THE UNIFORM COMMERCIAL CODE

Article 9 - Secured Transactions

OBJECTIVES



- What and Why of the UCC
- Some history of the UCC
- Article 9 The nuts and bolts
- Purchase Money Security Interest (PMSI)
- Default , Enforcement & Bankruptcy



My story

The "unicorn commercial code"



POLLING QUESTION

What is the Uniform Commercial Code?



UCC IS A UNIFORM ACT

- A Uniform Act is <u>proposed</u> state law that is intended to bring uniformity between the states
- Legislative proposal to the states
- Not federal law
- The Code itself is not the law it's a "model code"



STATE ADOPTION OF THE UCC

- Only becomes law once adopted by the states
- Remember the Code is a proposal
- States adopt as they see fit verbatim or with changes
- What appears to be uniform is <u>not</u> truly "uniform"



UNIFORMITY

- Adopted by all 50 states differing degrees
- Overall goal of uniformity essentially achieved
- What has your state adopted?



POLLING QUESTION

What is the purpose of the Uniform Commercial Code?



PURPOSE OF THE UCC

- Make it easier to do business across state lines
 - Uniformity in law governing commercial transactions
- Flexibility in state adoption
 - States can decide what works for them
- Bring some clarify to contracts
 - Attempts to fill gaps when contracts are silent



POLLING QUESTION

Which of the following statements is false regarding the Uniform Commercial Code?



HISTORY OF THE UCC

- Longest and most elaborate of the Uniform Acts
- Began drafting 1st version in 1942
- 10 years to develop 1st version released in 1952
- Revisions and amendments are made as our business environment evolves
 - Amendments are proposed and then adopted by the states

ARTICLES



- The UCC is broken into Articles (think chapters)
 - Article 1: General Provisions & Definitions
 - Article 2: Sales & Leases
 - Article 3: Negotiable Instruments
 - Article 4: Bank Deposits and Funds Transfers
 - Article 5: Letters of Credit
 - Article 6: Bulk Transfers
 - Article 7: Documents of Title
 - Article 8: Investment Securities
 - Article 9: Secured Transactions



ARTICLE 9 - SECURED TRANSACTIONS

 Article 9 – provides a framework for a creditor to obtain a security interest in the *personal property* of a debtor to secure payment of a creditor's claim

Become a secured creditor in the personal property

 A security interest is ONLY valid if a creditor follows the requirements of Article 9 of the UCC



DEFINITIONS - "NUTS & BOLTS"

- Personal property: exclusions include real property (real estate)
- Security Interest: interest in personal property created by the debtor to secure repayment of a debt
 - Requires that the debtor authenticate (sign) a security agreement
- Security agreement: describes the debtor's assets subject to the security interest, aka the collateral



DEFINITIONS - "NUTS & BOLTS"

- Attachment: The security interest "attaches" to the collateral when the security agreement is signed - the debtor has acquires rights in the collateral
- Perfection: steps taken by the creditor to ensure that the security interest in the collateral will withstand attack
 - Competing Creditors
 - Bankruptcy Trustee
- UCC Financing Statement: formal document filed with the proper authorities to "perfect" your security interest
 - Document is a matter of public record for all creditors to see



NUTS & BOLTS TOGETHER

- To obtain a perfected security interest in a debtor's assets, a credit manager would . . .
 - Obtain a <u>security agreement</u>
 - Describes the collateral
 - Authenticated (signed) by debtor
 - You now have a <u>security interest</u> that is attached to the collateral
 - File a UCC Financing Statement
 - UCC-1 form filed with the proper authorities
 - Your security interest is now PERFECTED



POLLING QUESTION

If you have a security interest that is not perfected, are you a secured creditor?



