

# PERFECTION OF SECURITY INTERESTS

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## I. Introduction

When Article 9 of the Uniform Commercial Code [hereinafter the “UCC”] was being drafted, there was some concern that it would be politically difficult to adopt because it did away with a number of other statutes (e.g., the Chattel Mortgage Act, the Factors Act, the Uniform Trust Receipts Act, the Conditional Sales Act, and others), and replaced them with a new system that lawyers would need to learn. As it turned out, Article 9 was a chief selling point during the state by state adoption of the UCC, as lawyers were relieved to have a hodgepodge of laws replaced by one set of well-structured rules.

Assuming that Article 9 applies to the transaction, Article 9 sets out the requirements for creating a security interest that is enforceable against the debtor. See UCC § 9-203. This process is called “attachment” of the security interest. Once a security interest attaches to the collateral, if the debtor fails to meet its underlying obligation, the secured party can enforce its security interest against the collateral. Enforcement means that the property to which the security interest attached may be seized by the creditor, using a prescribed process, in order to apply the value of that property to satisfy the underlying obligation.

If the debtor and the secured party were the only two people who ever had an interest in the collateral, attachment would be sufficient for the creditor’s purposes. Unfortunately, third parties often enter the picture and make some claim of their own against that property serving as the secured party’s collateral. It may be another secured

party, a buyer, a judicial lien creditor or, all too frequently, the trustee in bankruptcy, who appears on the scene in the event that a bankruptcy petition is filed by or against the debtor and whose obligation is to represent the rights of the unsecured creditors. The secured party needs more than attachment to protect its interest against these third parties. It needs to be sure that the security interest has not only attached, but that it has been “perfected” as well. The UCC provides five methods of perfecting a security interest: (1) the filing of a financing statement; (2) possession of the collateral; (3) control over the collateral; (4) the mere attachment of the security interest (automatic perfection); and (5) complying with other law (e.g., notation of lien on certificate of title). Depending on the type of collateral, there may be only one method or more than one method available. When there is more than one method of perfection, one particular method may give better priority to the lender’s security interest.

## **II. Classification of Collateral**

Classification of the collateral is important because many provisions of Article 9 (particularly those dealing with perfection and priorities) make legal distinctions based on the type of collateral.

### **A. Goods**

“Goods” include all things which are movable at the time the security interest attaches, and includes the unborn young of animals and growing crops. Goods also include fixtures. Goods are further classified as either (1) consumer goods, or (2) equipment, or (3) farm products, or (4) inventory. **In classifying the collateral, look to see the primary use to which the debtor puts the collateral at the time the security interest attaches.**

1. **Consumer goods:** Used or bought for use primarily for personal, family or household purposes.
2. **Equipment:** Used or bought for use primarily in business.
3. **Farm products:** Crops or livestock or supplies used or produced in farming operations or products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs) if they are in the possession of a debtor engaged in farming operations.
4. **Inventory:** Held by a person who holds them for sale or lease or to be furnished under service contracts; materials used or consumed in a business.

**B. Semi-intangible and intangible property ( 8 types)**

1. **Instruments:** Negotiable instruments and any other writing which evidences a right to the payment of a monetary obligation, and which are in the ordinary course of business transferred by delivery with any necessary endorsement or assignment (does not include investment property).
2. **Documents:** A document which in the regular course of business is treated as evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers (e.g., bill of lading, warehouse receipt).
3. **Chattel paper:** A record or records which evidence both a monetary obligation and a security interest in or a lease of specific goods. A

“record” is information that is stored in either a tangible medium (e.g., written on paper), or an intangible medium (e.g., electronically stored). Chattel paper that is stored in an electronic medium also is called “electronic chattel paper.”

4. **Investment property:** Includes items such as stocks, bonds, mutual funds, and brokerage accounts containing such items.
5. **Accounts: A right to payment [not evidenced by an instrument or chattel paper]** (1) for goods, (2) for services, (3) for real property, (4) for a policy of insurance issued or to be issued, (5) for a secondary obligation incurred or to be incurred, (6) for energy provided or to be provided, (7) for the use or hire of a vessel, (8) arising out of the use of a credit card, or (9) as lottery winnings. Health-care-insurance receivables are included. **A contractual obligation arising from a loan of money is not an account - it is a general intangible (see below).**
6. **Deposit accounts:** A demand, time, savings, passbook, or similar account maintained with a bank. Article 9 now **generally** applies to deposit accounts as original collateral and deposit accounts that are claimed as proceeds of other collateral.

**Important exception:** Article 9 does **not** apply to “an assignment of a deposit account in a consumer transaction.” Common law or extra-Article 9 statutory law controls whether consumers can grant security interests in deposit accounts as original collateral.

7. **Commercial tort claims:** A claim arising in tort with respect to which the claimant is an organization (e.g., partnership or corporation), or where the claimant is an individual and the claim arose in the claimant's business or profession **and** does not include damages for personal injury or the death of an individual.
8. **General intangibles:** Any personal property not coming within the scope of the other definitions (e.g., software, patent and trademark rights, copyrights, goodwill). A general intangible under which the account debtor's principal obligation is a monetary obligation is a **payment intangible**.

