory

Inventory generally consists of goods *sold*, *leased*, or *consumed* in the debtor's business. Inventory includes five categories of goods:

- leased goods,
- goods held for sale or lease,
- goods furnished by a person under a contract of service,
- raw materials, and
- materials used or consumed in a business.

Farm products are categorically excluded from inventory, even if the particular farm products would otherwise constitute inventory. [U.C.C. § 9-102(a)(48).]

d. Equipment

Equipment is the catch-all category of goods. If the goods are not consumer goods, farm products, or inventory, then they are equipment. In general, equipment includes goods other than farm products that are *used but not sold*, *consumed*, *or leased* in the debtor's business. Examples include office paraphernalia such as computers and copiers, or kitchen apparatuses like ovens, mixers, serving utensils, and so on at a restaurant. [*See* U.C.C. § 9-102(a)(33).]

B. Quasi-Tangible Property: Important Records

Quasi-tangible property generally includes important pieces of paper recording obligations or value. The five main categories of quasi-tangible property are:

- instruments,
- chattel paper,
- documents,
- investment property, and
- letter-of-credit rights.

1. Instruments

An instrument is generally any writing that

- embodies or evidences a financial obligation (other than one arising out of the use of a credit card);
- on its own, does not evidence a lease or a security interest in specific goods; and
- in the ordinary course of business, is transferred by delivering the writing with any needed indorsement or assignment.

Common instruments include promissory notes and checks. [U.C.C. § 9-102(a)(47).]

2. Chattel Paper

Chattel paper is a record evidencing not only a monetary obligation (excluding one arising out of the use of a credit card), but also any *security interest in specific goods* that secures the obligation. The general distinction between instruments and chattel paper is that chattel paper grants a security interest, and instruments do not. Article 9 further classifies chattel paper as either *tangible* chattel paper or *electronic* chattel paper. Chattel paper is commonly created in transactions in which expensive items such as cars and equipment are purchased on credit. A series of related records, including mere instruments, may constitute chattel paper if taken together. [*See* U.C.C. § 9-102(a)(11), (31), (79).]

3. Documents

In secured-transactions law, a document is a record, or sometimes simply a receipt, of *title*. The most common example is a warehouse receipt, which a warehouse issues upon storing goods. Subsequently, anyone asking to remove the goods from storage must present this receipt to the warehouse. Without the receipt, the warehouse should not release the goods. [U.C.C. § 9-102(a)(30).]

4. Investment Property

Under Article 9, investment property includes securities, security entitlements, securities accounts, commodity contracts, and commodity accounts. A classic example of investment property is corporate stock. [U.C.C. § 9-102(a)(49).]

5. Letter-of-Credit Rights

A letter-of-credit right is a right to payment or performance manifested in a written or electronic record. The record, in turn, is one of an issuer's (often a bank's) promise to a customer that it will *honor a beneficiary's demand* for payment or performance. The beneficiary's demand may need to comply with specified conditions. In practice, the letter of credit is recognizable by its *letter format*, most often on a bank's letterhead. The letter will generally inform the potential beneficiary that the issuer has a certain sum of money available for the beneficiary's use, regardless of whether the beneficiary has yet demanded payment or performance from the issuer. Letters of credit are often used in commercial transactions, such as the sale of goods, to permit the creditor to obtain payment from the issuer directly. [U.C.C. § 9-102(a)(51); *letter of credit, commercial letter of credit,* Black's Law Dictionary (10th ed. 2014).]

C. Intangible Property

Intangible property is personal property that is impossible to touch and move. Unlike quasi-tangibles, intangible property cannot be made tangible by transcription to record form. The main types of intangible property are:

- accounts,
- deposit accounts,
- commercial tort claims, and
- general intangibles.

1. Accounts

An account is a right to payment of money, regardless of whether the right has yet been earned by performance. The right can arise in several contexts. For example, an account may be created if property is sold, leased, licensed, or assigned, or if services are rendered or to be rendered. In practice and in secondary sources, accounts are often termed *accounts receivable*. [U.C.C. § 9-102(a)(2).]

a. Account Debtor

Under Article 9, an *account debtor* is a person with an obligation to pay money that arises from or is evidenced by a general intangible, chattel paper, or an account. The term does not include a person obligated to pay on an instrument such as a promissory note, even if the instrument is a component of chattel paper. [U.C.C. § 9-102(a)(3).]

b. Health-Care-Insurance Receivables

The *health-care-insurance receivable* is a type of account. Article 9 defines a health-care-insurance receivable as a right to payment of money that arises from an insurance policy and is for healthcare goods or services. [U.C.C. § 9-102(a)(46).]

c. Assignment of Accounts

Holders of accounts may assign accounts to others. The assigning holder is the assignor, and the person receiving assignment is called the assignee. This implicates some special rules under Article 9, most of which do not apply to health-care-insurance receivables or some consumer transactions falling under federal or other consumer-protection laws.

i. Assignee Subject to Account Debtor's Defenses

Generally, the assignee's rights on an assigned account are coextensive with the assignor's. This means that the assignee's rights are subject to all terms of any agreement between the assignor and assignee, along with any other defenses the account debtor has against collection or enforcement that arose before the account debtor received notification sufficient to bind her to pay the assignee. [U.C.C. § 9-404(a).]

ii. Account Debtor's Claims for Affirmative Recovery against Assignor

Generally, the account debtor may assert against the assignee any claims arising out of the account that she could assert against the assignor. However, the account debtor's remedy against the assignee is limited to reducing the outstanding debt. [U.C.C. § 9-404(b).]

iii. Modification of Assigned Contract

In general, any modification to an assigned contract by the assignor and account debtor is effective if made in good faith. The assignee acquires rights under and is bound by the modification, but only to the extent that either (1) the right to payment under the account has not been fully earned by performance, or (2) if it has been fully earned, the account debtor has not received notice of the assignment sufficient to bind him to make payments to the assignee. The assignment agreement, however, may provide that the assignor's modification of the account is a breach. [U.C.C. § 9-405.]

iv. Effect of Assignment on Account Debtor's Obligations

Even once an account is assigned, an account debtor may discharge its obligations by continuing to pay the assignor, but only until the account debtor receives authenticated notification (from the assignor or assignee), meeting specific requirements and stating (1) that any payments due or to become due have been assigned, and (2) that the account debtor should make further payments to the assignee. At that point, the account debtor may discharge its obligations only by paying the assignee, not the assignor. Upon receiving the notification, though, the account debtor may request that the assignee furnish proof of the assignment. If the assignee does not comply, then the account debtor may continue discharging its obligations by paying the assignor. [*See* U.C.C. § 9-406(a).]

v. Terms Restricting Assignment Generally Ineffective

Generally, any term in an agreement between an assignor and account debtor (or a term in a promissory note) is not effective insofar as it (1) prohibits, purports to void, or restricts any assignment of the account (including by requiring consent from the account debtor or other person obligated on the promissory note, if any) or (2) makes the assignment a breach of contract. [*See* U.C.C. § 9-406(d).]

2. Deposit Accounts

A *deposit account* is a savings account, demand account, certificate-of-deposit account, or other account *at a bank*. Deposit accounts are not the same as accounts; Article 9 assigns a distinct meaning to each term. Properly distinguishing a deposit account from an account is crucial to properly analyzing complex commercial transactions. [*See* U.C.C. § 9-102(a)(29).]

3. Commercial Tort Claims

A *commercial tort claim* is a specialized type of civil claim for harm. Generally, a claim is a commercial tort claim if the claimant is an organization. If the claimant is a natural person, then the claim is a commercial tort claim only if it arises in the course of the natural person's profession or business. Commercial tort claims do not include damages for an individual's personal injury or death. [*See* U.C.C. § 9-102(a)(13).]

Example:

A utility company failed to maintain its power lines properly. As a result, the power lines fell and set fire to an importer's commercial warehouses, in which the importer stored imported goods for later distribution and sale. The importer's resulting claim for damages was a commercial tort claim. It did not matter whether the importer was an organization or a natural person. The claim itself related to property damage that impaired the importer's business of distributing and selling imported goods, and the claim was not for personal injury or death to a natural person.

4. General Intangibles

General intangibles are the *catch-all category* for collateral other than goods. General intangibles are defined broadly to encompass any personal property, including causes of action, that does not constitute any other specifically defined type of collateral. *Payment intangibles* and *software* are expressly included in the definition of general intangible. Other examples of general intangibles include patent rights, rights to tax refunds, liquor licenses, and rights to refunds from security retainers. [U.C.C. § 9-102(a)(42).]

a. Payment Intangibles

Payment intangibles include any general intangible in which the relevant obligation is monetary. [U.C.C. § 9-102(a)(42), (61).]

b. Software

Article 9 expressly classifies *software* as a type of general intangible. Software generally means any computer program or application, along with supporting information provided in connection with a transaction in a program or application. Software does not include any physical medium in which software is contained, such as hard disks or thumb drives. Physical media capable of containing or recording software are classified as goods, not software. [*See* U.C.C. § 9-102(a)(42), (76).]

VII. Attachment

Attachment means that an enforceable security interest has come to exist in the debtor's personal property, or that the creditor holding the security interest is a secured creditor with rights in the debtor's personal property.

A. General Requirements for Attachment

For a security interest to attach:

- the creditor must provide some *value* to the debtor;
- the debtor must have *rights* in the collateral or the power to transfer rights in the collateral to a third party; and
- in most cases, the debtor must *authenticate* a written agreement that grants the creditor *rights* in specific collateral and reasonably *describes* the collateral.

[*See* U.C.C. § 9-203(b)(1)-(3)(A).]

1. Value to the Debtor

For purposes of attachment, a creditor gives value by giving any consideration that could support formation of a simple contract. Most often, creditors give value by extending *credit*, lending money, or obligating themselves to do so in the future, regardless of whether the credit is ever drawn upon or whether the arrangement contemplates a charge-back. [U.C.C. § 1-204(1), (4).]

2. Rights in the Collateral

To create a security interest, the debtor must have either (1) rights, or some enforceable interest, in the collateral or (2) the power to transfer some enforceable interest in the collateral to a third party. This requirement is generally satisfied if the debtor *owns* the collateral, but this is not required. With a few exceptions, the debtor *need not hold title* to the collateral. For instance, if a debtor has only a valuable lease on equipment, or even the true owner's permission to create a security interest in the collateral, that is enough. [*See* U.C.C. §§ 9-202, 9-203(b)(2).]

a. Determining Whether the Debtor Has Rights in the Collateral

Article 9 does not govern whether a debtor has rights in the collateral, nor does it govern how and whether a debtor might transfer those rights. Instead, Article 2 (sale of goods), Article 2A (lease of goods), and the common law of contracts and property govern this determination. In general, one cannot give what one does not have. This means that a debtor may not use, as collateral for its transaction, property wholly belonging to another person without that person's permission. [*See, e.g.*, U.C.C. § 9-401(a).]

3. The Security Agreement

In most cases, the debtor must *authenticate* a written agreement that (1) grants the creditor *rights* in specific collateral and (2) reasonably *describes* the collateral. This written agreement is generally referred to as a *security agreement*, technically defined as any agreement creating or providing for a security interest. [*See* U.C.C. §§ 9-102(a)(74), 9-203(b)(1)-(3)(A).]

a. Authenticating the Security Agreement

To authenticate a security agreement, the parties must either (1) sign it or (2) attach or associate some electronic symbol, sound, or process with it and do so with present intent to adopt or accept it. [U.C.C. § 9-102(a)(7)(B).]

b. Description of the Collateral Generally

To create an enforceable security interest, the security agreement must *reasonably describe* the collateral with *sufficient particularity.*

i. Sufficient Particularity

Generally, the collateral description is sufficiently particular if the agreement refers to a subgroup of the debtor's property *by the term the UCC would use* to describe that class of collateral (*e.g.,* "all equipment"). A description by category, specific listing, or computational or allocational formula or procedure will also suffice. Other methods are acceptable if the collateral is *objectively identifiable*. Of course, the security agreement may describe a narrower subset of collateral (*e.g.*, "all blue tractors"), supply a unique identifying number, or reference the specific type of property to be offered (*e.g.,* "all tractors"). The security agreement need not itemize each discrete article subject to the security interest. [*See* U.C.C. § 9-108(b).]

Example:

A security agreement granted a creditor a security interest in all of the debtor's equipment. This was a sufficient description of the collateral. It referred to a subset of the debtor's property by the term *equipment*, which is the term the UCC would use to describe that type of collateral.

ii. Supergeneric Description Not Sufficient

A *supergeneric description* is not sufficient. For instance, describing the collateral as "all the debtor's assets," "all the debtor's personal property," or something similarly all-encompassing is a supergeneric description that will not pass muster. [U.C.C. § 9-108(c).]

iii. Greater Specificity Required for Particular Transactions

If the collateral consists of (1) *commercial tort claims* or, (2) in a consumer transaction, *consumer goods, a securities entitlement or account, or commodities account*, then it is not enough to describe the collateral by type alone. Greater specificity is needed. In general, for these types of collateral, the description is specific enough if it obviates any reasonable risk that the debtor will inadvertently encumber collateral not meant to be included in the transaction. [*See* U.C.C. § 9-108 cmt. 5.]

1) Commercial Tort Claims

For commercial tort claims, it is not enough merely to refer to that type of collateral by the term the UCC would use to describe it, although the agreement should do that. The agreement should also reference either the *specific lawsuit* (if one has been filed) or the *specific events* giving rise to the claims, *e.g.* "all tort claims arising out of the January 2017 building fire." [*See* U.C.C. § 9-108(e)(1).]

2) Consumer Goods in a Consumer Transaction

Ideally, if the collateral is consumer goods in a consumer transaction, the security agreement should identify the *particular goods* constituting the collateral—for instance, by serial number. [*See* U.C.C. § 9-108(e)(2).]

3) Securities or Commodity Accounts in a Consumer Transactions

Ideally, if the collateral is securities or commodities accounts in a consumer transaction, the description should list the specific accounts made subject to the security interest. [*See* U.C.C. § 9-108 cmt. 5.]

4. Exceptions to the Requirement to Describe the Collateral

There are two primary exceptions to the general rule that the parties must authenticate an agreement sufficiently describing the collateral.

a. Secured Party's Possession of Collateral Not Constituting a Certificated Security

If the collateral is *not a certificated security* and is in the *possession* of the secured party, there is *no description requirement*. This is because the possession indicates precisely what the collateral is, effectively replacing the descriptive words in the security agreement. [*See* U.C.C. § 9-203(b)(3)(B).]

b. Secured Party's Control over Particular Types of Collateral

If (1) the collateral is electronic chattel paper, investment property, a deposit account, or a letter-of-credit right, and (2) the secured party has *control* of the collateral, there *does not* need to be a written description of the collateral. In practice, there will generally be paperwork showing the secured creditor's right to control these types of collateral. [U.C.C. § 9-203(b)(3)(D); Perfection by Control, *infra*.]