NO PERFECTION = NO VALUE

- There is <u>no value</u> in having a security agreement if you do not perfect your position
- You must file a UCC Financing Statement (UCC-1)
- No perfection = Unsecured creditor
- Perfection = Secured creditor



THE SECURITY AGREEMENT

- Minimum requirements
 - Identification of parties
 - Debtor and secured party
 - Granting clause
 - The magic words "expressly grants security interest"
 - Collateral Description



SECURITY AGREEMENT EXAMPLE FROM CREDIT APP

To secure payment and performance of all obligations, Applicant hereby grants Seller a Purchase Money Security Interest in all inventory, equipment, and materials distributed by Seller, whenever sold, consigned, leased, rented or delivered, directly or indirectly, to or for the benefit of Applicant by Seller. This includes all construction related materials and services sold by Seller including but not limited to building materials, plumbing, appliances, waterworks, heating and air conditioning along with tools, safety accessories and related supplies ("Collateral"). The security interest extends to all repossessions, returns, and all proceeds from the sale, lease or rental; and all existing or subsequently arising accounts and accounts receivable, chattel paper, general intangibles, and supporting obligations which may from time to time hereafter come into existence during the term of this Agreement. Applicant authorizes Seller to file financing statements describing the Collateral along with other notices, and will assist Seller in taking any other necessary action to perfect and protect Seller's security interest.

• If we have a <u>signed credit application</u>, we have an authenticated security agreement and therefore have a security interest in the **described collateral**.



NO SECURITY AGREEMENT IN APPLICATION?

- What are your options?
 - Draft a security agreement
 - Remember minimum requirements
 - Need an example?
 - NACM's Manual of Credit and Commercial Laws, Volume II. Chapter 6 "Applicable Forms"
 - Includes Simple Security Agreement



UCC FINANCING STATEMENT

- The form is universal and known as a UCC-1
 - Must be filed with the proper authorities secretary of state
- Requirements
 - Debtor's exact <u>legal name</u>
 - Name of secured party
 - Description of the collateral
- Mistakes in information when filing can cost you



UCC FINANCING STATEMENT

P.O. Box 24101 Cleveland OH 44124

FOLLOW INSTRUCTIONS (front and back) CAREFULLY

A.NAME +PHONE OF CONTACT AT FILER (optional) Smith, Michelle 440-461-9661 ucc@ncscredit.com 440-461-0822 B. SEND ACKNOWLEDGMENT TO: (Name and Address) 2013-756701-8

Recording District 500 UCC Central File 04/01/2013 03:21 PM Page 1 of 2

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

MIDDLE NAME

STATE AK

POSTAL CODE

99515-1809

SHEEK

COUNTRY



1.DE	BTOR'S EXACT	ULL LEGAL NA	ME -insert only <u>one</u> debtor na	me (1a or 1b) - do not abbreviate or comb	ine names		
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Oic	1b. INDIVIDUAL'S LAS	TNAME		FIRST NAME	MIDDLE NAM	AE.	SUFFIX
	MAILING ADDRESS 1 West Cottonwo	od Creek Drive	: Unit# 1	CITY Wasilla	STATE AK	POSTAL CODE 99654	COUNTRY USA
1d. 5	SEE INSTRUCTIONS	ADDIL INFO RE ORGANIZATION DEBTOR	1e. TYPE OF ORGANIZATION Corporation	1f. JURIS DICTION OF ORGANIZATION AK	1g. ORGANI 118337	ZATIONAL ID #. if any	
2. A	DDITIONAL DEBT	OR'S EXACT FL	JLL LEGAL NAME - insert or	nly <u>one</u> debtor name (2a or 2b) - do not ab	breviate or comb	ine names	
OR	2a. ORGANIZATION'S	NAME					
OK	2b. INDIVIDUAL'S LAST NAME			FIRST NAME	MIDDLE NAME SUFF		SUFFIX
2c. MAILING ADDRESS			CITY	STATE	POSTAL CODE	COUNTRY	
2d. <u>\$</u>	SEE INSTRUCTIONS	ADDIL INFO RE ORGANIZATION DESTOR	2e. TYPE OF ORGANIZATION	2f. JURIS DICTION OF ORGANIZATION	2g. ORGANIZ	ATIONAL ID #, if any	
3. S	ECURED PARTY'S	NAME (or NAM	E of TOTAL ASSIGNEE of ASS	IGNOR S (P) - insert only one secured par	ty name (3a or 3	b)	
	3a. ORGANIZATION'S	NAME					

FIRST NAME

Anchorage

4. This FINANCING STATEMENT covers the following collateral:

Ferguson Enterprises, Inc.

