Secured Transactions: An Introduction to Article 9 of the Uniform Commercial Code

Presented for the Risk Management Association

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What is Article 9??

- The law governing security interests in personal property and fixtures
- Secures the payment or performance of an obligation
- All states have adopted Article 9, but the law can vary from state to state

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Scope of Article 9

- To have a valid security interest, must have "attachment" and "perfection"
- Attachment is the process of creating a security interest
- Perfection is the process of making the security interest valid as against third parties (by filing a financing statement, taking possession, etc.)

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Understanding Collateral Categories

- When determining the classification, always look to how the debtor uses the assets
- Goods
  - All things that are movable at the time a security interest attaches
  - Includes fixtures

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Understanding Collateral Categories (cont.)

- Sub-classes of goods:
  - Inventory
    - Goods held for sale or lease
  - Farm products
    - Crops, livestock or other supplies used in farming
    - The debtor must be engaged in farming operations

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Understanding Collateral Categories (cont.)

- Equipment
  - This is the catch-all category
  - Includes all goods that are not consumer goods, inventory or farm products
- Investment Property
  - Certificated and uncertificated securities
  - Commodities contracts and accounts

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Understanding Collateral Categories (cont.)

- Semi-intangible property
  - Instruments (promissory notes)
  - Chattel paper
    - Evidences both a monetary obligation and a security interest in or lease of goods
    - Electronic chattel paper
    - Tangible chattel paper

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Understanding Collateral Categories (cont.)

- Other Intangibles
  - Accounts
  - Deposit accounts
  - Commercial tort claims (excludes damages for death and personal injury)
  - General intangibles
    - Intellectual property and software

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Attachment

- Describes the moment the security interest becomes enforceable against the debtor
- What are the requirements for attachment?
  - Value is given to debtor (loan is made, some other benefit, generally looking for consideration to support a contract)
  - Debtor has rights in the collateral
  - Must have a security agreement or control

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Attachment (cont.)

- What are the requirements for a valid security agreement?
  - Adequate description of collateral
    - Reasonably identify the collateral
    - Can use Article 9 categories (equipment, goods, etc.)
    - Cannot use "all assets"
  - Signed by the debtor

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Perfection

- Why perfect a security interest?
  - Priority
  - Notice to other creditors
  - Protection against claims by other creditors/bankruptcy trustee

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Perfection by Filing

- Filing a UCC financing statement
  - Perfect most types of collateral
    - General intangibles
    - Inventory and equipment
    - Commercial tort claims
    - Accounts receivable
  - Exceptions if control or possession is mandatory or permissive
    - Investment property
    - Deposit accounts

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Requirements for Effective UCC Financing Statement

- Debtor's legal name
  - Must be the exact legal name of the debtor
  - Trade names are insufficient
  - Use the certified articles of incorporation/organization
  - Look to most recently filed public records (name may have changed since original articles were filed)
  - For individuals, the name must match the name on driver's license or state issued ID card

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Requirements for Effective UCC Financing Statement (cont.)

- Describe the collateral
  - Can use "all assets" here if applicable
  - If not "all assets" then description in financing statement must match the granting clause in security agreement
  - If fixture filing or as extracted collateral or timber to be cut, must include a legal description of the property

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Requirements for Effective UCC Financing Statement (cont.)

- Must have authorization to file
  - Signing a security agreement is sufficient
  - No signature needed on financing statement
  - Pre-filing ok, but need specific authorization

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Where Do I File?

- Generally, file in the state the debtor is "located"
- For a registered organization, it’s the state of incorporation/organization (WDFI in Wisconsin)
- For non-registered organizations, it's the state in which debtor has its chief executive office
- For individuals, it's where the debtor has his or her principal residence
- For fixtures, "as-extracted" collateral and timber to be cut, file locally (typically register of deeds in county where collateral is located)

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Effectiveness of a Filed Financing Statement

- Generally, filings are effective for 5 years from the date of filing
- Secured Party can file a continuation statement that will extend the filing for another 5 years
- Continuation statement must be filed within 6 months prior to the original expiration date

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Errors in a Filed Financing Statement

- Debtor name changes are common
- Changes in jurisdiction of organization also occur
- If financing statement becomes "materially misleading", Secured Party has 4 months to amend the financing statement to remain perfected
- It's important to have a covenant in security agreement requiring Debtor to notify Secured Party of name changes and changes in jurisdiction

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UCC Financing Statement Review

- Debtor name
  - Certified articles
  - Individuals
- Collateral description
  - "All assets" generally works
  - Commercial tort claims (specificity)
- Location, forms, fees
  - Fixture filings
  - E.g., Florida, Tennessee

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Completing the UCC-1 form

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Perfecting Security Interests in Deposit Accounts

- Lender is the bank that maintains deposit account
- Control agreement if lender is not bank that maintains deposit account
- Deposit account is in the name of the lender

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Vehicles (Certificates of Title)

- Electronic filing with DOT
  - Listing lender as lien holder
  - Can search electronic filings online
- Filing alone not enough
  - Need underlying security agreement

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Priority of Competing Security Interests

- A perfected security interest prevails over unperfected security interest
- A perfected security interest prevails over a judgment lien creditor if the secured party's lien is perfected before the judgment lien arises.
- What happens when secured party vs. secured party?
- first to file or perfect generally has priority…but purchase money liens can alter the priority scheme, giving the PSMI lender a "super priority" lien

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Purchase Money Security Interests

- Two different types, equipment and inventory
- PMSI in Equipment
  - PMSI is perfected when the debtor takes possession of the collateral or within 20 days thereafter
  - Has priority over an earlier perfected security interest if secured party perfects within 20 days after debtor takes possession of collateral

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Purchase Money Security Interests (cont.)

- PMSI in Inventory
  - Rules are more complex than for equipment
    - Must give written notice to holders of competing security interests before debtor takes possession of the inventory
    - Must file a financing statement prior to the date debtor takes possession of the inventory
- Consignments are treated as PMSI's and consignors must comply with PMSI inventory rules stated above to protect consigned assets from creditors of consignee

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Other Priority Rules

- A secured party who has a perfected security interest by possessing an instrument has priority over a secured party who has filed a financing statement
- A security interest in investment property perfected by control is superior to one perfected by filing, even if control occurs after the filing was made

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Terminating a Security Interest

- When does this arise?
  - Full release
    - File a UCC termination statement to terminate the original filing
  - Partial release
    - Don't terminate the original filing, amend the filing to release specific assets

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Terminating a Security Interest (cont.)

- Who is authorized to release collateral or terminate a filing?
  - Secured party (they are obligated to do so when no secured obligations remain)
  - Debtor (if secured party refuses to do so)
    - Must make an "authenticated demand"
    - If no termination by secured party within 20 days of authenticated demand, debtor may file

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Questions?

Thank You!

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