VIII. Ongoing Financial Relationships

The parties to a security agreement may have *ongoing financial relationships* with each other. The drafters of Article 9 planned for ongoing financial relationships by permitting the original secured transaction to cover subsequent transactions without needing to amend the security agreement. The most important of these cases are *after-acquired collateral* and *future advances*.

A. After-Acquired Collateral: Floating Liens

A floating lien is a security interest in property acquired after the security interest takes effect. A floating lien is not a true lien in a technical sense, because a floating lien is a consensual transaction, and true liens are nonconsensual. A floating lien is typically created by an *after-acquired-property clause*. An after-acquired property clause will typically use language such as: "The debtor grants a security interest in all its inventory, *whether now owned or later acquired,* to the secured party." [*See* U.C.C. § 9-204(a).]

1. No Floating Liens in Commercial Tort Claims

Floating liens are *not permitted* in commercial tort claims. For there to be a security interest in a commercial tort claim, the claim must exist when the security agreement attaches. [U.C.C. § 9-204(b)(1).]

2. Limited Floating Lien in Consumer Goods

A floating lien is permitted over consumer goods in which the debtor has or acquires rights (usually ownership) within *10 days* after the secured party gives value. Generally, there can be no floating lien over consumer goods acquired beyond that 10-day window. [U.C.C. § 9-204(b)(1).]

B. Future Advances

The security agreement may contain a *future-advance clause* providing that the collateral will secure later extensions of credit, regardless of whether the secured party is obligated to extend future credit. Future-advance clauses are permitted; they are sometimes termed *dragnet clauses,* as they may cast a large net across all the debtor's personal property. [U.C.C. § 9-204 cmt. 5.]

C. Debtor's Ongoing Use of Collateral

A debtor may generally deal with the collateral in any lawful manner. A debtor may maintain the right or ability to use the collateral, commingle the collateral with other property, or even dispose of or transfer the collateral (including goods that are returned or repossessed); these right and actions alone will not make a security interest invalid or fraudulent against creditors other than the secured party. A secured party need not monitor the collateral or the debtor's use or movement of it. [U.C.C. § 9-205(a)(1)-(2).]

D. Debtor's Right to Transfer Collateral

Article 9 does not generally govern whether a debtor may transfer all or part its rights in collateral (*e.g.*, selling the collateral, leasing it, or creating another security interest in it); that is generally the subject of other law, such as UCC Article 2. If an agreement between the debtor and the secured party purports to bar the debtor from transferring the collateral or defines a transfer as a default, and the debtor transfers the collateral anyway, the transfer is not necessarily void. However, the transfer may be a breach of the security agreement, giving the secured party any corresponding remedies. [*See* U.C.C. § 9-401 cmt. 5.]

E. Debtor's Right to Clarify the Secured Obligation

Article 9 provides several ways for a debtor to confirm or clarify the scope of the secured obligation. Primarily, the debtor may send the secured creditor a:

- request for an accounting,
- request regarding a list of collateral, or
- request regarding a statement of account.

1. Request for an Accounting

To make a proper request for an accounting, a debtor must authenticate a record and transmit the record to the secured party. The record must request that the secured party furnish an accounting of any remaining unpaid secured obligation. The record must also reasonably identify the pertinent transaction. [U.C.C. § 9-210(a)(2).]

a. Accounting Defined

Article 9 defines an accounting as any record that a secured party authenticates and that (1) indicates the total amount outstanding on secured obligation as of no more than 35 days before or after the record's date and, (2) with reasonable detail, describes the various components constituting the obligation. [U.C.C. § 9-102(a)(4).]

2. Request Regarding a List of Collateral

To make a proper request regarding a list of collateral, a debtor must authenticate a record accompanied by a list of the items of property that the debtor believes to be subject to the security interest. The record, in turn, must (1) ask the secured party to approve or correct the list and (2) reasonably identify the pertinent transaction. [U.C.C. § 9-210(a)(3).]

3. Request Regarding a Statement of Account

To make a proper request regarding a list of collateral, a debtor must authenticate a record, accompanied by a statement indicating what the debtor contends to be, as of a particular date, the total outstanding amount of the secured obligation. The record, in turn, must (1) ask the secured party to approve or correct the statement and (2) reasonably identify the pertinent transaction. [U.C.C. § 9-210(a)(4).]

4. Secured Party's Duty to Respond

In most cases, the secured party has *14 days* to respond to a request for an accounting, request regarding a list of collateral, or request regarding a statement of account. Generally, the secured party must authenticate the response. [U.C.C. § 9-210(b).]

IX. Perfection

Perfecting a security interest provides notice to third parties that the perfecting secured creditor has (or claims) an enforceable security interest in the debtor's personal property. A secured party's rights as against other claimants to the collateral often hinge upon whether and when the security interest was perfected. [*See* Priority, *infra*.]

A. General Ways to Perfect

There are five main ways for a secured party to perfect its security interest:

- the secured party may file a properly completed *financing statement* or *fixture filing* with the appropriate office;
- the secured party may *take possession* of the collateral;

- the secured party may *take control* of the collateral;
- in some cases, the secured party may be *automatically perfected* upon attachment, without further action; and
- to perfect specific types of collateral, the secured party must use the state's *certificate-of-title* system.

B. Perfection by Filing

Filing a financing statement is by far the most common method of perfecting a security interest. Article 9 starts with a general rule that every security interest or agricultural lien must be perfected by filing a financing statement. Of course, there are exceptions to this general rule. For many types of collateral, filing is just one legitimate way among others to perfect a security interest. For some other types of collateral, filing a financing statement is the *only* legitimate method of perfection. Some types of collateral *cannot* be perfected by filing. [U.C.C. § 9-310(a).]

1. The Financing Statement

For a financing statement to perfect a security interest, it must be (1) filed in the *appropriate office* and (2) *properly completed*. It is the secured creditor's responsibility to meet these requirements.

a. Appropriate Office

In many states, but not all, the appropriate office in which to file a financing statement is the secretary of the state. [*See* U.C.C. § 9-501.]

b. Property Completed Financing Statement

To be properly completed, the financing statement must set forth these pieces of information:

- the *debtor's name* and *mailing address*,
- the name of the *secured party or its representative*, and
- an *indication of the collateral* covered by the financing statement.

[*See* U.C.C. § 9-502.]

c. The Debtor's Name

Correctly listing the debtor's name on the financing statement is crucial to proper perfection by filing. There are detailed rules for secured parties to determine the debtor's proper name, depending on whether the debtor is a *registered organization* with the state (such as a limited liability company, limited partnership, or corporation), an *unregistered organization* (such as a general partnership), or *an individual*.

i. Trade Name Alone Not Sufficient

Generally, listing the debtor's trade name alone is *not sufficient.* [U.C.C. § 9-503(c).]

ii. Registered Organization

If the debtor is an organization registered with the state, the financing statement must list the organization's *correct and complete legal name*, exactly as it appears on the public, organic record most recently filed with, issued by, or enacted by the state in which the organization is registered. Records like this might include, for example, a corporation's most recent annual report filed with the state. The easiest way to ascertain the record is generally to check the state's official website for business organizations. [U.C.C. § 9-503(a).]

iii. Unregistered Organization

If the debtor is an organization that is not registered with the state, the financing statement must include the names of all partners, members, associates, or others who make up the debtor's *equity stakeholders*. It is not sufficient simply to list the debtor's trade name; the financing statement must identify the discrete persons with an ownership stake in the debtor organization. [U.C.C. § 9-503 Alt. A (6)(B), Alt. B (5)(B).]

iv. Natural Person

If the debtor is a natural person, Article 9 (as adopted in most states) requires the financing statement to indicate the debtor's name as it appears on the debtor's driver's license or other *state-issued identification*. If the debtor does not have a driver's license or other identification, then the debtor's *surname and first personal name* will suffice. [U.C.C. § 9-503 Alt. A (4), Alt. B (4)(C).]

d. Seriously Misleading Financing Statement

For a financing statement to be effective to perfect a security interest, it must list the debtor's *correct and complete* legal name. If it does not, it is *seriously misleading.* More particularly, a financing statement is seriously misleading if a third party searching the appropriate online records could not locate the financing statement by typing in the debtor's correct, complete legal name. A seriously misleading financing statement is generally *ineffective* to perfect a security interest. [*See Official Comm. of Unsecured Creditors v. Suna Bros., Inc. (In re Tyringham Holdings, Inc.)*, 354 Bankr. 363 (E.D. Va. 2006); *see also* U.C.C. § 9-506(b).]

Examples:

(1) The debtor was a corporation, a registered entity. The debtor's name, as it appeared on the most recent public organic filing with the state, was "Taxi Cab, Inc." A financing statement corresponding to a security interest in the debtor's equipment listed the debtor's name as "Taxi Cab." The financing statement was seriously misleading, as it was not at all certain that a third party could find the financing statement by typing in the correct "Taxi Cab, Inc."

(2) A registered-organization debtor's correct, legal name was "Rodger House." A financing statement incorrectly listed the debtor's name as "Roger House." The financing statement was seriously misleading, as a third-party searcher likely could not find the financing statement by searching using "Rodger House."

e. The Creditor's Name

The financing statement must correctly set forth the *secured creditor's name* or that of its *representative*. Article 9 does not offer much guidance on how to ensure that the secured party's name is the legally correct name, leaving it to secured parties to assure that their names are properly indicated. If the financing statement indicates the name of the secured creditor's representative, it need not note the representative capacity. [*See* U.C.C. § 9-503(d).]

f. Indication of Collateral

The financing statement must *indicate the collateral*. An *indication* must convey what the collateral is, but it need not be as specific as the *description* of the collateral required in the security agreement. Unlike a security agreement, in the financing statement, *supergeneric language* is a sufficient indication of the collateral. Of course, more specificity is fine. Indeed, parties often simply copy the description of the collateral from the security agreement into the financing statement. [*See* U.C.C. §§ 9-108 cmt. 2, 9-504; Description of the Collateral Generally, *supra*.]

g. Financing Statement's Effectiveness for Five Years Unless Continued

Once a financing statement is properly completed and filed, it is effective to perfect the security interest for *five years*. Once the five years pass, the financing statement will lapse, and perfection will cease, unless the secured party timely files a *continuation statement*. [*See* U.C.C. § 9-515(a).]

i. Time to File Continuation Statement

The continuation statement may be filed only *within six months before* the expiration of the five-year period—no sooner and no later. This prevents secured parties from filing a financing statement and, at substantially the same time, filing a continuation statement to extend the five-year period to ten years. [*See* U.C.C. § 9-515(d).]

ii. Consequences of Lapse

If a secured party misses the six-month window to file a continuation statement, the original financing statement *lapses*. This means that the financing statement ceases to be effective. The result: the underlying security interest is *no longer perfected*. There is no way to remedy this lapse other than to file a new financing statement. However, the priority date will be that of the *new* financing statement, not that of the original one obtained at least five years before. [*See* U.C.C. § 9-515(c); Priority, *infra*.]

2. Amendment Statement

A secured party may file an *amendment statement* that amends a financing statement without losing the original priority date. A secured party might want to amend a financing statement for various reasons, including to add or delete collateral or to remove fewer than all of the debtors or secured parties. Of course, the amendment may not remove all debtors or secured parties, as a financing statement must name at least one debtor and one secured party to be effective. [*See* U.C.C. § 9-512; Priority, *infra*; Properly Completed Financing Statement, *supra*.]

3. Assigning a Financing Statement

A secured party may assign a financing statement in either the initial financing statement or an amendment to it. The secured party must ensure that the assignment identifies the initial financing statement by file number, and that it properly identifies the assignor and the assignee. There are two general types of assignments: *administrative* and *total*.

a. Administrative Assignments

An initial financing statement or an amendment to the initial financing statement may reflect an assignment of the secured creditor's ability to amend, continue, or terminate the financing statement. If the assigning secured party *remains the secured party of record*, then the assignment is an administrative assignment. An administrative assignment is not so much a true conveyance of rights in the collateral as it is a mere delegation of administrative authority, usually for the sake of convenience, from the secured party to another. [*See* U.C.C. § 9-514.]

b. Total Assignments

In a total assignment, one secured party of record may be *replaced or joined* by another secured party *of record*. The effect here is that another party assumes all or some of the secured party's rights as a secured creditor. Unlike an administrative assignment, a total assignment is a true transfer of rights in the collateral. [*See* U.C.C. § 9-511 cmt. 2.]

4. Terminating a Financing Statement

A secured party may terminate a financing statement by filing a termination statement. Once a termination statement is filed with respect to a financing statement, the financing statement ceases to be effective, and perfection ends. Most often, a termination statement is filed once the underlying secured obligation is satisfied or otherwise discharged. [*See* U.C.C. 9-513(d).]

a. Debtor's Authenticated Demand Generally

For most types of collateral, the debtor may send an *authenticated demand* to the secured party to either file a termination statement or send the debtor a termination statement that the debtor can then file. If the secured party receives this type of demand, it has 20 days to comply, provided that:

- the underlying secured obligation is satisfied, and the secured party is under no commitment to give further value, as by extending additional credit;
- the collateral is accounts or chattel paper and has been sold, and the account debtor has satisfied its obligations;
- the collateral consists of goods consigned to the debtor, and the collateral is not in the debtor's possession; or
- the debtor never authorized the initial financing statement to be filed.

[*See* U.C.C. § 9-513(c).]

b. Debtor's Authenticated Demand, Consumer Goods

If the collateral is consumer goods, the debtor may send an authenticated demand to the secured party to either file a termination statement or send the debtor a termination statement that the debtor can then file. The secured party must comply with the demand, provided that (1) the underlying secured obligation is satisfied, and the secured party is under no commitment to give further value, as by extending additional credit, or (2) the debtor never authorized the initial financing statement to be filed. The secured party's deadline to comply is the earlier of (1) one month after the underlying secured obligation is satisfied, if the secured party is under no commitment to give further value, or (2) 20 days after receiving the demand. [U.C.C. § 9-513(a), (b).]

C. Filing Office's Responsibilities Generally

In general, the filing office must index any initial financing statement according to the debtor's name. It must also index any later records relating to the initial financing statement (such as an assignment or termination statement) so that they are associated both with one another and with the initial financing statement. Incorrect indexing by a filing office does not render a record ineffective under Article 9. [U.C.C. § 9-517, 9-519(c)(1).]