3b. INDIVIDUAL'S LAST NAME

See Attached

3c, MAILING ADDRESS

151 East 95th Avenue

5. ALTERNATIVE DESIGNATION (if applicable): LESSEE/LESSOR CONSIGNEE/CONSIGNOR BAILEE/BAILOR SELLER/BUYER AG. LIEN NON-UCC FILING
6. This FINANCING STATEMENT is to be filed [for record] (or recorded) in the REAL A CONTROL OF REQUEST SEARCH REPORT(S) on Debtor(s) All Oebiors Debtor 1 Debtor 2
8. OPTIONAL FILER REFERENCE DATA covers the following collateral: NCS UCC #U136501 REF # Master# 356810



Attachment - Collateral Information: it is generated by the system.

To secure payment and performance of all obligations, Applicant hereby grants Seller a Purchase Money Security Interest in all inventory, equipment, and goods distributed by Seller, whenever sold, consigned, leased, rented or delivered, directly or indirectly, to or for the benefit of Applicant by Seller, wherever located, now owned and hereafter acquired including, but not limited to all Plumbing, fixtures, Tools, Safety Products, Waterworks Products, HVAC Products, PVF Mechanical & Industrial Products accessories and supplies The security interest extends to all repossessions and returns; and all proceeds from the sale, lease or rental; and all existing or subsequently arising accounts and accounts receivable, chattel paper, general intangibles. and supporting obligations which may from time to time hereafter come into existence during the term of this Security Agreement. Seller's security interest is explicitly limited to outstanding obligations between Seller and Applicant.

POLLING QUESTION



ABC Plumbing LLC has granted you a security interest in inventory. You are going to perfect your interest. ABC is a registered in NC, warehouses inventory in NC, SC and GA, and the principal owners live in NY. In what state should you file the UCC-1 financing statement?



UCC-1 FILING RULES

- As a general rule, you file in the state where the organization is registered
- Unregistered organizations like general partnerships are considered located in the state where they have their principal office
- Individuals are considered located in the state of their primary residence
- When in doubt, file in multiple states nothing prevents you from doing this



UCC-1 NEED A SIGNATURE?

- No signature is not required
 - The debtor has already authenticated the security agreement authorizing the creditor to file the UCC-1
 - Applicant authorizes Seller to file financing statements describing the Collateral along with other notices, and will assist Seller in taking any other necessary action to perfect and protect Seller's security interest.
 - Duration
 - Five (5) years after the date of filing
 - Lapses if not continued
 - Security agreement is still valid but no longer a secured creditor



UCC-1 CONTINUATION

- Must be filed within six (6) months prior to the expiration date
- Again, does <u>not</u> require customer signature
- Valid for another five (5) years





A. NAME & PHONE OF CONTACT AT FILER (options	n)		1			
B. E-MAIL CONTACT AT FILER (optional)			1			
C. SEND ACKNOWLEDGMENT TO: (Name and Add	iress)		1			
		7				
1a. INITIAL FINANCING STATEMENT FILE NUMBER					OR FILING OFFICE US	
			(or recorded) in the Filer, attach Amende	e REAL ESTAT nent Addendum (Form UCC3Ad) and provide De	btor's name in item 13
2. TERMINATION: Effectiveness of the Financing Statement	tement identified abov	e is terminated v				
ASSIGNMENT (full or partial): Provide name of Ass For partial assignment, complete items 7 and 9 and at	signee in item 7a or 71 tao indicate affected o	b, <u>and</u> address o	Assignee in item 7c and	name of Assign	or in item 9	
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PRIORITY RULES

- "First to file, first in right"
 - First secured party to file a UCC financing statement (perfect their security interest) has priority over competing secured parties
 - Again, the key word is <u>file</u> your security agreement is worthless until you have filed your UCC-1
- Major exception to the "first to file" rule
 - Purchase Money Security Interest (PMSI)