### **III. Scope of Article 9**

Article 9 generally applies to consensual grants of security interests in the debtor's personal property. UCC § 9-109(a) sets forth six different types of transactions that fall within the scope of Article 9. Section 9-109(a)(1) is the general scope provision defining what most people would call a secured transaction: "a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract." UCC § 1-201(b)(35) defines a "security interest" as "an interest in personal property or fixtures which secures payment or performance of an obligation." Therefore, whenever one is involved in a transaction that creates an interest in personal property or fixtures which secures payment or performance of an obligation, one would need to be concerned about Article 9 and about perfection.

But it is important to note that UCCs § 9-109(a)(2),(3),(4),(5) and (6) sweep into Article 9 certain transactions that are not "secured transactions" in the classic sense, but

that the drafters brought into the scope of Article 9 for policy reasons. These transactions include: (1) agricultural liens; (2) a sale of accounts, chattel paper, payment intangibles or promissory notes; (3) consignments; (4) a security interest arising under Articles 2 or 2A; and (5) a security interest arising under Article 4 or 5. In addition, UCC § 1-201(b)(35) defines “security interest” to include the interest of the buyer of accounts, chattel paper, payment intangibles, or promissory notes. This doesn’t mean that a party cannot transfer full and complete ownership of an account, chattel paper, payment intangible or promissory note. After a debtor’s outright sale and transfer of ownership, the debtor-seller retains no legal or equitable rights in the receivable sold. See UCC § 9-318(a). This is so whether or not the buyer’s security interest is perfected. But if the buyer is unperfected, a subsequent lien creditor (including a trustee in bankruptcy), perfected secured party, or qualified buyer can reach the sold receivable and achieve priority or take free of the buyer’s unperfected security interest. See UCC § 9-317.

The UCC drafters explain that they included such sales within the scope of Article 9 to avoid “difficult problems of distinguishing between transactions in which a receivable secures an obligation and those in which a receivable has been sold outright” noting that “in many commercial financing transactions the distinction is blurred.” See Official Comment 4 to UCC § 9-109. The drafters did not wish to include within Article 9’s scope those sales that do not involve commercial financing. So Article 9 does not apply to the sale of such a receivable as part of the sales of a business out of which it arose, or a sale which is made for the purposes of collection only, or transferred in full or partial satisfaction of a pre-existing debt, or assigned under a contract in which the assignee is

also obligated to perform under the contract, See UCC § 9-109(d)(4), (5), (6) and (7). See also Official Comment 12 to § 9-109.

#### **IV. Attachment**

As discussed earlier, “attachment” deals with those steps legally required to give the secured party a security interest in collateral that is effective as against the debtor. In order to perfect its security interest and so be protected from the claims of third parties, the secured party usually must take some additional step to perfect its security interest (except in cases of automatic perfection). See UCC § 9-308. But before a party can become perfected as to collateral, it must be sure that its interest has attached to that collateral. The requirements for attachment of a security interest are set out in UCC § 9-203.

##### **A. Security Agreement**

Unless the collateral is in the possession or control of the secured party pursuant to an agreement, a written (or electronically stored) security agreement is required. See UCC § 9-203(b)(3). Most often the debtor wants possession of the collateral, so a writing is necessary. Even when it is possible to have an effective oral security agreement, it’s never a good idea. While there is no specific language that must be used in order to create a security interest, the language must show that the parties did in fact intend to create a security interest. Courts sometimes say that, while there are no “magic words” which create a security interest, there must be language in the agreement which “leads to the logical conclusion that it was the intention of the parties that a security interest be created.” See, e.g., Mitchell v. Shepherd Mall State Bank, 458 F.2d 700, 703 (10<sup>th</sup> Cir. 1972); Thompson v. Thompson (In re Thompson), 315 B.R. 94, 103 (Bankr. W.D. Mo.

2004), modified, 316 B.R. 326 (Bankr. W.D. Mo. 2004). The agreement must be “authenticated” by the debtor. It must be signed or marked electronically with the present intent to identify the authenticating person and adopt the agreement. In addition, the agreement must contain a description of the collateral (and if the security interest covers timber to be cut, a description of the land concerned). UCC § 9-108(a) provides that the description is sufficient if it “reasonably identifies” the collateral, and Official Comment 2 to that section states that the description must “make possible the identification of the collateral described.” Collateral generally may be described by type (e.g., “all of debtor’s inventory”), except that commercial tort claims, consumer goods and consumer securities accounts must be described more specifically (e.g., “all of debtor’s consumer goods” would not be adequate). In addition, a super-generic description of the collateral is not sufficient for purposes of attachment. See UCC § 9-108(c). (e.g., “all assets” or “all personal property” would not be adequate).