D. Fixture Filing

A security interest in a fixture may be perfected only by a valid *fixture filing*. A fixture filing is a special financing statement covering goods that are, or are to become, fixtures. A fixture filing must meet particular filing requirements. [*See* U.C.C. § 9-102(a)(40).]

1. Precautionary Fixture Filing

Determining whether goods have become fixtures is often a difficult and fact-intensive inquiry. A secured party may be uncertain whether its collateral has or will become a fixture. A conventional financing statement is ineffective to perfect a security interest in a fixture, and a fixture filing is ineffective to perfect a security interest in anything other than fixtures. To address this, a secured party may file both a conventional financing statement and, as a precaution, a fixture filing with respect to the collateral. This protects the secured party should its collateral ever be deemed a fixture. [U.C.C. § 9-502 cmt. 6; Alphonse M. Squillante, *The Law of Fixtures: Common Law and the Uniform Commercial Code Part II: The UCC and Fixtures*, 15 Hofstra L. Rev. 535 (Spring, 1987).]

2. Requirements for Valid Fixture Filing

A fixture filing must correctly indicate the debtor's name and address, the secured creditor's name, and the collateral. The fixture filing must also:

- indicate that it *covers a fixture*;
- indicate that it is to be filed in the relevant *real-property records*;
- provide a *description* of the underlying real property; and
- if the debtor lacks an interest of record in the underlying realty, provide the *name of a record owner*.

[*See* U.C.C. § 9-502(b).]

3. Description of Underlying Real Property

In general, the fixture filing must describe the underlying realty clearly enough so that it can reasonably be identified. In some states, the description must be sufficient to give constructive notice of a mortgage if the fixture filing were instead a mortgage recorded in the relevant real-property records. Best practice, then, is for the fixture filing to reference the most recently recorded deed, mortgage, or other instrument of conveyance relating to and describing the realty. Under the UCC, this is not strictly necessary, but it will always suffice. Other ways to describe the realty adequately include describing it by metes and bounds or indicating the real property's street address. [*See* U.C.C. § 9-502 cmt. 5.]

E. Perfection by Possession

Another method of perfection is for the secured party to *take possession* of the collateral. Possession is the *only* way to perfect a security interest in money; a financing statement is ineffective in this case. Other types of collateral that *may*, but need not, be perfected through possession include some types of documents, along with goods, instruments, and tangible chattel paper. [*See* U.C.C. §§ 9-312(b)(3), 9-313(a).]

1. Possession Generally

Article 9 does not define possession, leaving that to state common law. Generally, the secured party possesses collateral if she exercises exclusive dominion over the collateral itself or the premises where the collateral is located, provided that the dominion is visible and extensive enough to put third parties on reasonable notice that the secured party has (or claims) an interest in the collateral. In the usual case, a secured party choosing to perfect by possession is a bank that stores the collateral in a secure vault.

In that case, the bank's possession is clear beyond reasonable dispute. [*See Clean Burn Fuels, LLC v. Purdue BioEnergy, LLC (In re Clean Burn Fuels, LLC)*, 492 B.R. 445 (Bankr. M.D.N.C. 2013).]

a. Possession by Designated Third Party

The secured party may designate a third party, such as a bailee or custodian, to take possession of the collateral. In this event, for most types of collateral, there must be an authenticated record showing that the bailee or custodian holds possession *on the secured party's behalf*. [*See* U.C.C. § 9-313(c).]

b. Possession by Secured Party's Agent

The secured party's *agent* is not deemed to be a third party for purposes of possession under the UCC. Possession by the secured party's agent acting in that capacity is tantamount to possession by the secured party, whether or not the agent authenticates a record acknowledging that he is holding the collateral on the secured party's behalf. The secured party's *employee* is clearly her agent. However, if it is unclear whether the party in possession is the secured party's agent, prudence dictates having that party authenticate the record. [*See* U.C.C. § 9-313 cmt. 3.]

Note: The debtor can never be the secured party's agent for purposes of possession. A person is not precluded from holding collateral as an agent for both the debtor and the secured party unless the person is so closely related to the debtor that the debtor has effectively retained possession of the collateral. [*See* U.C.C. § 9-313 cmt. 3.]

c. Duration of Perfection by Possession

Perfection by possession lasts for only as long as the secured party, its agent, or its designated third party *retains possession.* [U.C.C. § 9-313(d).]

F. Perfection by Control

If the collateral is quasi-intangible or intangible, a secured party may perfect a security interest by *taking control* of the collateral. Control is the only legitimate method to perfect a security interest in *deposit accounts* or letter-of-credit rights. Article 9 does not define control generally, but it does explain how a secured party may establish control over particular types of collateral. [*See* U.C.C. § 9-312(b)(1)-(2).]

1. Control of a Deposit Account

There are three ways for a secured party to establish control of a deposit account:

- be the *depositary bank*, or the bank where the deposit account is maintained;
- become the depositary bank's *customer* (usually, the account holder) with respect to the deposit account; or
- have an *authenticated agreement* among itself, the depositary bank, and the debtor, directing the depositary bank that the funds may be withdrawn without any further consent by the debtor.

[*See* U.C.C. § 9-104(a).]

2. Control of Electronic Chattel Paper

A secured party has control of *electronic chattel paper* if a system created to evidence the transfer of interests in the electronic chattel paper reliably establishes that the chattel paper was *assigned to the secured party*. Generally, a system accomplishes this if it shows how the electronic chattel paper was created, stored, and assigned, and if there is a single, unique, authoritative copy of the chattel paper that meets specific requirements. [*See* U.C.C. § 9-105.]

3. Control of Letter-of-Credit Right

A secured party may establish control of a letter-of-credit right if the issuer of the letter of credit, or the issuer's nominated person, *consents to the assignment* of the letter-of-credit proceeds to the secured party. [*See* U.C.C. § 9-107.]

4. Control of Investment Property

Control of most types of investment property is governed by UCC Article 8. [*See* U.C.C. §§ 9-106(a), 8-106.]

G. Automatic Perfection upon Attachment

With some types of collateral, the security interest is perfected automatically upon attachment. At that point, the secured party need take *no further steps* to perfect its security interest.

1. Purchase-Money Security Interest in Consumer Goods

A purchase-money security interest in most *consumer goods* is perfected automatically upon attachment. [U.C.C. § 9-309(1).]

2. Some Intangibles

A security interest in the sale of a *payment intangible* or a *promissory note* is perfected on attachment. [*See, e.g.* U.C.C. § 9-309(3), (4), (14).]

3. Assignment of Accounts or Payment Intangibles

Secured creditors also enjoy automatic perfection if the transaction is an *assignment of accounts or payment intangibles*. However, the assignment itself (considered together with any other assignments to the particular assignee) must not convey to the assignee a significant percentage or portion of the overall outstanding accounts or payment intangibles belonging to the assignor. Courts use two general tests to determine what counts as a significant part of the assignor's outstanding accounts or payment intangibles: the *percentage test* and the *casual-and-isolated test*. Some courts use just one of the tests. Other courts require each discrete transaction to satisfy both tests, and still others will permit automatic perfect if the transaction satisfies either test. [*See* U.C.C. § 9-309(2); *Union Nat'l Bank of Little Rock (In re B. Hollis Knight Co.)*, 605 F.2d 397 (8th Cir. 1979); *In re Wood*, 67 B.R. 321 (W.D.N.Y. 1986).]

a. Percentage Test

The percentage test looks at what percentage of the assignor's total outstanding accounts or payment intangibles were assigned in the specific transaction. Courts have said that approximately 27 percent is significant, and 16 percent is insignificant. [*See* 68A Am. Jur. 2d *Secured Transactions* § 354.]

b. Casual-and-Isolated Test

Under the casual-and-isolated test, automatic perfection applies to *unusual transactions* falling outside the parties' customary business dealings. Thus, a financing statement should be filed if either the assignor or the assignee regularly assigns or accepts assignment of accounts or payment intangibles in the usual course of business. [*See* U.C.C. § 9-309 cmt. 4; 68A Am. Jur. 2d *Secured Transactions* § 355.]

4. Automatic Attachment and Temporary Automatic Perfection in Proceeds

Secured creditors may enjoy automatic attachment and perfection in the *proceeds* of collateral.

a. Proceeds Defined

Proceeds are whatever a debtor acquires if it sells, leases, licenses, exchanges, or otherwise *disposes of collateral*. For instance, if the debtor sells or leases the collateral for cash, the cash constitutes proceeds. [*See* U.C.C. § 9-102(a)64).]

Example:

A secured party had a security interest in a debtor's inventory. The debtor sold three pieces of inventory to three different customers. One customer paid with cash and another with a check. The third customer paid with a credit card, creating a credit-card receivable. The cash, check, and credit-card receivable were all identifiable proceeds of the inventory collateral, as they were all things the debtor received for selling that collateral. Accordingly, Article 9 provided for automatic attachment and (at least) 20 days of automatic perfection because the underlying security interest here was perfected. [*See* U.C.C. § 9-315(a)(2), (c).]

b. Automatic Attachment and Perfection

If a debtor acquires identifiable proceeds from collateral, the underlying security interest *automatically attaches* to the proceeds. That security interest is also automatically perfected, assuming the underlying security interest is itself perfected. If the underlying security interest is not perfected, then the automatically attached security interest in the proceeds will not be perfected, either. [U.C.C. § 9-315.]

i. Identifiable Proceeds Explained

Generally, proceeds are identifiable if they are distinguishable from other property. Goods are generally identifiable unless they have been so combined with other goods that they have lost their distinct identity in a resulting mass or product (*e.g.*, eggs and flour used to make a cake). If cash proceeds are placed in the debtor's general deposit account and spent along with the debtor's general funds, rather than placed in a segregated account, they cease to become identifiable unless the secured creditor can identify the specific cash proceeds by some method of tracing recognized under equitable principles or the law of trusts. [*See* U.C.C. § 9-315 cmt. 3; 68A Am. Jur. 2d *Secured Transactions* § 67.]

c. Duration of Automatic Perfection

The general rule is that automatic perfection in proceeds is temporary, lasting *only 20 days*. Unless an exception to the general rule applies, the secured party must take further steps within that 20-day period to assure more lasting perfection. There are three exceptions.

i. Filed Financing Statement Covering Original Collateral

Automatic perfection in proceeds may continue beyond 20 days if

- a *filed financing statement* perfects a security interest in the original collateral,
- the proceeds are collateral in which a security interest *may be perfected by filing* in the appropriate office, and
- the proceeds are *not themselves acquired with cash proceeds*.

[U.C.C. § 9-315(d)(1)(a)-(c).]

ii. Identifiable Cash Proceeds

Automatic perfection in proceeds will continue beyond 20 days if the proceeds are *identifiable cash proceeds*. Cash proceeds include money and its functional equivalents, such as checks or deposit accounts. [*See* U.C.C. §§ 9-315(d)(2), 9-102(a)(9).]

iii. Perfection by Independent Means

If, within the 20-day period, the security interest in the proceeds is *perfected by independent means* and therefore does not need the temporary perfection, then the security interest in the proceeds remains perfected beyond the 20-day period. [*See* U.C.C. § 9-315(d)(3).]

H. Certificate-of-Title Systems

Certain types of collateral, notably *vehicles*, are subject to the state's *certificate-of-title* system. Generally, the only way to perfect a security interest in collateral subject to a certificate-of-title system is to ensure that a notation is made, or a lien is placed, on the title document for each piece of collateral. Filing a financing statement, taking possession, or taking control will not suffice. [*See* U.C.C. § 9-311(a)(2).]

Example:

A debtor was using a fleet of trucks as collateral in a secured transaction. The trucks were subject to the state's certificate-of-title system. To perfect the security interest, the secured party had to ensure that a notation was made, or a lien was placed, on the title certificate for *each truck*. This was the only way to perfect a security interest in any of the trucks.

X. Multistate Transactions, Changes

Transactions spanning multiple states, along with changes to the debtor's name, capital structure, and other attributes, are inevitable in secured transactions. Many debtors have locations in various states, and for some debtors, moving collateral from one location to another is a routine part of business. Thus, secured creditors' collateral is often scattered across multiple states. Article 9 has detailed statutes on how a security interest can remain perfected despite multistate transactions and changes to the debtor's attributes.

A. Article 9 Choice-of-Law Rules

Article 9 features its own choice-of-law rules distinct from those that apply to the UCC at large. The general choice-of-law rule under the UCC—that the parties may select the state whose laws will govern their rights and duties, assuming the transaction bears a reasonable relation to the chosen state—*does not apply* to secured transactions falling under Article 9. [*See* U.C.C. § 1-301.]

1. General Article 9 Choice-of-Law Rule

The general choice-of-law rule under Article 9 is that if the debtor is located in a particular jurisdiction, that jurisdiction's laws govern:

- perfection of the security interest,
- the effect of perfection or nonperfection, and
- the priority of the security interest relative to competing interests in the same collateral.

[U.C.C. § 9-301(1).]

a. Determining the Debtor's Location

The rules to determine the debtor's location vary depending on whether the debtor is an organization *registered with the state*, an *unregistered organization*, or a natural person. [*See* U.C.C. § 9-307(b)(1)-(3).]

i. Location of Registered Organization

If the debtor is a registered organization, then debtor is located in the *state of registration*. [*See* U.C.C. § 9-307(e).]

Example:

A debtor was a corporation incorporated—*i.e.,* registered—in State A. That meant that the debtor was located in State A for purposes of Article 9's choice-of-law rules. This was true even though the debtor had multiple locations across various states, and its chief executive office was not in State A.

ii. Location of Unregistered Organization

If the debtor is an organization that is not registered with the state, then the debtor is located where its *place of business* is located. If the debtor has multiple places of business, then the debtor's location is the state in which its *chief executive offices* are located. A debtor's chief executive offices are, generally speaking, those offices from which the debtor's owners or top managers direct and oversee the debtor's primary business operations and affairs. [*See* U.C.C. § 9-307 cmt. 2.]

Example:

A debtor was a general partnership—an unregistered organization—with retail outlets in State A, State B, and State C. The debtor's headquarters, from which its general partners and managers controlled its operations, were located in State B. Under UCC Article 9, the debtor's location was State B, even though it also had business locations in State A and State C.

iii. Location of Natural Person

If the debtor is an individual, then the debtor's location is the state of the debtor's *principal residence*. [*See* U.C.C. § 9-307(b)(1).]

