



GREEN·SEIFTER
ATTORNEYS, PLLC

110 WEST FAYETTE STREET · ONE LINCOLN CENTER · SUITE 900 · SYRACUSE NEW YORK 13202 · P 315 422 1391 · F 315 422 3549*
194 WASHINGTON AVENUE · SUITE 315 · ALBANY NEW YORK 12210 · P 518 472 0184 · F 518 472 0184*

**BASICS OF CREATION AND PERFECTION OF SECURITY INTERESTS
UNDER ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE**

Presented by Robert K. Weiler to the Onondaga County Bar Association (September 2006)

I. Introduction.

A. Article 9 of the Uniform Commercial Code was revised as of July 1, 2001 (sometimes "the Code" or "Revised Article 9"). The focus of this outline is the creation and perfection of security interests in business assets and the exercise of remedies.¹

II. Significance of Security Interests.

A. **Effect of Treatment As Unsecured Creditor.** To understand the significance of a security interest, it is important to understand the legal process if a creditor does not have security interest (i.e., is unsecured). If the creditor makes an unsecured loan or extends unsecured credit to a debtor, and the debtor defaults, then the creditor must commence an action and obtain a judgment. After the judgment is obtained, the creditor cannot simply take the debtor's property. It must enforce its judgment by execution through the sheriff. CPLR 5201 et seq. This is often a difficult and unrewarding process. Even worse, the debtor may file for bankruptcy, in which event, except in rare cases, the unsecured creditors receive little, if any, recovery.

¹ This outline is for educational purposes only. It should not be relied upon as a resource to provide legal advice to clients or to draft documents. The practitioner must review the statute.



B. Effect of Security Interests.

1. Basic Definition. A "security interest" is a right by a creditor to have a specific item or items of property sold to satisfy the debt owed to the secured party. In order to enforce a security interest against other creditors and in bankruptcy, the security interest must be properly created and perfected.

2. Perfection Generally. The most common example of a security interest is a mortgage on real property. In order to be enforceable against other creditors or the bankruptcy trustee a mortgage must be duly recorded. The process of "putting the world on notice" of the security interest in order to make the secured parties' rights fully enforceable is known as "perfection."

C. Creation of Security Interests in Personal Property.

1. Generally. This outline deals with the creation and perfection of security interests in personal property. There are two types of personal property - tangible personal property and intangible personal property. Tangible personal property is generally movable and would include "hard assets" such as cars, equipment, inventory, goods. Intangible property includes assets such as accounts receivable, promissory notes, securities, letters of credit, and interests in business entities. The Revised Article 9 is far more complex than the former Article 9 because the draftspersons tried to address many issues that are faced in complex commercial transactions. Fortunately, the revisions eliminated many of the ambiguities under the former



Article 9. Although many of these rules may seem trivial, they can have enormous economic significance if they are not followed.

2. Security Agreement. The rules in the Revised Article 9 for creation of security interests are very similar to the rules for creation of security interests under the Former Article 9. In order to create a security interest enforceable against the debtor, there are three requirements set forth in UCC 9-203(b):

- a. The secured party must give value;
- b. The debtor must have rights in the collateral; and
- c. The debtor has authenticated (e.g., signed) a security agreement.

The Code uses the phrase "authenticate" to mean "signed," but authentication may include electronic signatures or any other symbol, encryption or similar process which identifies the debtor and manifests adoption or acceptance. UCC 9-102(a)(7).

d. An enforceable security interest can also be created by pledge (i.e., by possession of the collateral) or in certain circumstances control of the assets. UCC 9-203(b)(3).

e. In most commercial cases, creation of the security interest is a fairly easy requirement to meet. The creditor must obtain a signed security agreement which describes the debt and states that debt is secured by the collateral. A specimen security agreement is appended to this outline.