#### **A. Value Given by Secured Party**

A security interest cannot attach until the secured party has given value. See UCC § 9-203(b)(1). A party cannot obtain a security interest in another’s property simply for being “a good guy.” The term “value” is not defined in Article 9, but UCC § 1-204 gives a general definition of the term that is good for all of the Code. A person gives value for rights if the person acquires those rights: (1) in return for any consideration that is sufficient to support a contract; (2) in return for a binding commitment to extend credit; or (3) as security for, or in partial or total satisfaction of a preexisting claim. Most often, value is given when the secured party extends credit to the debtor (secured party sells

collateral on credit, or the secured party loans the debtor money) and takes a security interest in the collateral.

### **B. Debtor has Rights in the Collateral or Power to Transfer Rights**

Granting a security interest in collateral is, in effect, granting a property interest in the collateral to the secured party. Under property law, a party generally can only transfer the property rights that the party actually has in that property. A debtor's limited rights in collateral, short of full ownership (e.g., rights under a lease agreement), are sufficient for a security interest to attach. But a security interest can only attach to whatever property rights in the collateral the debtor actually has, broad or limited as those rights might be. See UCC § 9-203(b)(1) and Official Comment 6 to § 9-203.

Sometimes, a debtor may be able to transfer, and have a security interest attach to, greater right than the debtor has in the property. For example, the debtor has sufficient rights in the collateral for attachment to occur where the collateral belongs to someone else who has authorized the debtor to put it up as collateral.

#### **1. After-Acquired Property**

UCC § 9-204(a) allows the security agreement to contain an after-acquired property clause. Such a clause typically provides that “the security interest attaches to all of the debtor’s (insert collateral description, such as “inventory, chattel paper, accounts”) now owned or hereafter acquired.” Such a clause is effective to attach a security interest to property that the debtor acquires rights in after the execution of the security agreement, as long as that property falls within the collateral description.

Even when the security agreement contains no after-acquired property clause, the court may, as a matter of contract interpretation, infer that the parties intended that the

security interest attach to collateral of the type described in the security agreement which was acquired after the security agreement was entered into. This inference is most often made when the collateral is of a type that turns over frequently, like inventory or accounts. The courts are not as inclined to make such an inference with collateral such as equipment, which is not quickly turned over. When the parties intend to include after-acquired property, it is certainly is wise to include a clause in the security agreement.

Article 9 does restrict the effectiveness of an after-acquired property clause in minor ways. Such a clause is not effective to attach the security interest to after-acquired consumer goods unless the debtor acquires rights in them within ten days after the secured party gives value, and also is ineffective as to after-acquired commercial tort claims. See UCC § 9-204(b). Federal law also limits the effectiveness of an after-acquired property clause in certain types of transactions, such as non-purchase money security interests in certain types of household goods. See, e.g., FTC Credit Practice Rule, 16 C.F.R. § 444.2.

## **2. Proceeds**

“Proceeds” is a broadly defined term that includes “whatever is acquired upon the sale, lease, license, exchange or other disposition of collateral.” See UCC § 9-102(a)(64). There is no need to mention proceeds in the security agreement. Article 9 provides that a security interest automatically extends to whatever proceeds of the original collateral are identifiable, and to each successive generation thereafter. See UCC §§ 9-203(f), 9-315(a)(2). So, for example, if inventory is sold that generates accounts, which are then paid by check, which are in turn deposited in a bank account, each change generates proceeds. Proceeds also include insurance payable by reason of any damage to the

collateral. The term also includes distributions on account of collateral. If securities are held as collateral, dividends paid to shareholders would be proceeds of that collateral.

### **3. Supporting Obligations and Liens securing Right to Payment**

If a security interest attaches to a right to payment, such as an account, it attaches automatically to any supporting obligation, such as a guaranty. See UCC § 9-203(f). Similarly, a security interest in a right to payment automatically extends to any lien securing that right. See UCC § 9-203(g).

## **V. Perfection**

Attachment is all that is necessary to have a security interest that is enforceable as between the debtor and the secured party. But the secured party needs more than attachment to protect itself from third party claims to the collateral. The secured party will want to “perfect” its security interest. The UCC provides for five methods of perfection: (1) automatic; (2) possession, (3) control, (4) filing, or (5) complying with other law (e.g., notation on certificate of title ).

### **A. Automatic Perfection**

Generally, a security interest is perfected when it has attached and other “applicable requirements for perfection” have been satisfied. See UCC § 9-308. Under some circumstances, though, Article 9 does not require that the secured party take any action other than attachment to perfect its security interest in collateral. Sometimes, the security interest is automatically perfected upon attachment of the security interest to the collateral. See UCC § 9-309. There is no central theme that binds together the fourteen situations listed in § 9-309 where automatic perfection is allowed. But in each of these situations, the drafters decided that it would be inefficient or unwise to require that the

secured party perfect its interest by possession, control or filing. A few of the more important provisions in § 9-309 will be discussed.

### **1. Purchase Money Security Interest in Consumer Goods**

A purchase money security interest in a consumer good is automatically perfected upon attachment unless that consumer good is subject to a certificate of title law that requires perfection to be accomplished thorough notation of the security interest on the certificate of title. See UCC §§ 9-309(a), 9-311. A secured party has a purchase money security interest (1) when it sells the debtor collateral on credit and retains a security interest, or (2) when it makes a loan to the debtor that enables the debtor to purchase the collateral (the loan proceeds must in fact be used to acquire the collateral). The drafters wanted to avoid the additional expense and the clogging of the filing system with filings that serve little purpose; it is very unlikely that there will be multiple security interests on this type of collateral.