2. Exceptions to Article 9's General Choice-of-Law Rule

There are several exceptions to Article 9's general choice-of-law rule.

a. Possessory Security Interest

If a security interest is perfected by *possession*, the law of the state where the collateral is located governs perfection, the effect of perfection or nonperfection, and priority. [*See* U.C.C. § 9-301(2).]

b. Agricultural Liens

In case of an agricultural lien, the law governing perfection, the effect of perfection, and priority is that of the state in which the relevant *farm products are located.* [U.C.C. § 9-302.]

c. Fixture Filings

In case of a fixture filing, the law governing perfection, its effect, and priority is that of the state in which *the fixture is located*. [*See* U.C.C. § 9-301(3)(A).]

d. Timber to Be Cut

If the security interest is in timber to be cut, the law governing perfection, its effect, and priority is the law of the state where the *timber is located*. [*See* U.C.C. §§ 9-301(3)(B), 9-302.]

e. Some Types of Tangible Property, Including Goods

If the collateral consists of goods, money, instruments, tangible chattel paper, or most documents, the law of the state where the *debtor is located* still generally governs whether the security interest is perfected. However, the law of the state where the *collateral* is located governs the *effect* of perfection (or nonperfection), as well as priority. [*See* U.C.C. § 9-301(3)(C).]

Example:

A debtor was located in State A. A bank had a perfected security interest attached to all of the debtor's equipment, whether then owned or later acquired. The debtor bought a new piece of equipment from State B. That equipment immediately became subject to the bank's perfected security interest. As the equipment was passing through State C on its way to State A, it was seized by another one of the debtor's creditors. Because the debtor was located in State A, State A governed whether the bank's security interest in the equipment was properly perfected. However, as the equipment happened to be located in State C, State C law controlled the effect of the bank's perfection and the bank's priority over other creditors, such as the creditor that seized the equipment.

f. Goods Perfected by Compliance with Certificate-of-Title System

For a good covered by a certificate of title, the law that governs perfection, its effects, and priority is the law of the jurisdiction where there is a *valid certificate of title* for the item. This is true regardless of any other connection between the jurisdiction and the goods. [*See* U.C.C. § 9-303(a)-(c).]

Example:

A rental-car company gave a lender a security interest in its entire fleet of cars. One of the cars was covered by a certificate of title in State A. The company moved the car from its primary rental outlet in State A to a different outlet in State B. The car was never returned to State A. For secured-transactions purposes, the car's location was State A for as long as there was a valid certificate of title in that state covering the car. The car's physical presence in State B (or any other state) was irrelevant.

g. Deposit Account

If the collateral is a deposit account, the law of the *bank's jurisdiction* governs perfection, its effects, and priority. [*See* U.C.C. § 9-304(1) cmt 2.]

i. Bank's Jurisdiction Generally

In most cases, the bank's jurisdiction is determined by the bank's agreement with the customer on the deposit account. If the agreement designates a particular jurisdiction as any of the following, then that jurisdiction is the bank's jurisdiction. If there are multiple jurisdictional designations, the following order of priority applies:

1. the bank's jurisdiction for purposes of the UCC at large, Article 9, or Part 3 of Article 9;
2. the jurisdiction whose law governs the agreement; or
3. the jurisdiction at which the deposit account is maintained.

[U.C.C. § 9-304(b)(1)-(3).]

Note: As banks generally draft these agreements, the choice of the bank's jurisdiction typically rests with the bank. The bank's jurisdiction may differ from one deposit account to the next, even at the same bank, depending on the bank's agreements with its respective customers.

Example:

A retailer and a car dealer both had deposit accounts at the same bank. The retailer's agreement with the bank stated that "The bank's jurisdiction, for purposes of this agreement and the Uniform Commercial Code, is State A." The car dealer's agreement with the bank did not designate a specific jurisdiction as the bank's jurisdiction, but it did provide that the law of State B would govern all issues relating to the agreement. As between the retailer and the bank, the bank's jurisdiction was State A. As between the car dealer and the bank, the bank's jurisdiction was State B.

ii. Bank's Jurisdiction Unaddressed in Agreement

If the bank's jurisdiction cannot be determined with reference to the bank's agreement with its customer, but an account statement identifies a specific office as the one servicing the account, then the bank's jurisdiction is the one in which that office is located. If no account statement identifies a specific office as the one servicing the account, then the bank's jurisdiction is the one in which the bank's chief executive offices are located. [U.C.C. § 9-304(b)(4)-(5).]

B. Change in Debtor's Location, Effect on Perfection by Filing

If a debtor's location changes, a security interest perfected by filing may *lapse* unless the secured creditor takes the needed action to continue perfection. The particular rules vary depending on whether the debtor is an *unregistered organization*, a *registered organization*, or an *individual*.

1. Natural Person or Unregistered Organization, Effect of Changed Location on Perfection by Filing

If the debtor is a natural person or unregistered organization, and the debtor changes location from one state to another, then a security interest perfected by filing remains perfected for *four months* after the change. This affords the secured creditor a four-month grace period to take steps to ensure its security interest remains perfected—or less, if the financing statement would expire on its own before the four-month period's elapse. Within the grace period, the secured creditor must properly perfect its security interest *in the debtor's new jurisdiction.* Otherwise, perfection will lapse once the grace period ends. In that event, the security interest will be deemed never to have been perfected against a purchaser for value, including a secured party. [*See* U.C.C. § 9-316(a)-(b).]

Example:

On January 1, 2018, a bank lent money to a debtor, a general partnership with its place of business in State A. That same day, the bank properly attached and perfected a security interest in the debtor's equipment. On December 1, 2018, without the bank's knowledge, the debtor moved its place of business to State B. The bank's security interest remained perfected for *four months* after the move. The financing statement would have remained effective until 2023 on its own. After the debtor changed states, though, the bank had four months to perfect its security interest in State B.

a. Collateral Acquired after Debtor Changes Jurisdiction, Perfection by Filing

If the debtor acquires new collateral to which a security interest perfected by filing attaches within the four-month grace period after the debtor's change of location, then the financing statement is effective as to that collateral for the duration of the grace period. But if the secured party fails to perfect in the new jurisdiction within the grace period (or earlier, if the financing statement would expire on its own before then), then the financing statement lapses as to collateral acquired within the grace period. If lapse occurs, then the security interest is deemed never to have been perfected against a purchaser of that collateral for value, including another secured party. [See U.C.C. § 9-316(h).]

2. Registered Organization

To change location for purposes of Article 9, a registered organization must dissolve in the first state and register anew in the new state. Once this happens, the organization is reconstituted as a different person, to whom the original collateral is transferred. Thus, if the debtor is a *registered organization* and changes location from one state to another, then the transaction must be analyzed as one in which the debtor transferred the collateral to a new debtor located in a different jurisdiction, *not* as one in which the debtor simply changed location. [*See* U.C.C. § 9-316(i).]

C. Transfer of Collateral Generally

If collateral is transferred, and the underlying security interest was perfected by filing, then the general rule is that the financing statement remains effective to perfect the security interest—regardless of whether the secured party knows about or consents to the transfer. [U.C.C. § 507(a).]

1. Collateral Acquired by New Debtor in Same Jurisdiction

If a debtor transfers collateral to a new debtor in the same jurisdiction, the new debtor becomes bound by the security agreement, and the original and new debtors' names are so different that a filed financing statement becomes *seriously misleading*, then the secured party has four months to amend the original financing statement to indicate the new debtor's legally correct name. Should the secured party fail to do so, then the security interest will remain perfected as to all collateral acquired by the new debtor before or within four months after the new debtor becomes bound, but will be unperfected as to any collateral acquired after that. [*See* U.C.C. § 9-508(b).]

2. Transfer of Collateral to New Debtor in a Different Jurisdiction

If collateral is transferred to a person located in a jurisdiction different from the debtor's location, then the security interest remains perfected as to collateral acquired prior to the transfer for up to *one year*. Within the one-year period, the secured party must take the proper steps to perfect the security interest in the new jurisdiction, or else perfection will lapse. If that happens, the security interest will be deemed never to have been perfected against any purchaser for value, including a secured party. [*See* U.C.C. § 9-316(a)(3).]

3. Collateral Acquired by New Debtor in Different Jurisdiction

If the recipient of the collateral becomes a new debtor in a different jurisdiction and becomes bound by the original debtor's security agreement, then any *financing statement* against the original debtor is effective to perfect a security interest in any collateral acquired by the new debtor either before or within four months after the new debtor becomes bound. However, if the secured party does not take the proper steps to perfect against the new debtor in the new jurisdiction, the financing statement will lapse, and the security interest will be deemed never to have been perfected as against any purchaser for value, including a secured party. [U.C.C. § 9-316(i).]

D. Name Changes

A financing statement is seriously misleading and ineffective to perfect a security interest unless it sets forth the debtor's *legally correct name*. If a debtor changes its name, and the name change makes the financing statement seriously misleading, the financing statement may become ineffective. [*See* Seriously Misleading Financing Statements, *supra*.]

1. General Rule, Name Changes

The general rule is that if the information in a financing statement *becomes seriously misleading* because the debtor has changed its name, that does not immediately render the financing statement ineffective. The security interest remains perfected for *four months* (or less time, if the financing statement would expire on its own before then). During those four months, the secured creditor must *amend its original financing statement* to indicate the debtor's new, legally correct name. If the secured creditor misses this deadline, then it remains perfected as to any collateral acquired (1) prior to the name change or (2) during the four months after the name change. However, the secured creditor will be *unperfected* as to any collateral acquired after the four-month period expires. [*See* U.C.C. § 9-507(b)-(c).]

Example:

A secured creditor had a security interest in a debtor's office equipment, perfected by filing. The debtor changed its name in a way that rendered the previous financing statement seriously misleading. Thus, the secured party had to amend its financing statement to indicate the debtor's new name. If it did not, it would remain perfected only as to any collateral acquired before four months after the change.

2. Name Change Signaling Change in Debtor's Capital Structure

If a business organization changes its name, this may reflect a change in the debtor's capital structure—*e.g.*, from a corporation to a limited liability company. In that event, the original debtor has effectively dissolved, and a new entity has come into being and succeeded to the original debtor's rights and liabilities. This means the transaction must be analyzed as a transfer of collateral, not a mere name change. [*See* U.C.C. § 9-508, with comments.]

E. New Debtor Becoming Bound by Original Debtor's Security Agreement

Generally, a new debtor becomes bound by an original debtor's security agreement if (1) the security agreement is effective on its own to create a security interest in the new debtor's property, or (2) the new debtor becomes generally liable for the original debtor's obligations (including the security agreement) and acquires substantially all of the original debtor's assets. This often happens in the context of mergers and acquisitions, in which a survivor or successor entity often succeeds to a target entity's assets and liabilities. [*See* U.C.C. § 9-203(d).]

XI. Priority

Article 9's *priority rules* determine the order in which competing claimants may satisfy their claims against the *same collateral*. The general rule is that a security interest is effective, according to the security agreement's terms, both between the parties to the security agreement and against third-party purchasers and creditors. But there are many exceptions to the general rule that a secured party prevails over all third parties. The priority rules in Article 9 comprise that system of exceptions.

A. General Rule: First in Time, First in Line

Subject to some qualifications, the general rule of priority is first in time, first in line. The claimant with the *earlier priority date* wins. [*See* U.C.C. §§ 9-317(a), 9-322, with comments.]

B. Secured Creditor v. General Unsecured Creditor

A secured creditor, whether perfected or not, will *always* have superior priority over a general unsecured creditor who has failed to reduce her claim to judgment and acquire a lien on the collateral. [*See* U.C.C. §§ 9-317(a), 9-322(a)(2); Lien Creditors, *infra*.]

C. Perfected Secured Creditor v. Perfected Secured Creditor

The general priority rule among conflicting *perfected* security interests in the same collateral is that the *first to file or perfect* wins. In other words, each competing perfected secured creditor's priority date is the earlier of (1) the date on which any *financing statement was filed* or (2) the date on which the security interest was *actually perfected*. A security interest cannot be perfected unless it has attached. This rule allows a creditor to file its financing statement before its security interest has even attached. Once the security interest attaches, it will be perfected; its priority will relate back to the date of filing. [U.C.C. § 322(a)(2).]

Example:

A bank was negotiating a loan with a small business. With the small business's consent, on January 1, the bank filed a financing statement covering the collateral that was to secure the eventual loan. The bank as yet had no security interest because the bank had not given value and the parties had not authenticated a security agreement. On February 1, the bank extended the loan, and the parties authenticated a security agreement. At that moment, the security interest attached, and the filed financing statement perfected it. Because the bank filed on January 1, that was the bank's priority date against competing, perfected secured creditors.

D. Time of Filing or Perfection of Security Interest in Proceeds

Generally, for purposes of determining priority, the filing or perfection date for proceeds of collateral is the same as the filing or perfection date for the security interest in the collateral that generated the proceeds. [*See* U.C.C. § 9-322(b)(1).]

E. General Priority Date for Future Advances

If a security interest secures future advances, then the priority date for any future advances is almost always the same as the priority date of the security interest itself. This is true regardless of whether the secured party is under a binding commitment to extend future advances. [*See* U.C.C. § 9-323 cmt. 3; *but see* Future Advances as against Lien Creditor, *infra*.]

Example:

On January 1, a debtor took a $100,000 loan from a bank, and the bank perfected a security interest in the debtor's inventory by filing, making the bank's priority date January 1. The loan and security agreement contained a valid future-advance clause providing for the security interest to secure any later lending from the bank to the debtor. On February 1, a finance company perfected a security interest in the debtor's inventory by filing, making the finance company's priority date February 1. On March 1, the bank lent the debtor an additional $50,000, pursuant to the initial loan and security agreement. The bank had priority over the finance company in the debtor's inventory with respect to both the January 1 and March 1 advances. The bank's priority date with respect to the March 1 advance related back to that of the initial secured transaction, perfected on January 1.

F. Special Rules for Deposit Accounts, Letter-of-Credit Rights, and Investment Property

Because security interests in *deposit accounts* and *letter-of-credit rights* must be perfected by control, the secured party with control of the collateral has priority over any other secured party lacking control. For investment property, a creditor perfected *by control* has priority over a competing creditor perfected by filing. [*See* U.C.C. §§ 9-327(1), 9-328 cmt 2, 9-329(1).]

