

MAGICSHEETS | SECURED TRANSACTIONS 1/4

- I. SCOPE (What are secured transactions about?)
 - a. Uniform Commercial Code (UCC) Article 9 governs security interests and provides rules for their priority, and applies to “any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures by contract” (consensual security interests in goods and not real property)
 - b. Parties
 - i. **Creditor (secured party):** party that extends value to a debtor in exchange for security interest in debtor’s collateral property
 - ii. **Debtor:** party with property right in the collateral, who made a security agreement with creditor
 - iii. **Obligor:** party under obligation to furnish money or services due (often also the debtor)
 - c. Definitions
 - i. **Collateral:** property subject to a security interest that a creditor can look to satisfy the debt
 1. **Consumer goods:** goods used *primarily* for personal, family, household purposes
 2. **Equipment:** goods (for business) other than consumer goods, inventory, farm products
 3. **Inventory:** goods for sale or lease to others in the ordinary course of business, or raw materials, work in process, or materials used or consumed in business
 4. **Accessions:** goods physically united with other goods while retaining separate identity (e.g., GPS unit installed in car)
 5. **Farm products:** goods used for or produced by farming operation, except uncut timber (includes growing/grown crops and born/unborn livestock)
 6. **Classification of tangible collateral may differ depending on the use or owner**
 - a. Example: A computer could be a consumer good or equipment depending on use
 - b. Equipment vs. inventory :: cash register vs. line of clothes
 - c. **Fixtures:** goods that are attached to real property such that an interest in them arises under real property law (e.g., chandelier, sprinkler system, furnace)
 7. **Intangibles/semi-intangibles** include intellectual property, financial instruments (e.g., stocks, bonds, cash proceeds), accounts (right to payment), promissory note / chattel paper (record of monetary obligation and security interest in or lease of specific goods)
 - ii. **Purchase money security interest (PMSI):** interest that arises where a secured party advances money or credit to enable the debtor to purchase the collateral itself (i.e., seller finances the sale)
 - iii. **Lease vs. security interest:** If a transaction is characterized as a lease of a good but is intended to have effect as security, it will be governed by Article 9 as a security interest. Intent for security depends on the “economic realities” of the transaction. A transaction creates a security interest rather than a lease if the rental obligation is not terminable by the lessee, and the lessee has an option to purchase the goods for no or nominal consideration at the end of the lease
- II. ATTACHMENT AND PERFECTION OF SECURITY INTEREST
 - a. **A valid security interest in collateral against debtors requires attachment to collateral, and against others requires perfection of the interest**
 - i. Perfection cannot occur until all of the requirements for attachment have also been satisfied
 - b. **Attachment:** Is the security interest enforceable against a debtor with respect to the collateral?
 - i. To attach a security interest to the collateral requires:
 1. **Security agreement:** Debtor must authenticate a security agreement granting the creditor security interest in collateral + reasonably identify collateral (including any after-acquired property—see below)
 - a. **EXCEPTION – creditor in possession:** If the creditor has taken possession of the collateral, authentication of the security agreement that evidences the secured transaction is not needed
 - b. **After-acquired property** (e.g., “all equipment now owned and hereinafter acquired”) can create a security interest in property that the debtor does not currently own but may or will acquire in the future
 - i. The creditor’s security interest automatically attaches when the debtor acquires rights in collateral (not currently owned) in the future
 1. **EXCEPTION:** Will not attach to *consumer goods* UNLESS debtor acquired the rights within 10 days after creditor extended value
 - ii. Clause not required when collateral is *inventory* or *accounts receivable*
 2. **Value:** Creditor must have given value (consideration) at time of agreement or in the past
 - a. Creditor may make a definite commitment to give future value (e.g., line of credit)
 3. **Rights to collateral:** Debtor must have rights in the collateral
 - a. Possession alone is insufficient to show debtor’s rights in the collateral
 - b. Show rights via ownership, possession via contract, or identification in a contract

