



UCC Filings: Secured Transactions Overview

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Article 9 of the Uniform Commercial Code provides an opportunity for trade creditors to secure goods and/or accounts receivable by leveraging the personal property assets of their customer. A properly perfected UCC Financing Statement grants the creditor a security interest, reducing the risk associated with extending credit.

The Security Interest

Under UCC Article 9, a security interest is an interest in personal property or fixtures and secures payment or performance of an obligation. Before extending credit, many creditors require their debtors to enter into a security agreement.

The debtor will pledge specific personal property as collateral to grant a security interest to the creditor. Then, in the event of debtor default, the creditor can use the collateral to recover payment. Typically, the collateral can be sold to reduce the debt. Then, any surplus proceeds belong to the debtor and, vice versa, any deficit is still an obligation of the debtor.

The Scope of Article 9

Article 9 includes consensual security interests in personal property and fixtures.

What's Included?

Included under the Article 9 umbrella are all forms of consignment and letter of credit payment rights that support the payment or performance of other collateral. Article 9 applies to leases if the parties intend that the lease provide security, as well as sales of account and chattel paper, including pledge, chattel mortgage, conditional sales, trust receipts, and field warehousing.

Software is also included as a category. Software is a computer program and includes related supporting information. However, software embedded in goods and customarily viewed as part of the goods is treated as part of the goods and not software.

What's Not Included?

Article 9 does not apply to income tax liens, landlord's liens, statutory liens (i.e. mechanic's liens), wage assignments, interest in or liens on real property, sales of securities, airplane engines or maritime liens.

What is Collateral?

According to Article 9, collateral is "property subject to a security interest or agricultural lien. The term includes: (A) proceeds to which a security interest attaches; (B) accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and (C) goods that are the subject of a consignment." - [§ 9-102. DEFINITIONS AND INDEX OF DEFINITIONS](#)

Collateral can be tangible or intangible. Tangible collateral could include consumer goods, equipment, inventory and farm products. Intangible collateral could include instruments which include any written evidence of the right to receive money, documents of title and receipts, chattel paper, accounts, general intangibles, healthcare receivable and supporting obligations.



Conveying a Security Interest and Perfection & Priority under Article 9

UCC filings are a form of consensual security. This means your debtor must consent or agree to the filing of the UCC.

“Securing receivables via a UCC filing requires the debtor to sign a security agreement – which makes it consensual – the debtor is **agreeing** to the filing. This security agreement grants the creditor a security interest in the goods/services (as noted in the collateral description within the agreement) in the event the debtor defaults or files for bankruptcy protection. A properly perfected UCC filing benefits creditors that provide equipment, inventory and consigned goods.”
- [NCS Blog Post: Consensual Liens & Statutory Liens](#)

Attachment

A security interest attaches or forms once the creditor has established a security interest in the collateral. To create the security interest, the following requirements must be met:

1. Secured Party and the debtor execute a Security Agreement,
2. Secured Party gives value for the security interest, and
3. Debtor has rights to the collateral

Security Agreement

Under Article 9-102, a Security Agreement is an authenticated agreement that creates or provides a security interest. The agreement must include the date, debtor’s legal name and address, authentication, granting clause, collateral description and default terms.

There are additional clauses which are commonly incorporated in a Security Agreement.

- After-Acquired Property Clause: provides for a floating lien which will attach to specified property the debtor may acquire in the future.
- Future Advance Clause: extends to future liabilities of the debtor to the Secured Party.
- Acceleration Clause: may provide that the full amount of the debt will mature upon default.
- Add-On Clause: failure to make payment on the goods purchased permits both current and prior contract items to be repossessed.

Rights & Duties of The Secured Party

The debtor and the Secured Party have an obligation to preserve the pledged collateral, when the collateral is in the possession of the Secured Party.

§ 9-207. RIGHTS AND DUTIES OF SECURED PARTY HAVING POSSESSION OR CONTROL OF COLLATERAL.

(a) [Duty of care when Secured Party in possession.]

Except as otherwise provided in subsection (d), a Secured Party shall use reasonable care in the custody and preservation of collateral in the Secured Party's possession. In the case of chattel paper or an instrument, reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

The debtor is responsible for the cost of reasonable expenses incurred for the preservation, use or custody of the collateral, as well as the costs of accidental loss or damage when the costs exceed the insurance coverage.