1. Competing Perfected Secured Creditors with Control of a Deposit Account

For competing perfected secured creditors in the same deposit account, priority often depends on how each secured creditor established *control*. [*See* Perfection by Control, *supra*.]

a. Depositary Bank's Customer

If the secured party achieves control by becoming the *depositary bank's customer* with respect to the deposit account, then that secured party beats out any competing secured party to achieve control by some other method. [*See* U.C.C. §§ 9-327(3)-(4), 9-104(a)(3).]

b. Depositary Bank

If neither competing secured party achieved control by becoming the depositary bank's customer on the deposit account, then the prevailing secured party is the one to achieve control by *being the bank with which the deposit account is maintained*, or the depositary bank. [*See* U.C.C. § 9-327(3)-(4).]

c. Authenticated Control Agreements

If each competing creditor achieved control of the deposit account through an authenticated record or agreement, then whichever creditor *obtained control first* will have priority. [*See* U.C.C. § 9-327(3)-(4).]

2. Letter-of-Credit Rights

If the competing secured creditors are perfected in the same letter-of-credit right through control, the *first creditor to achieve control* has priority. [U.C.C. § 9-329(2).]

3. Investment Property and Specific Instruments, Documents, or Securities

Generally, Article 9 does not affect the rights of a holder in due course of a negotiable instrument, a holder of a duly negotiated document of title, or specified protected securities purchasers. These persons' interests take priority over any conflicted perfected or unperfected security interest to the extent provided in Articles 3, 7, and 8 of the UCC. [*See* U.C.C. § 9-331(a).]

G. Purchase-Money-Security-Interest (PMSI) Holders: Superpriority

Holders of perfected purchase-money security interests (PMSIs) may enjoy *superpriority*. Superpriority means that the PMSI holder takes priority over earlier, perfected secured creditors.

1. PMSI in Goods Other Than Inventory or Livestock

For all goods other than inventory or livestock, if a PMSI is perfected within *20 days* of the debtor's receiving possession of the goods, the holder will have superpriority both in those goods and in their identifiable proceeds. [*See* U.C.C. § 9-324(a).]

2. PMSI in Inventory

If the collateral is inventory, the PMSI holder must take four specific steps to achieve superpriority.

Note: A consignor's security interest in consigned goods is deemed to be a PMSI in inventory. [U.C.C. § 9-103(d).]

a. Perfected When Debtor Receives Possession

The PMSI must be perfected when the debtor *receives possession* of the inventory. There is no 20-day post-possession grace period with inventory, as there is with other goods. [*See* U.C.C. § 9-324(b).]

b. Authenticated Notification

The PMSI holder must send an authenticated notification to specific creditors with conflicting security interests in the inventory, including those perfected by filing. [*See* U.C.C. § 9-324(b), (c).]

c. Timely Notification

The competing claimants must receive the notification within five years before the debtor receives possession of the inventory. [*See* U.C.C. § 9-324(b).]

d. Contents of Notification

The notification must describe the inventory and clearly state that the person sending the notification has or expects to have a PMSI in that inventory. [*See* U.C.C. § 9-324(b).]

3. PMSI in Livestock

To achieve superpriority, a creditor with a PMSI in livestock must take the same steps as one with a PMSI in inventory. However, with livestock, the authenticated notification must be received within *six months* before the debtor receives possession of the collateral, not five years. [*See* U.C.C. § 9-324(d).]

H. Unperfected Secured Creditor v. Unperfected Secured Creditor

Between two secured but unperfected creditors, the *first secured creditor to attach* its security interest has top priority. [*See* U.C.C. § 9-322(a)(3); Attachment, *supra*.]

I. Lien Creditors

A lien creditor is:

- one who has acquired a *nonconsensual interest* in property by way of levy, attachment, or similar means, from the date the interest was acquired—for instance, an unsecured creditor who reduces a claim to judgment and acquires a judicial lien;
- an *assignee* for the benefit of creditors;
- a *trustee in bankruptcy*, from the date the bankruptcy petition is filed; or

- a *receiver in equity*, from the time of appointment.

[*See* U.C.C. § 9-102(a)(52).]

1. Priority of Lien Creditors Generally

Generally, Article 9 places a lien creditor:

- *below* a perfected secured creditor having filed or perfected before the lien arose;
- *above* a subsequent perfected secured creditor; and
- *above* both an unperfected secured creditor and a general unsecured creditor, whether prior or subsequent.

[U.C.C. § 9-317.]

2. Future Advances as against Lien Creditor

If a lien creditor provides a perfected secured creditor notice of its lien, usually a judicial lien, and, more than 45 days later, the secured creditor provides an advance to the debtor under the terms of a secured transaction *predating* the lien, the lien creditor will have priority over the future advance but not the prior transaction at large. This rule does not apply, and the perfected secured creditor retains priority in the future advance, if the advance is made (1) without the required notice or (2) pursuant to a commitment entered without knowledge of the lien. [*See* U.C.C. § 9-323(b).; *see also* Future Advances, *supra*.]

XII. The Possessory-Lien Creditor

A possessory lien has priority over a *prior or subsequent* security interest in the goods, unless the statute creating the lien explicitly alters this priority rule. [*See* U.C.C. § 9-333(b).]

A. Possessory Lien Defined

A possessory lien secures an obligation for *services or materials* furnished concerning goods. The person who provided the services or materials must have done so in the ordinary course of her business. Also, the lien must arise by *statute or rule of law* in favor of the provider, and the lien's effectiveness must depend on the provider's *possessing* the goods. [*See* U.C.C. § 9-323(a).]

Example:

A woman took her car to a mechanic's shop for repairs. By applicable statute, the shop had the right to retain possession of the car to secure the repair bill. This gave the shop a statutory mechanic's lien effective only while the mechanic retained possession. The shop thus had a possessory lien on the woman's car with priority over any competing prior or subsequent security interest.

XIII. Purchasers v. Perfected and Unperfected Secured Parties

In general, a security interest continues to exist even if the collateral is sold, leased, exchanged, licensed, or otherwise disposed of. There are two notable exceptions to this rule. The first exception involves *buyers of tangible goods* who meet specific requirements. The second exception involves buyers of *intangible collateral*, primarily chattel paper and instruments. [*See* U.C.C. § 9-315(a)(1).]

A. Buyer (or Lessee) in the Ordinary Course of Business

Some buyers of goods take free of any security interest that already exists in tangible goods. These include *buyers in the ordinary course of business* and *buyers of consumer goods from consumers.*

1. Priority of Buyer in the Ordinary Course

If a buyer in the ordinary course of business buys any goods (other than farm products from a person engaged in farming operations), she takes free of any prior existing security interest in those goods, perfected or not, as long as the security interest was created by the one selling the goods to the buyer. This is true even if the buyer knows about the security interest. (Farm products are excluded because the federal Food Security Act protects buyers of farm products.) [See U.C.C. § 9-320(a).]

2. Buyer Defined

In general, a buyer is one who gives real, pecuniary value for the goods. A buyer is not, therefore, a mere donee—one receiving the goods gratuitously or as a gift. [*See buyer, purchaser,* Black's Law Dictionary (10th ed. 2014); 68A Am. Jur. 2d *Secured Transactions* § 764.]

3. Buyer in the Ordinary Course of Business Defined

A *buyer in the ordinary course of business* is a person buying in *good faith* and *without knowledge* that the sale violates another's rights in the goods. The seller must be someone (not a pawnbroker) in the business of selling goods of the kind, and the sale must comport with the usual, customary practice of the *seller* or the *kind of business* in which the seller engages. The buyer must take possession of or have the right to recover the goods, and the buyer must not acquire the goods in a bulk transfer or as security for or satisfaction of a money debt. [*See* U.C.C. § 1-201(b)(9).]

a. Good Faith Defined

The term *good faith,* as used throughout Article 9 and most of the rest of the UCC means actual honesty, together with observing commercial fair-dealing standards that are *reasonable*. [U.C.C. § 1-201(b)(20).]

b. Without Knowledge That Sale Violates Another's Rights

A buyer does not qualify as a buyer in the ordinary course if she knows that the sale violates another's rights in the goods. The fact that a debtor sells or otherwise disposes of collateral does not, by itself, violate the secured party's (or anyone else's) rights in the collateral. Thus, the buyer's knowledge of the security interest is not alone enough to defeat the status of a buyer in the ordinary course of business. However, if the buyer knows that the sale violates a contractual *agreement* between the debtor and the secured party, then the buyer will take subject to the security interest. [*See* U.C.C. § 9-320 cmt. 3.]

Example:

A debtor in the timber business secured a loan by giving the lender a security interest in all the debtor's inventory. The debtor often sold its timber to various lumber mills as gatewood (*i.e.*, timber brought to a mill's front gate and offered for sale to the mill). If the gatewood met the mill's specifications, the mill would buy it and take possession. The debtor's own customary practice was to sell gatewood, the practice was common in the debtor's location and trade, and the debtor was not a pawnbroker. Any mill buying gatewood from the debtor and taking possession of it was thus a *buyer in the ordinary course of business*, provided that the mill acted in good faith and without knowledge that the sale somehow violated anyone's rights. [*Adapted from Fordyce Bank & Trust Co. v. Bean Timberland, Inc*., 251 S.W.3d 267 (Ark. 2007).]

Compare:

A manufacturer in the business of manufacturing appliances owned equipment subject to a security interest that the manufacturer created in favor of a lender. The manufacturer sold the equipment to a dealer, whose business was to buy and sell used equipment. The dealer, in turn, sold the equipment to a buyer. The buyer did not take free of the lender's security interest as a buyer in the ordinary course. The security interest was not created by the dealer, the one who sold the goods to the buyer; rather, the manufacturer created the security interest. [*Adapted from* U.C.C. § 9-320 cmt. 3, example 1.]

4. Lessee in the Ordinary Course of Business

If a person leases collateral instead of purchasing it, but otherwise meets the definition of a buyer in the ordinary course of business, then the person's lease is free of any prior perfected or unperfected security interest created by the lessor. As with a buyer in the ordinary course, this holds true even if the lessee knows about the security interest. [*See* U.C.C. § 9-321 cmt. 3.]

5. Buyer of Consumer Goods from a Consumer

A buyer of consumer goods from a person who used them as consumer goods takes free of any prior security interest, even if that security interest is perfected, provided that the goods are bought:

- without knowledge of the security interest,
- for value,
- for use as consumer goods (the buyer's own personal, family, or household purposes), and
- before a financing statement covering the consumer goods is filed.

[*See* U.C.C. § 9-320(b)(1)-(4).]

6. Effect on Possessory Security Interest

Even a buyer or lessee in the ordinary course or a buyer of consumer goods from a consumer will take subject to a security interest perfected by *possession*. [*See* U.C.C. §§ 9-320(e), 9-321 cmt. 3.]

7. Buyer without Knowledge of Security Interest or Agricultural Lien

A buyer of goods (as well as instruments, tangible chattel paper, or tangible documents) takes free of a security interest or agricultural lien in the collateral if the buyer is not a secured party, gives value, and takes delivery of the goods (1) without knowing about the security interest or agricultural lien and (2) before perfection. [U.C.C. § 9-317(b).]

8. Lessee without Knowledge of Security Interest

A lessee of collateral constituting goods will take free of any security interest or agricultural lien in the collateral if the lessee gives value and takes delivery (1) without knowing about the security interest or agricultural lien and (2) before perfection. [U.C.C. § 9-317(c).]

B. Purchaser of Chattel Paper as Proceeds of Inventory Collateral

To take free of a conflicting security interest in chattel paper claimed as *proceeds of inventory collateral*, the buyer of the chattel paper must:

- act in *good faith*,
- buy in the *ordinary course* of the buyer's business,
- give *new value* for the chattel paper, and
- take *possession or control* of the chattel paper.

Additionally, the chattel paper must not indicate that it has been assigned to another person who is not the buyer. [U.C.C. § 9-330(a).]

C. Purchaser of Chattel Paper Not Constituting Proceeds of Inventory Collateral

To take free of a conflicting security interest in chattel paper that *does not* originate from proceeds of inventory collateral, the buyer must:

- act in good faith,
- buy in the *ordinary course* of the buyer's business,
- give *new value* for the chattel paper,
- take *possession or control* of the chattel paper, and
- buy *without knowledge* that the purchase violates the secured party's rights.

[U.C.C. § 9-330(b).]

D. Purchaser of Instruments

A purchaser of instruments will take free of a conflicting security interest perfected by a method other than possession, such as filing a financing statement, if the purchaser acts in *good faith* and *without knowledge* that the purchase violates the secured party's rights. The purchaser must also *give value* and *take possession* of the instrument. [*See* U.C.C. § 9-330(d).]

XIV. Priority of Security Interests in Transferred Collateral

Some parties receive transferred collateral subject to another's security interest. This can create thorny issues of priority if the recipient later creates a security interest in the same collateral.

A. General Rule, Receipt of Collateral Subject to Security Interest

In general, a security interest created by a debtor is subordinate to a security interest created by another person if:

- the debtor acquired the collateral *subject to* the security interest that the other person created,
- that security interest *was perfected* when the debtor acquired the collateral, and
- there is *no later period* when the security interest is unperfected. [U.C.C. § 9-325(a).]

Example:

A bank had a valid security interest in a delivery company's truck, perfected by filing. The delivery company sold the truck to a shipper in the same jurisdiction. The delivery company took the truck subject to the bank's security interest. The bank promptly perfected its security interest against the shipper by amending its financing statement to indicate the shipper's correct, complete legal name. Afterwards, the shipper gave a finance company a security interest in the truck to secure a loan; the finance company perfected by filing. The finance company's security interest in the truck was subordinate to the bank's. The shipper took the truck subject to the bank's security interest, the bank's interest was perfected when the shipper acquired the truck, and the bank took steps to assure that there was no lapse in perfection. [*Adapted from* U.C.C. § 9-325 cmt. 2, example 1.]

B. Security Interest Created by New Debtor

Sometimes, an original debtor will transfer collateral to a new debtor who becomes bound to the original debtor's security agreement(s). The original security interest may be perfected by filing. However, if the new debtor's name is too different from the original debtor's (making the financing statement seriously misleading), or if the new debtor is in another jurisdiction, then the financing statement will be effective for only four months, unless the secured party takes steps to perfect against the new debtor. As long as the financing statement is effectively *solely* because of the four-month grace period, the security interest is subordinate to any other security interest created by the new debtor. [*See* U.C.C. § 9-326(a) cmt. 2.]