While automatic perfection will protect the secured party against the claims of most third parties (including the trustee in bankruptcy), with “big-ticket” consumer goods, it nevertheless may be wise for the secured party to file a financing statement. UCC § 9-320(b) provides that, in the case of consumer goods, a buyer takes free of the perfected security interest if the buyer buys without knowledge of the security interest, for value, for his own personal, family or household purposes, unless prior to his purchase the secured party has filed a financing statement (note, the goods must be consumer goods in the hands of both the buyer and the seller). Filing is necessary for the secured party to protect its security interest when such a consumer to consumer sale takes place.

## 2. Insignificant Assignment of Accounts or Payment Intangibles

As discussed earlier, an assignment of accounts or payment intangibles generally is governed by Article 9 whether it involves an outright sale of the accounts or payment intangibles or the voluntary creation of a lien in the accounts or payment intangibles to secure an obligation. UCC § 9-309(2) provides that an assignment of accounts or payment intangibles that does not in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts or payment intangibles of the assignor is automatically perfected upon attachment. For purposes of determining a “significant part,” all transfers made to the particular assignee are considered, including other earlier assignments made in conjunction with the assignment that is arguably exempt from any perfection requirement. An assignor cannot avoid the UCC’s perfection requirements by serial assignment.

Unfortunately, what constitutes a “significant part” of the debtor’s outstanding accounts or payment intangibles is not defined. Some courts apply the “casual and isolated test,” finding that there is no need to file as to assignments “which no one would think of filing.” Any person who regularly takes assignments of the debtor’s accounts or general intangibles should file. See, e.g., Architectural Woods, Inc. v. State of Washington, 88 Wash.2d 406, 562 P.2d 248 (1977) (assignee not in the regular business of taking assignments of accounts was perfected without having to file). See also Official Comment 4 to § 9-309 (automatic perfection should apply to casual or isolated assignments where no one would think of filing; a person who regularly takes assignments of the debtor’s accounts or payment intangibles should file). Other courts

apply a “percentage test,” disregarding the professional status of the assignee and only considering what percentage of the total accounts of the assignor was assigned and whether the percentage constitutes a “significant” part of the whole. See, e.g. Consolidated Film Industries v. United States, 547 F.2d 533 (10<sup>th</sup> Cir. 1977); In re Vigil Bros. Constr. Inc. 193 B.R. 513, 520 (B.A.P. 9<sup>th</sup> Cir. 1996) (“We find that the bankruptcy court did not err by choosing the percentage of accounts test.”). Courts adopting this test have not come up with a hard and fast rule as to what constitutes a “significant part.” At least one case can be read as holding that a secured party is protected and need not have filed if the situation meets either the “casual and isolated test” or the “percentage test.” See In re Wood, 67 B.R. 321 (Bankr. W.D.N.Y. 1986). Because of the uncertainty in this area, it probably is best to file a financing statement and not to rely on automatic perfection.

### **3. Sale of Payment Intangibles and Promissory Notes**

A security interest created by the sale of a payment intangible or the sale of a promissory note is automatically perfected upon attachment of the security interest. See UCC §§ 9-309(3), (4). This is likely attributable to the influence of banks and other parties that did not wish to be troubled with filing in certain situations.

The sale of payment intangibles covers, among other things, the granting of loan participations. For example, a bank with a large loan might sell off parts of that loan to third parties (often smaller banks). If that transaction was subject to conventional perfection rules, the buyer would have to file a financing statement (or if there were a note, file or take possession of the note). In “mortgage warehousing,” a creditor lends to a mortgage lender and takes a security interest in the pool of notes and mortgages pending

the securitization and sale of those notes and mortgages to third parties. Again, if conventional perfection rules applied, the creditor would need to file or take possession of the notes. These transactions are tightly controlled and have caused little problem in the past, so it was decided that automatic perfection made sense.

It should be noted that UCC § 9-331(a) provides that Article 9 does not limit the right of a holder in due course, and that these holders take priority over earlier security interests, even if perfected. A party with a security interest in a negotiable instrument that fails to perfect by taking possession of the instrument does run the risk of that instrument getting into the hands of a holder in due course.

#### **4. Assignment of Health Care Insurance Receivable to Provider**

An insured that has a right to payment under a health care insurance policy creates a security interest in that right to payment when it assigns the right to payment to a health care provider. See UCC §§ 9-102(a)(46), 9-109(d)(8). Article 9 provides that the security interest created by this assignment is automatically perfected. See UCC § 9-309(5). The health care provider need not file a financing statement. It should be noted that the health care provider's further assignment of that right to payment to a secured party is not automatically perfected. See Official Comment 5 to § 9-309. The normal filing requirements would apply to these assignments.