- ii. A security interest attaches to the collateral as soon as the three requirements are satisfied, unless the parties expressly agree to postpone the time for attachment
- c. **Perfection:** Is the creditor's security interest in the debtor's collateral good against others?
 - i. Any *one* of the following steps may perfect a security interest in collateral:
 - 1. **Automatic perfection of security interest**
 - a. **PMSI in consumer goods:** A security interest is *automatically* perfected upon attachment for a PMSI in *consumer goods*
 - i. **PMSI in equipment:** To perfect, creditor must file a financing statement within **20 days** after debtor is in possession of collateral
 - ii. **PMSI in inventory:** To perfect, creditor must file by the time debtor is in possession of collateral + give notice to others with security interest
 - b. **Small-scale assignment of account receivable** that does not *alone* transfer a significant part of outstanding accounts or payments to creditor
 - c. **Non-consumer deposit accounts** (e.g., corporate accounts) do not require filing
 - i. Must perfect by control (e.g., bank gets debtor's bank acct as collateral)
 - 2. **Filing of notice:** Creditor files with a public office (e.g., Secretary of State of debtor's state) a financing statement that identifies the security interest and the collateral covered
 - a. Financing statement should include debtor's address and correct name (e.g., no trade name). Filed name should not be so misleading so as to be undiscoverable
 - b. Filing location: state of individual's principal residence; state where registered organization (e.g., corporation, LLC) organized; county of timber, mineral, fixture
 - c. If a statute requires perfection by other means (e.g., notation on certificate of title), security interest is perfected by doing so. State issuing the most recent certificate of title governs perfection of goods covered by a certificate of title
 - i. EXCEPTION: Interests created by dealers in vehicles for sale/lease may be perfected by filing (or upon possession or control)
 - 3. **Possession:** Creditor takes possession over the collateral, shown by physical control over the property sufficient to put 3Ps on notice of the secured party's interest in the collateral
 - a. Perfection is effective upon and for the duration of possession
 - b. Not applicable to intangible goods—but see **control** over collateral below
 - 4. **Control:** Creditor has control over the collateral
 - a. Security interest in a **non-consumer deposit account** is perfected by control (e.g., bank where an account maintained in automatically has control over account)
 - b. What is control? For bank *deposit accounts*, have or change name on account to that of creditor. For *financial instruments*, creditor receives certificate. For *electronic chattel papers*, copy of electronic chattel paper designates creditor as assignee, is maintained by creditor, and can only be changed by creditor
 - ii. **Proceeds:** Security interest in proceeds (from sale or other disposition of collateral) remains automatically and temporarily perfected for **20 days** from when debtor receives the proceeds
 - 1. A security interest will continue after a sale, lease, license, exchange, or other disposition
 - 2. Security interest in proceeds may be effective beyond the 20 days if...
 - a. **Cash proceeds:** Proceeds are identifiable cash proceeds
 - b. **Financing statement in same office:** For non-cash proceeds, the financing statement covering the proceeds *would be* filed in the same office as the financing statement for the original perfected security interest in collateral
 - c. **Perfected within 20 days:** Security interest in proceeds is actually perfected, e.g., by identifying in financial statement for collateral "all of debtor's property"
 - iii. **Delivery of goods:** Creditor that delivers goods or negotiable documents to debtor for disposition has a perfection period of **20 days**. To retain perfection beyond that, must re-perfect (see § II-c-i)
 - iv. When re-perfection is needed
 - 1. **Lapse:** A perfected security interest lasts 5 years. Perfected secured party must file a continuation statement within six months before the expiration of the 5-year period. Otherwise, the perfection lapses, and the perfection procedure must be repeated
 - 2. **Debtor or collateral moves out of state:** Perfection continues in the other jurisdiction for 4 months (debtor) or 1 year (collateral), respectively. Perfection is continuous from the original perfection date if the security interest is reperfected (e.g., financing statement filed) in the new jurisdiction within the 4 months or 1 year, respectively

MAGICSHEETS | SECURED TRANSACTIONS 3/4

- III. PRIORITIES (resolving which conflicting security interest takes priority over another)
- a. Each superseding creditor is entitled to payment in full before a subordinate claimant
 - b. **Buyer in the ordinary course of business takes free of a security interest held by a secured creditor in the inventory (i.e., has priority over the creditor).** A buyer in the ordinary course of business is a person that buys goods in good faith, without knowledge that the sale violates rights of another party, in the ordinary course of business from a merchant (in the business of selling goods of that kind)
 - i. Think innocent consumer, who can rest assured of having good title to the inventory
 - ii. Buyer takes free even if buyer had knowledge of interest, but only if purchased in good faith
 - iii. Shelter rule: If buyer takes free of security interest, subsequent transfers are also free of interest
 - c. **Perfect > unperfected.** Perfection gives secured party priority over competing unperfected creditors
 - i. **Between perfected creditors, first to file or perfect (complete security interest) has priority**
 1. Relation back: Creditors may file even before the security interest attaches to collateral. When determining priority between perfected creditors, see whose filing date precedes
 - a. Note that *consumer goods* PMSI perfects automatically (no filing—see § 11-c-i)
 - d. **Prior perfected > lien.** Prior perfected creditors have priority over lien creditors. Judgment/judicial lien creditors have priority over conflicting interests only if they became lien creditor before security perfected
 - i. For example, state sheriff levies on collateral on behalf of creditor; creditor becomes lien creditor
 - e. Buyer *not* in the ordinary course of business has priority over unperfected (maybe attached) creditors
 - f. Between unperfected creditors, first to attach has priority over later unperfected creditors (and over general unsecured creditors, who did not take collateral from debtor in exchange for loan)
 - g. Specific cases that may supersede general priorities above
 - i. Accession vs. whole: If an accession becomes part of a whole that is subject to a perfected security interest, security interest in the whole has priority over security interest in the accession
 - ii. After-acquired equipment vs. PMSI in same equipment: PMSI in equipment has priority over a conflicting security interest (regardless of earlier priority date) if PMSI is perfected when debtor receives possession of collateral (or perfected within 20 days of debtor receiving possession)
 - iii. Mortgage interest vs. security interest in fixture: Creditor with interest in fixture must perfect in 20 days, or holder of mortgage interest will prevail