Example:

A bank held a security interest, perfected by filing, in a corporation's existing and after-acquired inventory. A finance company held a security interest, perfected by filing, in a partnership's existing and after-acquired inventory. The partnership was located in a different state from the corporation. The corporation dissolved and transferred all its assets to the partnership, making the partnership liable for the corporation's obligations, including the security agreement with the bank. One month after the transfer, and before the bank took any steps to perfect against the partnership, the partnership acquired new inventory. Both the bank and the finance company had a perfected security interest in the inventory. However, because the bank's financing statement was effective only due to a four-month grace period taking effect upon a transfer of collateral to a new debtor in a new jurisdiction, the finance company's security interest had priority. [*Adapted from* U.C.C. § 9-326 cmt. 2, example 2.]

C. Article 2A Lessors

Generally, a *true lessor* of goods will prevail over any Article 9 secured creditor. If a lessor worries that the transaction may be classified as a secured sale on credit, and not a true lease, it may file a financing statement to maintain its priority. However, this is not required if the arrangement is a true lease. [*See* Article 2A Leases, *supra*.]

D. Security Interests Under UCC Article 2 or Article 2A

Special security interests sometimes arise under UCC Article 2 and Article 2A. In this case, the seller or lessor is the debtor, and the Article 2 or 2A security interest *has priority* over a conflicting Article 9 security interest. This is so even though the buyer or lessee, the secured party, does not comply with Article 9's attachment or perfection requirements. [*See* U.C.C. §§ 322(f), 9-110.]

1. Buyer's or Lessee's Security Interest upon Rightful Rejection or Revocation of Acceptance of Goods

In a transaction for the sale or lease of goods, if the buyer or lessee rightfully rejects the goods or revokes acceptance of them (usually because the goods do not conform to the contract), then the buyer or lessee has a special Article 2 security interest in the goods. The security interest covers (1) any payments toward the purchase or lease price and (2) any reasonable expenses in receiving, transporting, storing, or caring for the goods. [*See* U.C.C. §§ 2-711(3), 2A-508(5).]

2. Security Interest Arising from Seller's Reservation of Title

In a transaction for the sale of goods, the seller may purport to retain or reserve title in the goods. Article 2 of the UCC limits the retention's or reservation's effect to merely reserving a *security interest* in the goods. [*See* U.C.C. § 2-401(1).]

E. Consignors

Article 9 provides no automatic attachment or perfection or other special protection for a consignor giving possession of its inventory to another, to sell on its behalf. To have priority against other potential claimants, such as the consignee's bankruptcy trustee, the consignor must properly *attach and perfect a security interest* in its goods. Here, the consignor is the secured party, and the consignee is the debtor.

F. Fixtures, Accessions, and Commingled Goods

Goods subject to a security interest may be united with either real property or other goods in such a way that the goods change into another type of collateral if the goods become *fixtures*, *accessions*, or *commingled goods*.

1. Continuation and Priority of a Security Interest in Fixtures

Generally, a security interest in goods *continues to exist* even after the goods become fixtures. [*See* U.C.C. § 9-334(a); Security Interests in Fixtures, *supra*.]

a. Ordinary Building Materials

Any security interest in *ordinary building materials* incorporated into an improvement on land ceases to exist once the goods are incorporated into the improvement. Examples of ordinary building materials include siding, windows, studs, joists, pipes, duct work, and so on. [*See* U.C.C. § 9-334(a); *In re Vincent*, 468 B.R. 802 (Bankr. E.D. Va. 2012).]

b. Priority in Fixtures: General Rule

Generally, any security interest in a fixture is subordinate to any conflicting interest in the underlying real property held by someone other than the debtor. This means that an Article 9 secured creditor in the fixture will generally lose to a mortgage holder or subsequent purchaser of the realty. [*See* U.C.C. § 9-334(c).]

i. Exception: Purchase-Money Security Interest in Fixtures

Someone with a security interest in a fixture will have priority over the holder of an interest in the underlying realty if:

- the secured creditor holds a *PMSI* in the fixture,
- the secured creditor perfected the PMSI within *20 days after* the debtor took possession of the goods that became fixtures, and
- the real-property interest arose *before* the goods became fixtures.

[*See* U.C.C. § 9-334(d).]

ii. Exception: Prior Fixture Filing

A prior security interest in a fixture usually takes priority over a subsequent interest of record in the underlying realty if (1) the debtor either possesses the real property or has some interest of record in it, and (2) the security interest is perfected by a fixture filing before the underlying real-property interest became one of record. [*See* U.C.C. § 9-334(e)(1) cmt. 6.]

iii. Special Rule for Some Types of Equipment and Appliances

A security interest in fixtures will generally take priority over an interest in the underlying realty if the security interest is perfected by any legitimate means, and the fixtures are easily removable. The fixtures must consist of

- factory machines,
- office machines,
- equipment not primarily used in the realty's operation, or
- domestic-appliance replacements (not original installations) consisting of consumer goods (*e.g.*, refrigerators or washing machines).

[*See* U.C.C. § 9-334(e)(2) cmt. 8.]

iv. Fixtures and Judgment Liens

A security interest in a fixture perfected by any means (not just filing) takes priority over a later judicial-lien creditor. Generally, a judicial-lien creditor is a creditor with a lien against the underlying realty (thus including the fixture) arising out of some judicial proceeding, usually one to reduce an unsecured debt to judgment. [*See* U.C.C. § 9-334(e)(3) cmt. 9.]

v. Special Priority for Construction Mortgage

A security interest in a fixture, including a PMSI in the fixture, is typically subordinate (inferior in priority) to a construction mortgage if (1) the mortgage is recorded before the goods become fixtures, and (2) the goods become fixtures before completion of construction. A construction mortgage secures an obligation incurred to create a building or other improvement on land—including (1) costs to acquire the land and (2) if the recorded mortgage indicates as much, the cost to acquire the land. A mortgage securing a loan to refinance an earlier loan secured by a construction mortgage has the same priority as the earlier loan. [*See* U.C.C. § 9-334(h) cmt. 11.]

Note: If the security interest in the fixture is perfected by a fixture filing *before* the construction mortgage is recorded, then the fixture filing will take priority over the construction mortgage. [*See* U.C.C. § 9-334(h) cmt. 11.]

2. Accessions

An accession is a good *physically united* with other goods in such a way that its identity is not lost. In other words, it remains possible to distinguish the original good from the other goods. [*See* U.C.C. § 9-102(a)(1).]

Example:

A mechanic installed a new engine in a debtor's truck. The engine was an accession. It was a good, and it remained distinctly identifiable after it was joined to the truck.

a. Security Interest in an Accession

In the case of an accession, the original good's identity is not lost. Thus, a security interest may be created in the original good, and that security interest *will continue* when the good becomes an accession. If a security interest in the original good is perfected when the good becomes an accession, the security interest will remain perfected afterwards. [*See* U.C.C. §§ 9-102(b), 9-335(a).]

b. Priority in Accessions

For accessions, the ordinary rules of priority govern in most cases. However, if the accession becomes part of a larger good, and a security interest in the larger good is perfected by compliance with the state's certificate-of-title system, then the security interest in the larger good takes priority over a security interest in the accession alone. [*See* U.C.C. § 9-335(c)-(d).]

Example:

A truck owner purchased new tires for the truck on credit. The seller retained a security interest in the tires to secure payment of the purchase price, and the seller perfected its interest by filing. Later, the owner installed the tires on the truck, making the tires accessions to the truck. The owner then gave a bank a security interest in the truck to secure repayment of a loan. The bank perfected by noting its security interest on the truck's certificate of title. The bank's security interest in the truck at large attached to the tires (which were part of the truck) and, thus, took priority over the seller's security interest in the tires alone. [*Adapted from* U.C.C. § 9-335 cmt. 7, example 4.]

3. Commingled Goods

A commingled good is *physically united* with other goods in such a way that *it is impossible to distinguish* the original good from the other goods. [*See* U.C.C. § 9-336(a).]

a. Security Interest in Commingled Goods

Because the identity of the original good is lost, a security interest does not exist in commingled goods. However, if a good that is collateral does change into a commingled good, a security interest attaches to the *resulting product or mass*. Assuming the security interest in the original good was perfected, the security interest in the resulting product or mass remains perfected. [*See* U.C.C. § 9-336(b)-(d).]

b. Priority of Security Interests in Product or Mass

In general, the *ordinary priority rules* apply to a security interest in the product or mass. However, if more than one security interest attaches to the product or mass for having previously existed in the commingled goods, then the rule differs. In this case, a security interest that was perfected when the goods became commingled prevails over one that was not. Security interests that were perfected at commingling *rank equally* in proportion to the value of the collateral when it became commingled. [U.C.C. § 9-336(e)-(f).]

Example:

A debtor was a baker. A bank had a perfected security interest in the debtor's eggs (worth $300, securing a debt of $500), and a finance company had a perfected security interest in the debtor's flour (worth $500, securing a debt of $700). When the debtor combined the eggs and flour, the eggs and flour became commingled goods leading to a single product or mass—a cake worth $1,000. Each secured party now had a perfected security interest in the cake. As each was perfected at commingling, each ranked equally in proportion to the value of its collateral at the time it became commingled. The value of the eggs was three-eighths of the cake's value, so the bank was secured up to $375 (three-eighths of $1,000). The value of the flour was five-eighths cake's total value, so the finance company was secured up to $625 (five-eighths of $1,000). [*Adapted from* U.C.C. § 9-336 cmt. 4, example 1.]

G. Subordination Agreements

A party entitled to superior priority may *subordinate*, or give up, its position to another. This subordination must be accomplished by *agreement* between the two parties, in which the superior creditor agrees to take an inferior priority position versus what Article 9 would provide. This agreement need not satisfy any particular formalities. [U.C.C. § 9-339 cmt. 2.]

XV. Particular Rights and Responsibilities of Secured Creditor in Possession or Control of Collateral

If the secured party is in control or possession of collateral, Article 9 imposes on the secured party several duties and grants it some special rights, particularly as it exercises its post-default remedies. Many of these rights and duties, though, are limited or inapplicable if the secured party is a consignor or a buyer of accounts, chattel paper, payment intangibles, or promissory notes. [U.C.C. § 9-207(d).]

A. Reasonable Care in Custody and Preservation

The secured party must exercise reasonable care in preserving collateral in her possession, though she may charge any reasonable expenses to the debtor as additional obligations secured by the collateral. [U.C.C. § 9-207(a).]

B. Keeping Collateral Identifiable

The secured party must keep the collateral *identifiable*. [*See* U.C.C. § 9-207(b)(3).]

C. Right to Hold Proceeds

The secured party may hold proceeds, except money or funds, from any collateral it possesses or controls as *additional security*. The secured party must apply any money or funds received from the collateral to *reduce the secured obligation*, or else remit the money or funds to the debtor. [*See* U.C.C. § 9-207(c).]

D. Right to Create a Security Interest

A secured party may generally create a *security interest* in collateral it controls or possesses. [U.C.C. § 9-207(c).]

XVI. Default

A security interest affords the secured party specific remedies *after default*. The remedies' availability does not depend on whether the secured party has perfected its security interest. Perfection affects priority, which in turn affects the secured creditor's rights relative to competing claimants against the same collateral. However, priority does not affect the secured creditor's basic entitlement to remedies on default. The secured party's default remedies are *cumulative*, meaning that the secured party may exercise whatever remedies it desires in whatever order best fits the situation. This assumes, of course, that the secured party selects its remedies in *good faith*. The debtor, though, has certain *rights* in connection with the secured party's remedies. [*See* U.C.C. § 9-601 cmt 5.]

A. Default Generally

Article 9 lacks any provision that defines default. Instead, the parties themselves may agree on what constitutes default, limited only by the UCC's good-faith requirement and the general rules of contract law. [*See* U.C.C. § 9-601 cmt 3.]

1. Common Types of Default

Most often, the parties' agreement will include language stating that default includes the debtor's *uncured failure to make a payment* when due, specified changes in the debtor's *financial circumstances* making repayment less likely (*e.g.*, insolvency or a decline in the collateral's value past a particular point), or actions that *reduce the value* of the collateral. If the parties' agreement does not define default, then the uncured failure to make a payment when due will usually trigger a default.

B. Secured Party's Remedies on Default Generally

In general, upon default, the secured party: (1) may *enforce* the claim, security interest, or agricultural lien by any available judicial process (for instance, by foreclosing on the security interest or reducing the underlying debt to judgment) and (2) if the collateral is documents, may proceed either as to the documents or as to the goods they cover. [U.C.C. § 9-601(a)(1)-(2).]

1. Procedure if Security Agreement Covers Real Property or Fixtures

If the security agreement covers both personal property and real property, the secured party may proceed under Article 9 alone as to the personal property, without prejudicing any rights with respect to the real property that is also covered by the security agreement. Or, the secured party may proceed against both the personal and real property under the applicable real-property law. If the security agreement covers goods that are or were to become fixtures, a secured party may proceed either under Article 9 or under the applicable real-property law. [*See* U.C.C. § 9-604(a), (b).]

2. Standards of Conduct

The secured party has certain duties toward the debtor, any obligor, and others as it exercises its default remedies. The parties may agree to particular standards of conduct to govern a debtor or obligor's rights and the secured party's duties regarding enforcement of a security interest. Those standards must *not be manifestly unreasonable* or run afoul of Article 9's explicit requirements. In particular, the parties may not waive or modify the requirement to *avoid breaching the peace* or particular rules dealing with the repossession and foreclosure process. [*See* U.C.C. § 9-603; Breaching the Peace, *infra*.]

C. Specific Remedies Against Collateral

After default, the secured party has these general remedies against the collateral:

- repossession,
- disposition of collateral (simple foreclosure),
- foreclosure on intangible assets, and
- strict foreclosure.

1. Repossession and Related Remedies

After default, the secured party has the right of *repossession*. This is the right to exercise self-help and take possession of tangible collateral, provided the secured party is able to do so without a *breach of the peace*. The secured party may also render collateral unusable and dispose of collateral, subject to the obligation to avoid breaching the peace. Of course, the secured party may choose not to exercise self-help and instead take possession by following the appropriate judicial process. [U.C.C. § 9-609(b)(1)-(2).]

2. Liability for Damages

Even if the secured party does not breach the peace during a repossession, the general rule is that the secured party is liable for any damages arising from the repossession.