#### **5. Investment Property**

A broker who includes a security agreement in its general stock account form is automatically perfected as to all of the security entitlements in that account. See UCC § 9-309(10). If a person in the business of dealing with securities or financial assets delivers a certificated security or other financial asset that is represented by a writing to

another person who also is in the business of dealing with securities or financial assets, and the agreement calls for delivery against payment, the transferor has a security interest in the securities or financial assets to secure the purchase price. See UCC § 9-206(c),(d). That security interest is automatically perfected upon attachment. See UCC § 9-309(9).

## **6. Supporting Obligations and Liens Securing Right to Payment**

UCC § 9-308(d) provides for automatic perfection of a security interest in a supporting obligation for collateral if the security interest in the collateral is perfected (using any permitted method of perfection). For example, suppose a secured party perfects a security interest in an account that is supported with a guarantee from a third party. By perfecting its security interest in the account, the secured party automatically perfects its security interest in the supporting obligation.

Similarly, perfection of a security interest in a right to payment automatically perfects a security interest in a mortgage or other lien securing that right. See UCC § 9-308(e). For example, assume that the debtor is the payee of a note secured by a mortgage on real estate and that the debtor grants a security interest in the note to a secured party. By perfecting its security interest in the note, the secured party is automatically perfected as to the mortgage secured that note.

## **7. Proceeds**

If a secured party has a perfected security interest in collateral, it automatically has a perfected security interest in whatever proceeds the debtor receives in exchange for that collateral **for 20 days**. To remain perfected in those proceeds beyond 20 days, the secured party must take new action to perfect its interest **unless**: (1) the proceeds are identifiable cash proceeds; or (2) the security interest in the original collateral was

perfected by filing a financing statement, a security interest in the type of collateral constituting proceeds would be filed in the same place as the financing statement for the original collateral, and the proceeds were not purchased with cash proceeds. (sometimes called the “same office” rule). See UCC § 9-315(c), (d).

### **B. Perfection by Possession**

If a security interest is not automatically perfected upon attachment, the secured party must take some additional action to achieve perfection. One action that may be available to the secured party is to take possession of the collateral. UCC § 9-313(a) provides that “a secured party can perfect a security interest in tangible negotiable documents, goods, instruments, money or tangible chattel paper by taking possession of the collateral,” and “may perfect a security interest in certificated securities by taking delivery of the certificated securities.” Since the creditor’s possession (and the debtor’s lack thereof) puts third parties on notice, the collateral must have a physical embodiment that is recognized as the exclusive representation of that right. Therefore, a security interest in accounts, deposit accounts, nonnegotiable documents, electronic chattel paper, and general intangible cannot be perfected by possession. In addition, certificate of title goods, subject to a very limited exception, cannot be perfected by possession. See Official Comment 7 to § 9-313.

If perfection depends on possession, the security interest is perfected from the moment of possession without relation back to the time of attachment. Generally, perfection continues only so long as possession is retained. When the secured party gives up possession, it becomes unperfected. See UCC § 9-313(d). To remain continuously

perfected, the secured party can file an appropriate financing statement before surrendering possession of the property. See UCC § 9-308(c).

The drafters of Article 9 did recognize that there are a variety of legitimate reasons why certain types of collateral might be released temporarily to the debtor, and that no useful purpose would be served by cluttering the files with records of these very short term transactions. See Official Comment 9 to § 9-312. So, for example, a secured party can make available to the debtor on a temporary basis an instrument, negotiable document, certificated security, or goods not covered by a negotiable document that are in the possession of a bailee (e.g., for sale, exchange or presentation) and will remain perfected for 20 days, after which time the secured party will become unperfected unless it again takes possession or files a financing statement. See UCC § 9-312 (f), (g) (h).

### **1. Possession by an Agent**

Article 9 does not define the term “possession.” An agent of the secured party, other than the debtor, may have possession on behalf of the secured party. See Official Comment 3 to § 9-313. The debtor may have some access, such as when the collateral is with an escrow agent, without defeating the secured party’s possession. But if the debtor has unfettered access to the collateral, the secured party will not be in possession for purposes of perfection. Some third persons in possession might be so closely connected to the debtor that the debtor in reality retains effective possession, even though the third party may have agreed to take possession on behalf of the secured party. See, e.g., In re Hill, 7 B.R. 433 (Bankr. W.D. Okla. 1980) (motorboat in possession of debtor’s father, with notice of bank’s security interest, not constructively in bank’s possession).

## **2. Possession by Bailee**

A secured party can file a financing statement to perfect its security interest in goods being held by a bailee, but is not limited to this method of perfection. Article 9 provides other ways by which the secured party can perfect its security interest in the goods.

### **a. Goods Covered by Negotiable Document of Title**

Since a negotiable document of title (e.g., a bill of lading or warehouse receipt) represents the goods being held by the bailee, the secured party should perfect a security interest in the document of title. This can be accomplished by either filing against or taking possession of the document of title. This perfects a security interest in both the document and the goods covered thereby. See UCC § 9-312(c) and Official Comment 7 to § 9-312.