IV. RIGHTS OF SECURED PARTY

- a. A secured party (creditor) has statutory remedies under Article 9 if debtor defaults on the agreement
- b. Secured party's right to take possession of collateral
 - i. Via self-help: After default by debtor, a secured party may take possession of the collateral if done so without "breach of the peace"
 1. "Breach of the peace" is characterized by likelihood to result in violence, and includes any disturbance, threat of disturbance, constructive force (e.g., impersonating police officer), or breaking and entering. Repossession over any protest (e.g., telling creditor "do not enter") is a breach of the peace (creditor should try another day or use another method)
 - a. If creditor repossesses by breaching the peace, debtor may bring civil/criminal suit for conversion and recover actual and punitive damages
 - b. If collateral is on debtor's property, creditor needs voluntary consent to enter
 - c. Trickery OK: Creditor may trick debtor to repossess (*without* constructive force)
 - ii. Via judicial process: Get a judicial writ ordering sheriff to obtain and deliver collateral to creditor
 - iii. Via strict foreclosure: Secured party may keep collateral in full satisfaction of outstanding debt
 1. Notification: Secured party must send a written proposal to retain the collateral in full satisfaction of outstanding debt

	Consumer goods	Non-consumer goods
Recipients of notification	Debtor + any secondary obligors	Debtor + any secondary obligors + other secured parties who told foreclosing creditor of their interest + creditors perfected 10 days before the notification date

2. If any notified party objects w/in 20 days of notice, strict foreclosure is not allowed. Instead, collateral must be disposed of by sale
3. For consumer goods, if debtor has paid 60% of cash price or loan, creditor must instead sell the collateral within 90 days or be liable for conversion (can't keep collateral)
- c. Secured party's right to dispose of collateral
 - i. Via sale: After default by debtor, a secured party may sell, lease, or otherwise dispose of the collateral in a "**commercially reasonable**" manner (and apply the sale proceeds to the debt)
 1. Every aspect of sale must be commercially reasonable: usual manner, current price, etc.
 2. *Sale* by a secured party may be *public* or *private*

MAGICSHEETS | SECURED TRANSACTIONS 4/4

3. *Purchase* by secured party may be *public*—but generally not *private*, unless collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations (reliable external market to check the sale price against)
4. Notification: Prior to sale, secured party must send reasonable notice
 - a. Contents should include time and place of *public* sale, or time after which *private* sale will be made (e.g., “after MM/DD/YYYY, the following collateral will be sold”)

	Consumer goods	Non-consumer goods
Recipients of notification	Debtor + any secondary obligors	Debtor + any secondary obligors + other secured parties who told foreclosing creditor of their interest + creditors perfected 10 days before the notification date
Timing: Notification must be sent within...	A reasonable time under standard of commercial reasonableness. No brightline requirement. Reasonableness is a QOF.	10 or more days before earliest time of disposition stated in the notification is presumed to be commercially reasonable

- b. A secured party that fails to provide notice may be liable for damages regardless of the debtor having actual knowledge of the disposition
 5. Proceeds of sale go to expenses, then to debt, then to subordinate interests (if left over)
 6. After sale of collateral after default, its security interest and all subordinate interests in the collateral sold are discharged, UNLESS bad faith by purchaser
- ii. Via deficiency judgment: Secured party may proceed against the debtor for a deficiency judgment if sale proceeds from the collateral are insufficient to satisfy the debtor’s obligations
 1. Amount of deficiency is calculated based on amount of sale and outstanding debt
 2. Debtor’s right to redeem: Debtor may redeem the collateral by paying the obligated amount owed plus any interest and secured party’s reasonable expenses after default (including attorney’s fees). Redemption may only occur before a sale or strict foreclosure
 - a. Waiver: Right to redeem collateral may be waived only *after* default. An agreement that includes a waiver of right to redeem is invalid
 3. Secured party in breach of rules may be unable to seek deficiency from debtor (see § V-c)

V.

RIGHTS OF THIRD PARTY (debtor may also recover damages)

- a. Alienability of debtor’s rights: A debtor’s rights may be transferred to a third party. Any agreement that prohibits a transfer does not prevent the transfer
- b. A secured party may be liable to debtor for actual damages caused by failure to follow an Article 9 rule
 - i. However, the debtor has a duty to mitigate damages (e.g., could place bid at sale of collateral)
- c. A secured party that breaches an Article 9 rule may be prohibited from collecting deficiency from debtor
 - i. UNLESS the secured party can show that the breach did not cause the deficiency
 1. For example, if debtor had enough funds to pay the debt before a sale, or the sale was commercially reasonable