3. Breaching the Peace

If the secured party repossesses or disables collateral by self-help, it must do so *without breaching the peace*. Article 9 does not define what constitutes a breach of the peace, and it forbids the parties to define it themselves or to waive the requirement to avoid it. Instead, Article 9 leaves it to each state's courts to define what constitutes a breach of the peace. The states' courts have done so, creating a robust common law that is largely consistent across the United States. [U.C.C. §§ 9-603(b), 9-609.]

a. General Definition, Breach of the Peace

In general, courts have defined a breach of the peace as conduct that does or is likely to create imminent (1) violence or (2) public disturbance, unrest, or disorder (even without violence). Examples include threats, actual violence, damaging property, abusive language, and so on. [*See Murray v. Poani*, 980 N.E.2d 1275 (Ill. App. Ct. 2012); 68A Am. Jur. 2d *Secured Transactions* § 476.]

i. Violence Required, Some Jurisdictions

Some courts will not find a breach of the peace unless the secured party's conduct was violent or created the potential for violence. [*See Riley State Bank of Riley v. Spillman*, 750 P.2d 1024 (Kan. 1988).]

ii. Deceit by Secured Party

Courts in at least one jurisdiction will find a breach of the peace if a secured creditor effectuates a repossession by deceiving a debtor. A common example is a case in which the secured party persuades the debtor to bring the collateral onto the secured creditor's premises under false pretenses and then repossesses the collateral. [*See* Robert M. Lloyd, *Wrongful Repossession in Tennessee*, 65 Tenn. L. Rev. 761 (Spring 1998).]

b. Determining Breach of the Peace

Determining whether the peace has been breached is highly fact-intensive. The most important factors are:

- the *nature of the premises*,
- the *potential for immediate violence*,
- whether the *debtor is present* and,
- whether the debtor *consents* to the repossession.

i. Nature of the Premises

Conduct that constitutes a breach of the peace on one type of premises may not on another, depending on the nature and degree of any reasonable expectations of privacy and quiet enjoyment that attend the discrete premises.

1) **Repossession on Private Property: The Home and Attached Structures**

In many jurisdictions, without consent from one authorized to give it—such as the debtor or the debtor's roommate—a creditor or its agent may not enter the debtor's home or a structure attached to it (such as a garage, at least if the structure is closed) to repossess collateral. As for the home itself, this is true even if a door or window is unlocked or open, such that the repossessor could enter the premises without force. (Some courts permit entry into an open garage, though some do not.) Breaking a lock or similar forcible entry into the debtor's home is automatically a breach of the peace in some jurisdictions. [*See Riley State Bank of Riley v. Spillman*, 750 P.2d 1024 (Kan. 1988); *Laurel Coal Co. v. Walter E. Heller & Co., Inc*., 539 F.Supp. 1006 (W.D. Pa. 1982).]

Note: Some courts apply a similar rule to unauthorized entry into a structure on the debtor's business premises. [*See Riley State Bank of Riley v. Spillman*, 750 P.2d 1024 (Kan. 1988).]

2) **Repossession on Private Property Just Beyond the Home**

A peaceful repossession becomes more likely as the repossession moves away from the home to more remote places—such as a driveway, an unattached structure, the front yard adjoining a road, and so on. But even for private property outside the home, there is a strong expectation of privacy and quiet enjoyment requiring a high degree of caution to avoid breaching the peace. [*See Clarin v. Minn. Repossessors, Inc.*, 198 F.3d 661 (8th Cir. 1999); 68A Am. Jur. 2d *Secured Transactions* § 476.]

Example:

A secured party moved to repossess a car parked in the driveway. The debtor did not come out and overtly object to the repossession while it was ongoing, and the secured party did not enter the home or any attached structures. There was no breach of the peace. [*See* 68A Am. Jur. 2d *Secured Transactions* § 476.]

3) **Repossession on Public Property**

Generally, a repossession on *public property*, such as a public parking lot or public street, is less likely to produce a breach of the peace than one on private property. This is because public property carries a *lesser expectation* of privacy and safe, quiet occupation than does private property, especially the home. Even on public property, however, the repossessor must act with caution, taking care not to do anything that might frighten or provoke the debtor or anyone else. [*See Clarin v. Minn. Repossessors, Inc.*, 198 F.3d 661 (8th Cir. 1999).]

ii. Potential for Immediate Violence

If the repossession creates the *potential* for immediate violence, a court is highly likely to find a breach of the peace. [*See Riley State Bank of Riley v. Spillman*, 750 P.2d 1024 (Kan. 1988).]

iii. Debtor's Presence and Consent

If the debtor is present and consents to the repossession, there is no breach of the peace. However, in some jurisdictions, if the debtor is present and objects to the repossession, the repossession should *immediately stop*, regardless of other considerations. Otherwise, a court will likely find that a breach of the peace has occurred. In other jurisdictions, an express protest from the debtor does not necessarily mean that the repossession must stop, at least if the debtor's protest is minor, perfunctory, or halfhearted. [*See* 68A Am. Jur. 2d *Secured Transactions* § 476; *Clarin v. Minn. Repossessors, Inc.*, 198 F.3d 661 (8th Cir. 1999).]

iv. Best Practices to Avoid Breaching the Peace

Best practices that reduce the potential for violence and breaching the peace include:

- providing the debtor *notice* before the repossession,
- repossessing during *daylight hours* and on *public property*, and
- notifying the *local police* that the collateral has been lawfully repossessed.

1) Notifying the Debtor Before the Repossession

Better practice is to give the debtor notice before repossessing, especially before repossessing on private property. If the debtor is on notice that the secured party means to come and repossess the collateral, the debtor is less likely to react out of surprise or a perceived threat. Indeed, having received notice, the debtor may simply consent to the repossession. If that occurs, there is no breach of the peace. [*See* 68A Am. Jur. 2d *Secured Transactions* § 476; *Salisbury Livestock Co. v. Colo. Cent. Credit Union*, 793 P.2d 470 (Wyo. 1990).]

2) **Repossessing During Daylight Hours**

Better practice is to avoid repossessing collateral late at night, as this produces a greater chance of immediate violence. For instance, if the resulting commotion awakens or disturbs the debtor, and the debtor decides to investigate, the debtor may mistake the repossession for a break-in and react in unpredictable and violent ways. That said, however, many nighttime repossessions occur without breaching the peace. [*See Marcum v. Eastman Credit Union*, No. 2:10–CV–10, 2012 WL 1795058 (E.D. Tenn. May 7, 2012); 68A Am. Jur. 2d *Secured Transactions* § 476.]

3) **Repossessing on Public Property**

Ideally, a repossession would occur either on public property or private non-residential property viewable from a public road—for example, the debtor's workplace, if the collateral is the debtor's car parked there. [*See Clarin v. Minn. Repossessors, Inc.*, 198 F.3d 661 (8th Cir. 1999).]

4) **Notifying the Local Police**

Notifying the local police of the repossession is an advisable precaution to take, in case the debtor calls them to report the collateral stolen after the repossession.

v. Removing Fixtures

If the tangible collateral is a fixture, then the secured party may remove it, but only if the secured party (1) has priority over *all* owners and encumbrancers on the real property and (2) removes the fixture *without breaching the peace*. The secured party is generally liable for damages arising from the removal. [*See* U.C.C. § 9-604(b)(c).]

c. Disabling the Collateral

At times, repossessing collateral on the debtor's premises may be unworkable or unreasonably expensive if the collateral is heavy or impractical to move. In those cases, the secured party may simply *disable* the collateral or *render it inoperable*, provided this is done without breaching the peace. Having disabled the collateral, the secured creditor may then dispose of it while it is on the debtor's premises. [*See* U.C.C. § 9-609 cmt 6.]

4. Simple Foreclosure

After default, once the secured party has repossessed, disabled, or removed tangible collateral, the secured party may implement simple foreclosure. Simple foreclosure means to dispose of the collateral by sale, lease, license, or other means. The secured party may dispose of the collateral as it is or after any preparation or processing that is commercially reasonable. [*See* U.C.C. § 9-610(a).]

a. Commercial Reasonableness Generally

The terms of the simple foreclosure must be *commercially reasonable*. This rule applies to the method and manner of the disposition, the time and place where it occurs, and all other facets of the transaction. In general, a disposition is commercially reasonable if the secured party takes adequate steps to assure that the disposition yields a *fair price* for the collateral. The fact that the secured party might have obtained greater value by disposing of the collateral in a different way, or at a different time, is not by itself enough to show commercial unreasonableness. Even so, if the price seems conspicuously low, then courts will scrutinize each aspect of the transaction carefully to make sure it was commercially reasonable. [*See* U.C.C. §§ 9-610(b), 9-627(a) cmt. 2, *In re Massaquoi*, 412 B.R. 702 (Bankr. E.D. Pa. 2008).]

i. Commercial Reasonableness Safe Harbor

A disposition is automatically commercially reasonable if made:

- in the typical manner on a recognized market,
- at the current price in any recognized market when the disposition occurs, or
- in a manner that conforms to reasonable commercial practices among dealers in collateral.

[U.C.C. § 9-627(a)-(b).]

1) Recognized Market

For purposes of simple foreclosure under Article 9, the concept of a recognized market is very narrow and limited in scope, embracing only markets with standardized price quotations for fungible property. Standardized price quotation means that the prices are not individually negotiable. A classic example of a recognized market is a stock market, such as the New York Stock Exchange. [U.C.C. §§ 9-610 cmt. 9, 9-627 cmt. 4.]

ii. Approval as Establishing Commercial Reasonableness

Though approval is not required, the disposition is automatically commercially reasonable if approved in advance by a court order, creditors' committee, representative of creditors, or assignee for the benefit of creditors. [U.C.C. § 9-627(c) cmt. 3.]

b. Disposition by Sale

The secured party may dispose of the collateral by *public or private sale*, including sale over the Internet. [*See* U.C.C. § 9-610(c).]

i. Secured Party's Right to Purchase Collateral

At a *public sale*, the secured party may bid on and purchase the collateral. In this context, secured parties often engage in credit bidding, meaning to offset the unsatisfied secured obligation against the purchase price. In a *private sale*, the secured party may purchase the collateral itself, but only if the collateral is of a kind that is ordinarily sold at a standard, widely distributed price quotation or on a recognized market. [*See* U.C.C. § 9-610(c).]

ii. No Time Limit for Sale of Collateral

There is no specific time period within which a secured party must dispose of collateral. If commercially reasonable, the secured party may dispose of the collateral at any time. [*See* U.C.C. § 9-610(b).]

iii. Notice Requirement

If the secured party intends to dispose of collateral in a private or public sale, it must send a reasonable, authenticated *notification* to the debtor and any secondary obligor. If the collateral is *not consumer goods,* the secured party must also send notice to most other competing claimants to the collateral. The debtor or other obligor may waive this right to notification, but only by authenticated agreement made *after* default. [*See* U.C.C. §§ 9-611(b), 9-624(a).]

1) Exceptions to Notice Requirement

The general notice requirement does not apply if the collateral (1) is perishable, (2) threatens to decline quickly in value, or (3) is typically sold on a recognized market. [U.C.C. § 9-611(d).]

2) **Competing Claimants Entitled to Notice Generally**

If the collateral is *not consumer goods*, then the competing claimants who must receive notice of the sale include: (1) any claimant from whom the secured party *received an authenticated notification* of a claim of an interest in the collateral ten or more days before the notification date (the date notification is either sent by the secured party or waived by the debtor and any secondary obligor); (2) any competing claimant with a financing statement (or lien) properly filed and indexed *ten or more days before* the notification date; and (3) any party with a security interest perfected through a *certificate-of-title system* (or according to certain statutes, regulations, or even treaties), again ten or more days before the notification date. [*See* U.C.C. § 9-611(c).]

3) **Identifying Claimants with Properly Filed and Indexed Financing Statements**

A secured party may request information from the appropriate filing office in a commercially reasonable manner, as to all financing statements indexed under the debtor's name in that office. The secured party must do this *not later* than 20 days but *not earlier* than 30 days before the notification date. The secured party must then send the notification to any claimants identified in any response it receives from the office. But if the secured party receives no response from the office by the notification date, it will be deemed to have complied with the requirement to send notice to all competing claimants with properly filed and indexed financing statements, provided it properly follows this procedure. [*See* U.C.C. § 9-611(e).]

4) **Timeliness of Notification**

The secured party must send the notification within a reasonable time before disposing of the collateral. In general, notification is sent within a reasonable time if sent far enough in advance that parties receiving notice can act on it or at least account for it. For transactions that are not consumer transactions, notification is sent within a reasonable time if sent after default but *10 days or more* before the earliest date of disposition indicated in the notification. [*See* U.C.C. § 9-612 cmt. 2.]

5) **Content and Form of Notification: Nonconsumer Transactions**

For all *nonconsumer* transactions, the notification of disposition generally should: (1) describe the debtor, the secured party, and the collateral that is subject to the disposition; (2) indicate the method of the intended disposition; (3) include a statement that the debtor is entitled to an accounting of any unpaid indebtedness, stating any charge for the accounting; (4) if the disposition is public, indicate the time and place of the disposition; and (5) include the time of any subsequent disposition. A fact finder may find the content and form of the notification sufficient even if it fails these requirements as long as the overall form and content of the notice are reasonable. [*See* U.C.C. § 9-613(1) cmt. 2.]

6) **Accuracy of Notification**

The information must be substantially accurate and complete, but minor errors are acceptable if not seriously misleading. No particular language is required to articulate the needed information. [*See* U.C.C. § 9-613(3), (4).]

7) **Content and Form of Notification: Consumer-Goods Transactions**

For a consumer-goods transaction, the notification must contain everything required if the transaction were a nonconsumer transaction. In addition, it must: (1) *describe any deficiency* for which the debtor or other obligors will be liable following the disposition, (2) list a telephone number that the debtor or other obligors may call to inquire about the amount that must be *paid to redeem the collateral*, and (3) furnish a telephone number or mailing address to obtain more information regarding the disposition. [*See* U.C.C. § 9-614.]

iv. Applying the Proceeds of the Disposition

After the disposition, the proceeds must be applied in the following order:

1. to cover all costs associated with the disposition, including the costs of retaking and holding the collateral, along with any reasonable attorney's fees (if agreed by the parties);
2. to satisfy the obligation secured by the security interest enforced in the disposition;
3. to satisfy any obligations secured by a subordinate security interest in or lien on the collateral, but only if the secured party receives authenticated demand from the subordinate-interest holder before completion of distribution, *and* the subordinate interest is senior to any consignor's interest in the collateral; and
4. to satisfy the interest of any consignor in the collateral, provided the secured party receives authenticated demand from the consignor before completion of distribution.

[*See* U.C.C. § 9-615(a) cmt 2.]

v. Deficiency and Surplus

If the proceeds are not sufficient to satisfy all outstanding obligations against the collateral, then any other obligor is liable for the *deficiency*. If the proceeds exceed all outstanding obligations against the collateral, plus the costs of disposition, then there is a *surplus*. Assuming there is no other claimant against the collateral, such as a consignor, the surplus goes to the debtor. [*See* U.C.C. § 9-615(d)(1)-(2).]