### **b. Goods Covered by Nonnegotiable Document of Title**

A nonnegotiable document of title is basically a contract by which the bailee agrees to deliver the goods to whomever the bailor later directs. Title to the goods is not “locked up in the document,” so the secured party does not perfect an interest in the document. Instead, a security interest in the goods can be perfected by (1) having the document issued directly to the secured party, or (2) sending the bailee notice of the secured party’s interest in the goods. See UCC § 9-312(d). Receipt of notification is effective to perfect, regardless of whether the bailee responds. See Official Comment 7 to § 9-312.

### **c. Bailment with no Document of Title**

In this situation, the secured party can perfect by getting the bailee to authenticate a record acknowledging that the bailee holds the goods for the benefit of the secured party. See UCC § 9-312(d). It should be noted that the bailee need not respond to this notification or agree to hold the goods on the secured party's behalf. See UCC § 9-313(f). Filing as to the goods may be necessary in that situation.

### **C. Perfection by Control**

Security interest in investment property (stocks, bonds commodity contracts, and rights in securities held by a broker), deposit accounts, and electronic chattel paper, and letter of credit rights may be perfected by control.

#### **1. Investment Property**

For investment property, there are two methods of perfection: filing a financing statement and getting "control" over the investment property. See UCC §§ 9-312(a) (perfection by filing), 9-314(a) (perfection by control). A security interest perfected by control has priority over a security interest perfected by filing, so perfecting by control is the preferred method of perfecting with regard to investment property. See UCC§ 9-328. Basically, a secured party has control of an item of investment property when the secured party has taken whatever steps are necessary to be able to have the investment property sold without further action from the owner.

- a. Certificated securities:** If the security is represented by a certificate, the secured party who wants to perfect by control must take possession of the certificate. If the certificate is not

in “bearer” form (if it is payable to a specific person rather than to “bearer”), it also must be indorsed to the secured party.

**b. Uncertificated securities:** If the security is not represented by a certificate, the secured party who wants to perfect by control must have the owner of the security notify the issuer to either (1) re-register the stock in the name of the secured party, or (2) agree to follow the secured party’s instructions without further consent by the owner. See UCC § 8-106 (c).

**c. Securities accounts:** Persons often instruct brokers or mutual fund companies to purchase stocks, bonds, or mutual funds shares on their behalf and to hold them in a securities account. A creditor can take a security interest in such an account. A security interest in a securities account may be perfected by control by having the owner of the account contact the broker or mutual fund company (called a “securities intermediary”) and instruct the intermediary that the secured party has the owner’s rights in the account or that the intermediary should comply with the secured party’s orders without further consent of the owner. See UCC § 8-106(d).

## **2. Deposit Accounts**

Filing is not an available method of perfecting security interest in a deposit account. Getting control over the account is the only way to perfect a security interest in a deposit account. See UCC § 9-312(b)(1).

The bank in which the deposit account is maintained automatically has control over the deposit account when it makes a loan to one of its depositors using that deposit account as collateral. See UCC § 9-314(a)(1). If a creditor other than the bank in which the account is maintained wants control, it can do so by either: (1) putting the deposit account in the secured party's name, or (2) agreeing in an authenticated record with the owner of the account and the bank in which the account is maintained that the bank will follow the secured party's orders without further consent by the owner of the account. See UCC § 9-104(a)(2), (3). To have the highest priority, it is best for the secured party, if possible, to perfect by having the deposit account put in that secured party's name. See UCC § 9-327.

### **3. Electronic Chattel Paper**

A security interest in electronic chattel paper may be perfected by filing or taking control. See UCC §§ 9-312(a) (perfection by filing), 9-314 (perfection by control). A secured party has control over electronic chattel paper if : (1) a single, authoritative copy of the record or records exist, and, (2) this authoritative copy identifies the secured party as the assignee of the record or records, and (3) the authoritative copy is communicated and maintained by the secured party or its designated custodian. See UCC § 9-105.

### **4. Letter of Credit Rights**

Filing is not an available method to perfect a security interest in rights against the issuer of a letter of credit. Gaining control over the letter of credit rights is the only way to perfect a direct interest in such collateral. See UCC § 9-312(b)(2). A creditor gets such control by having the issuer of the letter of credit consent to an assignment to the creditor of the proceeds of the letter of credit. See UCC § 9-107.

For example, assume that to pay for goods purchased from the seller, the buyer has a bank issue a letter of credit to the seller (the “beneficiary” of the letter of credit), guaranteeing that the bank will pay for the goods if the seller sends the bank the relevant paper work that the goods have been shipped to the buyer (the “applicant” of the letter of credit). If the seller wants to borrow money from a creditor using the letter of credit rights as collateral, the seller’s creditor could get control only if the bank agrees to this assignment.

It should be noted that the issuer of the letter of credit is not obligated to consent to the assignment. See UCC § 5-114(c). So the creditor may not be able to perfect by control. But the creditor could still achieve perfection in the letter of credit rights by taking a security interest in the account that the buyer owes to the seller, and perfecting an interest in that account. As discussed earlier, the attachment of a security interest in collateral also is attachment of a security interest in any supporting obligation See UCC § 9-203(f). Also, perfection in the account automatically perfects a security interest in the letter of credit supporting the account. See § 9-308(d). The disadvantage to perfecting in this manner is that the seller still might collect under the letter of credit, get the cash, and spend it before the creditor could collect it from the seller. If the issuer of the letter of credit will agree to the assignment of proceeds of the letter of credit to the secured party, the issuer would have paid the money directly to the secured party.