Except for money (which should be used to reduce the amount of the secured obligation or sent directly to the debtor), the Secured Party may keep any increase in collateral, must ensure the collateral remains identifiable and may use or operate the collateral if necessary to preserve the collateral. Should the Secured Party fail to meet the imposed obligations, the Secured Party is liable for the loss.



Perfection of a Security Interest

Perfection of a security interest is the process where the Secured Party gives notice of the security interest to third parties, which cannot occur prior to attachment.

The Financing Statement

The most common form of perfection is the filing of a Financing Statement. The Financing Statement must include the debtor's name as it appears in the public organic record, it must identify the collateral, and should be filed in the state in which your customer's business is registered.

Generally, Financing Statements can be used for consumer goods, equipment, farm products, inventory, fixtures, general intangibles, accounts, and chattel paper.

A Financing Statement is effective for 5 years (10 years in Wyoming), and if a Continuation is not filed timely, the Financing Statement will lapse, and the Security Interest will be extinguished. Once the debtor fulfills the obligation, a Termination should be filed.

Where to File a Financing Statement

The Secured Party must file a Financing Statement in the state in which the Debtor is located. The definition of location may vary based on whether the debtor is a registered or unregistered entity, an individual or foreign entity.

- **Registered Entities:** including corporations, limited liability corporations and limited partnerships, are deemed to be "located" in the state in which they are incorporated or formed.
- **Unregistered Entities:** primarily partnerships, are deemed to be "located" in the state in which the organization has its place of business, or if it has more than one place of business, its "chief executive office."
- **Individuals** are "located" in their primary state of residence, as indicated on the unexpired driver's license.

Financing Statements, for land-related collateral, are generally filed in the real estate records of the county where the land is located.

Section 9-307 defines the debtor's location.

§ 9-307. LOCATION OF DEBTOR.

(b) [Debtor's location: general rules.]

Except as otherwise provided in this section, the following rules determine a debtor's location:

- (1) A debtor who is an individual is located at the individual's principal residence, as indicated on the unexpired driver's license.
- (2) A debtor that is an organization and has only one place of business is located at its place of business.
- (3) A debtor that is an organization and has more than one place of business is located at its chief executive office.

If a foreign debtor is in a jurisdiction outside the United States, and the jurisdiction does not provide for a public filing system, the debtor is deemed to be "located" in the District of Columbia.



Priority of a Security Interest

Generally, a creditor's priority is based on whether the creditor has a perfected security interest, and priority dates from the time of filing or perfection, whichever is first. If an interest in the same collateral exists, the creditor with the perfected security interest has priority over the creditor with the unperfected security interest. Further, the creditor with the unperfected security interest has priority over general unsecured creditors.

Exceptions to Priority Rules

Buyers of Goods

- **Ordinary Course of Business:** If, in the ordinary course of business, a buyer purchases goods, the goods are free of a security interest (except for farm products).
- **Consumer Goods:** If the buyer purchases consumer goods, the goods are free of a security interest if the buyer had no knowledge of a security interest, if the goods are purchased for value, the goods are primarily for the buyer's personal use, and if the buyer purchases the goods prior to the filing of the Financing Statement by the Secured Party.

Buyers of Instruments and Chattel Paper

Buyers have priority over non-possessory interest in proceeds of non-inventory collateral if

- value has been given to the collateral,
- the buyer takes possession of instrument or chattel paper in the ordinary course of business, and
- the buyer acts with knowledge of competing security interest.

PMSI: Equipment & Inventory

A perfected PMSI in Equipment or Inventory generally has priority over other security interests.

§ 9-324. PRIORITY OF PURCHASE-MONEY SECURITY INTERESTS.

(a) [General rule: purchase-money priority.]

Except as otherwise provided in subsection (g), a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in Section 9-327, a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.

Ensure the PMSI is perfected

To perfect a PMSI in Equipment, a Secured Party must have the debtor execute a security agreement containing the appropriate granting and authorization language and file a Financing Statement in the appropriate jurisdiction before or within 20 days after the debtor receives possession of the equipment.

To perfect a PMSI in Inventory, a Secured Party must have the debtor execute a security agreement containing the appropriate granting and authorization language, file a Financing Statement in the appropriate jurisdiction before the debtor receives possession of the inventory and notify existing holders of security interests of record in the same type of collateral that the Secured Party intends to take a PMSI in Inventory within five years before the debtor receives possession of the inventory.