1) Sale to Buyer Related to Secured Party

Sometimes, the collateral is sold to the secured party, a person *related to the secured party*, or a secondary obligor, and this results in proceeds falling below the range that an ordinary sale to a disinterested third party would have yielded. If so, any deficiency is calculated based not on the true proceeds of the disposition, but rather as if the sale had been an ordinary *commercially reasonable disposition* to a disinterested third party—that is, as if the disposition had yielded something within the range of proceeds that an ordinary sale would have produced. This usually produces a significantly smaller deficiency. [*See* U.C.C. § 9-615(f).]

2) Persons Related to Natural Person

Persons related to a natural person include (1) the natural person's spouse, siblings, ancestors, and descendants; (2) the spouse's siblings and lineal descendants; and (3) any relative of the natural person or her spouse who shares a home with the natural person. [*See* U.C.C. § 9-102(b)(63).]

3) Persons Related to Organization

Persons related to an organization include (1) anyone who directly or indirectly controls the organization; (2) any entity controlled by or under common control with the organization (*e.g.*, a subsidiary or affiliate); (3) an officer, director, or person with similar managerial authority in the organization; (4) an officer, director, or person with similar managerial authority in an entity that controls, is controlled by, or is under common control with the organization; (5) the spouse of any natural person related to the organization; (6) any family member of any natural person related to the organization (including any spouse), provided the family member shares a home with the natural person who is related to the organization. [U.C.C. § 9-102(b)(63).]

4) Explaining How the Deficiency or Surplus was Calculated in a Consumer-Goods Transaction

In the case of a consumer-goods transaction yielding a surplus or creating a deficiency, the secured party *must* provide a detailed explanation of the surplus or deficiency to the debtor and any consumer obligor. The explanation must provide *great detail* about the sale, the resulting proceeds, the amount and nature of any obligations and expenses to which the proceeds were applied, any credit to which the debtor or obligor is entitled, and the amount of the surplus or deficiency. The secured party must explain the surplus or deficiency: (1) before (or when) it *accounts* to the debtor and *pays* the debtor a surplus or demands a deficiency from a consumer obligor or (2) within 14 days after receiving an authenticated post-disposition *request*. [*See* U.C.C. § 9-616.]

c. Legal Consequences of Disposition of Collateral

A proper disposition of collateral will, of course, bear significant legal consequences. Any good-faith transferee for value takes the collateral free of the debtor's interest, the interest of the secured creditor effectuating the disposition, and any interests subordinate to that of the secured creditor effectuating the disposition. Those interests are, in turn, extinguished. [*See* U.C.C. § 9-617.]

d. Transfer Statement for Collateral Subject to Certificate-of-Title System

If the security interest was perfected under the state's *certificate-of-title system*, the buyer will generally demand that the certificate reflect the buyer's ownership of the collateral. This may be accomplished if either the debtor *consents* or the secured party files a *transfer statement*. A transfer statement is a record, authenticated by the secured party, stating that:

- the *debtor defaulted* on an obligation secured by the collateral;
- the secured party has *exercised its post-default remedies* concerning the collateral; and
- because of the exercise, a transferee has now *acquired the debtor's rights* in the collateral.

The transfer statement must also indicate the debtor's, secured party's, and transferee's names and addresses. [*See* U.C.C. § 9-617(a).]

i. Effect of Filing Transfer Statement

Once the secured party files the transfer statement with the proper office, it may transfer record ownership of the collateral to the transferee. The relevant office must then issue a certificate of title reflecting the transferee's ownership. [*See* U.C.C. § 9-619(b).]

5. Foreclosure on Intangible Assets

Sometimes, the collateral consists of intangible assets, such as accounts, deposit accounts, investment property, payments made pursuant to instruments, and chattel paper. In that event, the secured party may take steps to collect, from the account debtor, amounts due on the account to the debtor. This practice is known as *foreclosure on intangible assets*. [*See* U.C.C. § 9-607.]

a. Time for Foreclosure on Intangible Assets

The secured party may exercise the right to foreclose on intangible assets *after default*, whether or not the security agreement permits it. But for the secured party to exercise this right *before* default, the security agreement *must permit it*. Thus, if the security agreement does not specifically state that pre-default foreclosure is permitted, the secured party may do it upon default—but not before. [*See* U.C.C. § 9-607.]

b. Notification Lending

Foreclosure on accounts is often done by *notification lending*, so named because the secured creditor *notifies* the account debtor to pay the secured party directly. The notification serves to effectuate, and to alert the account debtor to, an *assignment* of the debtor's rights to the secured party. Thus, once the secured party gives the account debtor proper notification, Article 9 obligates the account debtor to make payments directly to the secured party instead of the debtor. [*See* U.C.C. §§ 9-406, 9-607(a)(1).]

Example:

A debtor, a taxi company, allowed its riders to pay fares by credit card. A bank held a valid, perfected security interest in the debtor's accounts. If a rider paid by credit card, a credit-card receivable (a type of account) would be created. The credit-card company was the account debtor because it owed the debtor the amount of the fare. (The rider, in turn, owed the amount of the fare to the credit-card company.) The debtor defaulted on its obligations to the bank. Thus, the bank was permitted to engage in notification lending. The bank could notify the credit-card company to pay, directly to the bank, all credit-card receivables owing to the debtor. The notification, in turn, obligated the credit-card company to do just that. Because a default had occurred, the bank could exercise this right whether or not the security agreement permitted it.

c. Foreclosure on Intangible Assets: Deposit Accounts

If the intangible asset is a *deposit account* over which the secured party has control by being the depositary bank, the secured party may simply apply the balance in the deposit account to the secured obligation. If the secured party has control *by agreement* with the depositary bank, the debtor, and the secured party or by being the bank's customer on the account, then the secured party must *provide instructions* to the bank. The instructions must inform the bank how much of the balance in the deposit account should be transferred to the secured party to pay down the secured obligation. [*See* U.C.C. § 9-607(a)(4)-(5).]

d. Foreclosure on Intangible Assets: Distributing Proceeds

Similar to proceeds generated from the foreclosure of tangible collateral, proceeds of foreclosure on intangible collateral must be distributed in a particular order:

- all *costs of foreclosure*, including reasonable attorney's fees;
- the secured obligation being foreclosed upon;
- any security interests or liens that are *junior* to the foreclosing secured party; and
- any surplus, which must be paid to the debtor.

[*See* U.C.C. § 9-608(a).]

D. Strict Foreclosure

Sometimes, a secured creditor may simply *accept the collateral* as full or partial satisfaction of the secured obligation. This is called a *strict foreclosure*. [*See* U.C.C. §§ 9-620, 9-622.]

1. Effect of Strict Foreclosure

Strict foreclosure transfers to the secured party all the debtor's rights in the collateral. It also extinguishes the foreclosed security interest, along with any subordinate security interest, lien, or other interest in the collateral. Thus, after accepting collateral as full or partial satisfaction, the secured party may later decide to sell the collateral. If so, no notice or other formalities are required prior to the sale. The collateral now belongs to the secured party, to dispose of as it sees fit. [*See* U.C.C. § 9-622(a).]

2. Strict Foreclosure in Partial Satisfaction

Strict foreclosure in *partial* satisfaction of the secured obligation requires that the debtor consent to strict foreclosure *after default* and in an *authenticated record*. This means that the debtor must agree to the terms and conditions of the partial satisfaction, including the amount of debt to be discharged. [U.C.C. § 9-620.]

3. Strict Foreclosure in Full Satisfaction

If the strict foreclosure will *fully* satisfy the secured obligation, the debtor may consent to the strict default in an authenticated record made *after default*. In that event, the secured party may proceed. If the debtor does not consent, the secured creditor must, after default, send the debtor an essentially *unconditional proposal* explaining that the secured creditor intends to take the collateral in full satisfaction of the secured obligation. (The proposal may be conditioned on the debtor's maintaining or preserving the collateral.) If the debtor does not respond with an authenticated objection within 20 days, the secured party may proceed with the strict foreclosure. However, if the debtor does respond with an authenticated objection within 20 days, the secured party may not proceed. [U.C.C. § 9-620(c).]

4. Notice to Competing Claimants

Whether the strict foreclosure is in full or partial satisfaction of the debt, the secured party should also give *notice* to other parties. These are primarily actual or potential *competing claimants* against the collateral, and they include any party having filed a financing statement against the collateral, given the secured party notice of a competing interest, or perfected under the state's certificate-of-title system. [*See* U.C.C. § 9-621.]

a. Effect of Failure to Give Notice

Failure to give notice *will not invalidate* the strict foreclosure. It may, however, expose the secured party to *liability* in favor of one who suffered damages because of the strict foreclosure—usually a junior creditor whose interest the foreclosure extinguished. [*See* U.C.C. § 9-622 cmt 2.]

5. Strict Foreclosure of Consumer Goods

Special rules apply to strict foreclosure of *consumer goods.*

a. Mandatory Disposition

If (1) the secured party has taken possession of collateral constituting consumer goods, and (2) the consumer debtor has paid more than 60 percent of the principal amount of the debt (or the cash price, in the case of a PMSI), then the secured party *may not* exercise the right to strict foreclosure. Instead, the secured party *must* dispose of the collateral within 90 days after taking possession of the collateral (or a longer timeframe if provided in an authenticated agreement entered into after default with the debtor and any secondary obligors). The mandatory disposition itself must follow the *normal rules governing disposition of tangible goods*. [*See* U.C.C. § 9-620(e)-(f).]

i. Waiving Mandatory Disposition

The parties may waive mandatory disposition by an authenticated agreement entered into *after default*. [*See* U.C.C. § 9-624(b).]

b. No Strict Foreclosure in Partial Satisfaction

A secured party *may not* accept consumer goods in partial satisfaction. [*See* U.C.C. § 9-620(g).]

E. Redemption

The debtor, a secondary obligor, or a secured party or lienholder other than the one foreclosing may redeem the collateral. [*See* U.C.C. § 9-623(a).]

1. Time for Redemption

Redemption must occur (1) *after* default and repossession and (2) *before* the secured party collects amounts owing on intangible collateral, disposes of tangible collateral (or enters a contract to dispose of tangible collateral), or accepts the collateral in full or partial satisfaction of the secured obligation. [*See* U.C.C. § 9-623(c).]

2. Amount Needed to Redeem Collateral

To redeem the collateral, the redeeming party must tender (1) full payment of *all* obligations secured by the collateral that are then due and owing, along with (2) the reasonable expenses of foreclosure, including (if agreed) attorney's fees. [*See* U.C.C. § 9-623(b) cmt. 2.]

3. Waiving the Right to Redeem

The parties may waive a right to redeem, but only by authenticated agreement entered into *after default*. However, redemption *cannot* be waived in connection with a consumer-goods transaction. [U.C.C. § 9-624 (c).]

F. Remedies for Secured Party's Failure to Comply

A secured party may fail to comply with the Article 9 provisions dealing with repossession, collection of intangible assets, or sale of tangible assets. In that event, a court may direct or limit collection or enforcement of the secured obligation or disposition of the collateral on any terms that are appropriate. Also, a secured party is liable in damages for *any loss* resulting from its noncompliance. Damages might arise if, for instance, the debtor cannot obtain alternative financing, or the debtor can obtain alternative financing but only at greater expense. [U.C.C. § 9-625(a)-(b).]

G. Minimum Statutory Damages, Consumer-Goods Transaction

Article 9 provides for minimum statutory damages for failure to comply with its disposition or enforcement rules (*e.g.*, a breach of the peace or failure to provide required notice, even if the overall transaction is commercially reasonable) if the collateral is *consumer goods*. These minimum statutory damages apply regardless of actual damages, and even if the debtor cannot prove actual damages. The amount of the punitive award is at least (1) the credit-service charge, plus one-tenth of the principal debt or, alternatively, (2) the time-price differential plus one-tenth of the cash price. In most instances, this means that the punitive damage award will be the total interest charge plus one-tenth of the original principal amount of the debt, regardless of any payments toward the interest or principal. [U.C.C. § 9-625(c)(2); *In re Schwalb*, 347 B.R. 726 (Bankr. D. Nev. 2006).]

Example:

A man financed a car purchase from a seller. The man planned to use the car for personal purposes, making the car a consumer good. The cash price of the vehicle was $10,000. The man agreed to pay the seller $200 per month for 60 months (totaling $12,000), with no money down. The seller took a perfected security interest in the car to secure the purchase price. Before the first payment was made, the man defaulted. Later, the seller repossessed the car but breached the peace while doing so. Regardless of actual damages, the man was entitled to minimum statutory damages of at least $3,000, consisting of (1) the $2,000 cost of credit (the excess of total payments over the purchase price) plus (2) $1,000, or one-tenth of the purchase price.

H. Statutory Fines

Article 9 imposes statutory fines, usually of $500, for special instances in which the secured party violates its provisions.

1. Failure to Send a Termination Statement

There is a fine if a secured party wrongly fails to file or send a *termination statement* upon a debtor's request. [*See* U.C.C. §§ 9-513, 9-625(e)(4).]

2. Failure to Explain Deficiency or Surplus

There is also a fine if the secured party fails, if required, to provide a *proper explanation* of any surplus or deficiency stemming from the sale of collateral, and the failure is part of a pattern or in line with a practice of noncompliance. [U.C.C. § 9-625(e)(5).]

I. Explanation and Conduct Regarding a Deficiency or Surplus, Nonconsumer Transaction

In a nonconsumer transaction, if a *debtor or secondary obligor* places in issue a secured party's explanation of (or other conduct regarding) a surplus or deficiency, the secured party's burden is to establish that the overall transaction and proceedings creating the surplus or deficiency complied with Article 9. If the secured party fails to do this, then any deficiency is generally eliminated altogether, except insofar as the secured party proves that the proceeds of a *conforming* disposition would have been less than the sum of the secured debt plus reasonable expenses and attorney's fees. But the secured party need not prove compliance if the debtor or a secondary obligor does not place compliance in issue. [*See* U.C.C. § 9-626.]

XVII. Assignment of Rights and Duties to Secondary Obligors

A secondary obligor may become obligated to perform the secured party's duties, and the secured party may correspondingly be relieved of those duties, if:

- the secured party *assigns its rights* to the secondary obligor;
- the secured party *transfers the collateral* to the secondary obligor, and the secondary obligor accepts the transfer and agrees to accept the secured party's rights and assume its duties; or
- the secured party *subrogates* its rights, with respect to the collateral, to the secondary obligor.

[*See* U.C.C. § 9-618(b)(3).]