#### **D. Filing a Financing Statement**

Security interests in most types of personal property can be perfected by filing a properly completed financing statement (a UCC-1) in the appropriate filing office, but there are a few exceptions. One may not file a financing statement to perfect a security

interest in deposit accounts, letter of credit rights, or money (but if the deposit accounts or money are claimed as proceeds of other collateral, a filing as to the original collateral perfects a security interest in the deposit account or money). The only way to perfect a security interest in a motor vehicle required to be titled under state law is by noting the lien on the certificate of title (unless the debtor is holding the motor vehicle as inventory for sale or lease). See UCC § 9-311(a)(2). Sometimes, federal law establishes a filing system for certain types of personal property (e.g., aircraft, ship mortgages), and filing under Article 9 is not a permissible alternative. See UCC § 9-311(a)(1) and Official Comment 2 to § 9-311. There is still some disagreement about the perfection of a security interest in intellectual property, which is a general intangible. See UCC § 9-102(a)(42). The federal trademark, patent and copyright statutes all provide that security interests may be recorded in the relevant federal office (the U.S. Patent and Trademark Office or the Copyright Office), but none of these federal statutes is clear on whether federal filing is required to perfect the security interest. It is now generally accepted that a security interest in a patent or a trademark can only be perfected by filing a UCC financing statement in the appropriate state, but that a security interest in a registered copyright can only be perfected by filing in the federal Copyright Office. See, e.g., In re Cybernetic Services, Inc., 252 F.3d 1039 (9<sup>th</sup> Cir. 2001) (patents should be filed under Article 9); In re Together Development Corp., 227 B.R. 439 (Bankr. D. Mass. 1998) (trademarks should be filed under Article 9). A registered copyright should be filed in the federal copyright office. See In re Peregrine Entertainment, Ltd., 116 B.R. 194 (C.D. Cal. 1990) (security interest in registered copyright should be filed in Copyright Office) . Unregistered copyrights should be filed under Article 9. See In re World Auxiliary Power

Co., 303 F.3d 1120 (9<sup>th</sup> Cir. 2002) (security interest in unregistered copyrights should be filed under Article 9). It may be wise to file in both the relevant federal and state offices.

### **1. Contents of Financing Statement**

A financing statement merely provides inquiry notice; it only indicates that a person may have a security interest in the collateral indicated. A financing statement must provide enough information to alert the searcher to inquire further, and to direct the searcher to the source for more information. See Official Comment 2 to § 9-502.

Basically, UCC §§ 9-502 and 9-516 provide that the financing statement must (1) provide the name and address of the debtor, (2) provide the name and address of the secured party, and (3) it must indicate the collateral covered by the financing statement. Where the collateral is as-extracted collateral, timber to be cut, or fixtures where a fixture filing is to be filed, the financing statement also must expressly state this fact, must describe the realty, must provide the record owner of the realty if the debtor is not the record owner, and must further recite that the financing statement is to be recorded in the real estate records. See UCC § 9-502(b).

#### **a. Debtor's Name**

Because a financing statement is indexed under the debtor's name, it is particularly important that this information is correct. If the debtor is an **individual**, the individual's name should be given. UCC § 9-503(a)(4) provides two alternatives for determining how the individual's name should appear on the financing statement. Under one alternative (adopted by most jurisdictions), the name on the debtor's driver's license should be used, if the license has not on its face expired and the license was issued by the state in which the debtor is located; if the debtor does not have such a driver's license, the

filer must use the individual name of the debtor (not defined in Article 9) or the debtor's surname and first personal name. A few jurisdictions have adopted the second alternative, under which the financing statement may identify an individual debtor by (i) the name on the debtor's unexpired driver's license, (ii) the debtor's personal name and surname, or (iii) the debtor's individual name. A financing statement that properly identifies the individual is not rendered ineffective by the absence of a trade name. A financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor. See UCC § 9-503(c).

If the debtor is a **corporation or other registered organization**, the filer should use the name stated to be the debtor's name in the "public organic record" (i.e., the record available to the public for inspection that was filed with or issued by the state to form or organize the registered organization). If the debtor is a **partnership**, the partnership name should be given (or the names of the partners if it has no partnership name).

If a financing statement contains errors in the debtor's name, the financing statement is still effective to perfect the security interest so long as the mistake is not "seriously misleading." If a search of the records at the filing office under the debtor's correct name turns up the financing statement with the incorrect name, then the incorrect name is deemed to be not seriously misleading. See UCC§ 9-506(c). The search has to be in accordance with the filing office's standard search logic (which may vary from filing office to filing office). In addition, if the debtor so changes its name that a filed financing statement becomes seriously misleading, the financing statement is effective to perfect a security interest in collateral acquired by the debtor before or within four months of the name change. It is not effective to perfect a security interest in collateral acquired by the

debtor more than four months after the name change (unless an amended financing statement is filed within the four months that renders the financing statement not seriously misleading). See UCC § 9-507(c).