What Happens with Security Interests in Fixtures vs. Real Estate Interests?

When one party has a security interest in real estate and another party has a security interest in a fixture to the real estate, the fixture filing has priority if the Financing Statement was filed before the mortgage is recorded. If the mortgage was recorded prior to the fixture filing, then the mortgage has priority.



Defaults & Remedies

Your debtor defaults, or is in default, when they fail to fulfill the obligations identified in the Security Agreement. Default includes bankruptcy or insolvency of your debtor, debtor's failure to pay debts when due, removal of collateral and failure to insure collateral.

What to do When Your Debtor Defaults

Option 1: Repossession

With the filing of a PMSI, you secure the right to peacefully repossess your goods, if so desired. The Secured Party can either repossess the goods on their own or seek a judicial order.

§ 9-609. SECURED PARTY'S RIGHT TO TAKE POSSESSION AFTER DEFAULT.

(a) [Possession; rendering equipment unusable; disposition on debtor's premises.]

After default, a secured party:

- (1) may take possession of the collateral; and
- (2) without removal, may render equipment unusable and dispose of collateral on a debtor's premises under Section 9-610.

(b) [Judicial and nonjudicial process.]

A secured party may proceed under subsection (a):

- (1) pursuant to judicial process; or
- (2) without judicial process, if it proceeds without breach of the peace.

Option 2: Foreclosure

Under 9-610, the Secured Party may sell (or foreclose upon) the collateral. A foreclosure sale may be private or public, the Secured Party must ensure the sale is commercially reasonable, the Secured Party must provide the debtor with reasonable notice of the sale and the Secured Party must notify other secured parties with an interest in the collateral (for non-consumer transactions).

The proceeds from a foreclosure sale are applied in the following order: 1. Secured Party's repossession and foreclosure sale expenses, 2. debt owed to the Secured Party, 3. debts owed to inferior secured parties, 4. remaining proceeds go to the debtor.

Debtor's Remedies

The debtor can redeem his/her interest in collateral at any time before the debt is satisfied by strict foreclosure, the collateral is sold, or a binding contract for the sale of the collateral is entered. The debtor must pay full amount of the secured debt and any expenses the Secured Party reasonably incurred in dealing with the collateral.

Prior to disposition of the collateral, a court may order or restrain disposition if the Secured Party fails to comply with the UCC provisions governing default. After disposition, the Secured Party is liable for any damages resulting from his/her noncompliance with the default provisions.

§ 9-625. REMEDIES FOR SECURED PARTY'S FAILURE TO COMPLY WITH ARTICLE.

(b) [Damages for noncompliance.]

Subject to subsections (c), (d), and (f), a person is liable for damages in the amount of any loss caused by a failure to comply with this article. Loss caused by a failure to comply may include loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing.

If the Secured Party does not comply with the mandatory sale provision relating to consumer goods, the debtor may recover under the code or in conversion.



Key Points for the Secured Party to Remember Upon Debtor's Default

- The term default is not defined under Article 9; the debtor and Secured Party are left to define events of default within their contract.
- The collateral may be repossessed.
 - If desired, the Secured Party has the right to repossess without disturbing the peace. If the Secured Party is unable to peacefully repossess the collateral, legal steps may be necessary including a temporary restraining order or pursuing suit against the debtor.
 - If the Secured Party does not want to repossess the collateral, the claim could be placed with an attorney to file suit, which could result in Judgment, allowing the garnishment of accounts and/or asset attachments.
- The disposition of collateral.
 - After recovering personal property, exercise reasonable care of the property (i.e. clean & repair the collateral prior to sale).
 - Act in a commercially reasonable manner.
 - Consider disclaiming all express and implied warranties in the bill of sale delivered to the purchaser of collateral at the foreclosure sale.
 - Properly notify all parties of the disposition and allow for sufficient time prior to the disposition.
- Satisfaction of the account.
 - If permitted by contract, or applicable law, satisfy all costs and expenses of repossession and sale from the sale proceeds.
 - If the sold collateral is consumer goods, provide the debtor and all other obligors with a calculation of any surplus or deficiency and an explanation of how the calculation was made.
 - The Secured Party should consider accepting the collateral in full or partial satisfaction of the debt. Adhere to all technical statutory requirements when doing so.

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