PURCHASE MONEY SECURITY INTEREST

- Definition
 - A security interest granted to a trade creditor in goods sold on credit terms to the customer for the purchase price of the goods



PURCHASE / MONEY - 2 PARTS

- "Purchase"
 - Security interest in the goods sold on credit terms for the <u>purchase</u> price
- "Money"
 - Security interest in the debtor's proceeds (<u>money</u>) from the sale of the goods
 - Allows access to co-mingled funds not specifically identifiable by the creditor or courts
 - 2001 revision adopted by the states



PMSI – THE SUPERMAN OF FILINGS

- Superpriority Status
 - PMSI is granted superpriority status over existing perfected security interests
 - You move to the front of the line
 - Superpriority status is not automatic
 - Strict notification requirement for perfection



PMSI - PERFECTION

- Must notify all other secured creditors
 - Documented proof of notification
- Must have the appropriate granting language
 - From security agreement:

Applicant hereby grants Seller a Purchase Money Security Interest in all inventory, equipment, and materials distributed by Seller . . .



PMSI - WHAT IS IT NOT

- It is <u>not</u> a means to gain a security interest in debt that has already been incurred
 - Article 9 of the UCC does not allow this
- It is a means to acquire a security interest in goods sold on credit terms going forward



PMSI - COMMON PITFALLS

- Poor communication with the customer
- Not understanding the notification requirement
- Not researching if the customer has other secured creditors and knowing who they are



PMSI & YOUR CUSTOMER'S BANK

- In the event a customer has a banking relationship (line of credit), bank will have a perfected security interest in certain or all assets
- Typically, the bank has a "blanket" filing covering all assets
- Most banks will object to your PMSI's superprioity status
 - Loan covenants
 - Banks expect to be #1 in priority



PMSI - COMMUNICATION IS KEY

- Always discuss the PMSI with your customer before proceeding
- Always do a UCC search so you know of other existing secured creditors
- Subordination to the bank's position is a possible solution



DEFAULT & ENFORCEMENT

- Collection rights
 - A secured creditor may exercise collection rights with respect to the collateral & demand payment
- Non Judicial Repossession
 - Keep the peace
 - Taking possession of the collateral without any court action
 - Recovery through stealth or without permission could be viewed as theft
- Judicial Foreclosure
 - Court ordered turnover of collateral



ISSUES WITH ENFORCEMENT FOR FERGUSON

- Where did the collateral go?
 - By the time our customer is in default, the collateral (material) is probably gone
 - The money (proceeds) are probably nonexistent
 - How can you repossess something that isn't there?
- Identity of collateral
 - We sell a lot of commodities that are similar to other suppliers
 - Equipment can be easily identified with serial numbers, but that too is probably gone



SO WHERE'S THE VALUE?

- You're a secured creditor in bankruptcy
- Gives your demand a little more strength
- It <u>might</u> make repossession easier
- It's better than not having it



INSOLVENCY (BANKRUPTCY)

- Forget the UCC, you're now subject to the US Bankruptcy Code
- The automatic stay, baring collection action, applies to secured creditors
- Collection action or repossession without court approval could result in contempt
- You must file a motion for relief before . . .
 - Collection action
 - Repossession of any kind
- In the end, you are a secured creditor in bankruptcy hoping that you're first in line and the trustee has assets to liquidate and distribute



DISTRIBUTIONS IN BANKRUPTCY

- Secured creditors
 - Claims are paid in order of priority
 - PMSI, in most cases, gives you superprioity status
 - Secured creditor's claims are always paid before unsecured creditors
- Unsecured creditors
 - Tossed into one bucket and claims are paid on a prorated basis
 - Only paid if all unsecured creditor's claims are paid in full



LESSONS I'VE LEARNED

- Repossession of collateral is unlikely
- Most customers have few assets to liquidate in BK
- Even secured creditor's claims can go unpaid
- PMSI: My lesson learned
 - Not a tool to extend credit to customers who are not creditworthy