### **b. Indicating the Collateral**

UCC§ 9-504 provides guidance as to what would serve as an adequate description of the collateral in the financing statement. It permits the type of description that is adequate for purposes of the security agreement. See UCC §§ 9-108, 9-203. Collateral generally may be described by type (e.g., inventory, equipment, etc.), and there is no need to include an after-acquired property clause. The drafters recognized that debtors sometimes create a security interest in all, or substantially all of their assets. See Official Comment 2 to § 9-504. To accommodate this practice, it is permissible to indicate that the financing statement “covers all assets or all personal property.” See UCC § 9-504(2). Of course, when such a broad description is used, a financing statement has no effect with respect to property indicated but to which a security interest has not attached. It also should be noted that such a super-generic description is not adequate in the security agreement.

## **2. Where to File within a State**

Former Article 9 (§ 9-401) afforded each state three alternative approaches: (1) central filing (usually with the secretary of state), (2) local filing (usually with some county office), or both. UCC § 9-501 now dictates central filing for most situations (usually with the secretary of state), while retaining local filing for real estate related collateral and special filing provisions for transmitting utilities.

In Georgia, the system is a bit different. Generally, the proper place to file in order to perfect a security interest is with the clerk of the superior court of any county of the state (the “filing officer”), and the filing is then added to a statewide index. Filing may be made in any county regardless of the location of the debtor’s residence or place of business or location of the collateral. There is an exception, though. If the collateral is growing crops, minerals to be extracted or timber to be cut (once the timber is cut it is ordinary goods and filing should be made with the clerk of the superior court), or where the financing statement is filed as a fixture filing and the collateral is goods which are or are to become fixtures, filing must be made in the real estate records in the county in which the subject land is located.

### **3. Multiple State Transactions**

Former UCC § 9-103 contained different choice of law rules for different types of collateral. Generally, for tangible collateral, filing was required in the state where the collateral was physically located. For intangible collateral, or for collateral that regularly moves from state to state (e.g., road building equipment), the secured party was required to file where the debtor was located. Current UCC § 9-301(1) looks to the law of the debtor’s location as the state where the filing should be made. UCC § 9-307 sets out how to determine the locations of a debtor.

An individual debtor is deemed to be located at the individual’s principal residence with respect to both personal and business assets. An unregistered organization is located where its business is located, and if it has more than one business location, where its chief executive office is located. The “chief executive office” means the place from which the debtor manages the main part of its business operations or other affairs.

See UCC § 9-307(b) and Official Comment 2 to § 9-307. A registered organization (e.g., corporation, limited liability company, limited partnership) is located where it is organized. See UCC § 9-307(e).

Sometimes a financing statement is properly filed in one state, where the debtor is located, and the debtor then moves to another state. In that situation, the secured party remains perfected for 4 months after the move, both with respect to collateral owned by the debtor at the time of the move, and also with respect to collateral acquired post-move. If the secured party does not file in the new state within 4 months after the move, it becomes unperfected and is deemed never to have been perfected as against a purchaser (buyer or other secured party) of the collateral for value. See UCC § 9-316(a), (h).

#### **4. Continuation Statements**

With a few exceptions (e.g., public finance transaction, manufactured home transaction, transmitting utility), a financing statement is effective for five years from the date of filing. See UCC § 9-515(a). To remain perfected beyond the five year period, the secured party must file a continuation statement in the six months before the expiration of the five year period. If the secured party fails to file a continuation statement before the financing statement expires, then the security interest becomes unperfected. See UCC § 9-515(c).

Several courts have considered the effect of a post-petition lapse on the strong-arm powers of a trustee under Bankruptcy Code § 544(a). Under § 544(a), the trustee acquires the status of a judicial lien creditor as of the debtor's petition date. Under UCC § 9-515(c), if a financing statement lapses, the security interest becomes unperfected and is deemed to have never been perfected "as against a purchaser of the collateral for value."

This section does not provide that the security interest is deemed to be unperfected as against a judicial lien creditor. Consequently, even upon a post-petition lapse of the financing statement, the secured creditor retains its priority over a trustee under § 544(a). A trustee cannot use its strong-arm powers to avoid the lien of a creditor whose security interest was perfected on the petition date solely because the creditor's financing statement lapsed post-petition. See, e.g., Colony Beach, Inc. et al. v. Colony Lender LLC (In re Colony Beach and Tennis Club), 508 B.R. 468 (Bankr. M.D. Fla. 2014); Mostoller v. Citicapital Commercial Corp. (In re Stetson & Assoc., Inc.), 330 B.R. 613 (Bankr. E.D. Tenn. 2005); Am. Bank FSB v Miller Bros. Lumber Co., Inc. (In re Miller Bros. Lumber Co., Inc.), 2013 WL 5755052 (M.D.N.C. Oct. 23, 2013).