3. Attachment. A security interest attaches when it becomes enforceable against the debtor. UCC 9-203(a).

4. Description of Collateral.

a. Describe By Category. A creditor can take a security interest in virtually all of the debtor's personal property, which is known as "blanket security interest." However, the Revised Article 9 contains a tricky, potentially fatal, pitfall for creditors. It has been highly publicized that the Uniform Commercial Code permits financing statements to contain the words "all assets" or "all personal property." UCC 9-504(2). Although this may be true in the terms of the asset description in certain financing statements, it is not true with respect to the security agreement. THE STATUTE PROVIDES THAT "SUPERGENERIC" DESCRIPTIONS IN THE SECURITY AGREEMENT, SUCH AS "ALL ASSETS" OR "ALL DEBTOR'S PERSONAL PROPERTY" WILL FAIL TO CREATE A SECURITY INTEREST. UCC 9-108(c). The good news for practitioners, however, is that the Revised Article 9 permits the practice under the Former Article 9 of listing defined categories of assets in both the security agreement and the financing statements. UCC 9-108(b)(3); UCC 9-504(1).

b. Examples of Categories of Collateral:

(i) Tangible Property.



(A) "Goods." Goods means all things movable including fixtures, crops, and manufactured homes. UCC 9-102 (44).

(B) "Inventory." Inventory is generally goods sold or leased whether under a sale or service contract or that are consumed in business. UCC 9-102 (48).

(C) "Equipment." Equipment is defined as goods other than inventory, farm products, or consumer goods. UCC 9-102 (33).

(D) "Fixtures." Fixtures means goods that have become fixtures under real property law. UCC 9-102(41).

(ii) Intangible Property.

(A) "Account." The term "account" includes a right to payment for goods sold or services rendered, but could include assets as broad as credit card charges, lottery winnings, and might even include health care receivable if properly defined. However, it does not include chattel paper, commercial tort claims, deposit accounts, letters of credit, or rights arising out of other types of payment. UCC 9-102(2).

(B) "Chattel Paper." Chattel Paper means an obligation evidenced by monetary obligation and a security interest in specific goods. UCC 9-102(11).



(C) "General Intangibles" is the catch-all category that covers all intangible assets that are not included in other categories. UCC 9-102(42).

(iii) Other categories. There are several other categories of collateral including payment intangibles (UCC 9-102(a)(61)); documents (UCC 9-102(a)(30)); instruments (UCC 9-102(a)(47)); health-care insurance receivable (UCC 9-102(a)(46)); commercial tort claims (UCC 9-102(a)(13)); investment property (UCC 9-102(a)(49)); letter of credit rights (UCC 9-102(a)(51)); deposit accounts (UCC 9-102(a)(29)); money, or oil, gas, or other mineral rights.

c. Proceeds. A security interest in an asset also creates a security interest in the proceeds. Included within the definition of proceeds is the term "supporting obligation" which could include guaranties and letter of credits rights that support the collateral. UCC 9-102(a)(64); UCC 9-203(f); UCC 9-315.

d. After- Acquired Property Clauses. The revised Article 9 permits a description which grants to the secured party rights in all collateral "in which debtor now has or hereafter acquires an interest." This is known as an "after-acquired property clause." UCC 9-204.

(i) Limitations on After-Acquired Property Clause

(A) Purchase Money Security Interests. The debtor can create security interests in favor of other creditors on subsequently acquired assets



if the creditor complies with applicable rules and loans the purchase price of new goods or fixtures or enters into certain equipment leases. The purchase money creditor must comply with the statute and there are different rules depending on the nature of the asset. UCC 9-103; UCC 9-324.

(B) Buyer in the Ordinary Course of Business. A buyer from a debtor in the ordinary course of debtor's business takes free of the security interest. This does not apply to farm products. UCC 9-320(a).

(C) Security Interest Survives Disposition. Except if the transfer is to a buyer in the ordinary course of business or if there is a secured creditor "foreclosure" sale in accordance with UCC 9-601 et seq., the transfer of collateral is subject to the security interest, unless the secured party agrees that the security interest is to be released. UCC 9-315(a)(1).

e. Future Advances. The security interest may secure any and all obligations now existing or in the future. This is known as a "future advances clause." The statute requires the "magic words" to be in the security agreement in order to obtain this broad treatment. UCC 9-323.

(i) Limitations on Future Advances Clause.

(A) 45 Day Rule. There are limitations on the effect of advances under a future advance clause 45 days after federal tax liens are filed, or with respect to other lien creditors, if the party advancing knows of a lien, lease or



purchase and is not committed to make the advance. See UCC 9-323 and Comments; Internal Revenue Code 6323 §§ (c)(2) and (b).

f. Consumer Transactions. The rules regarding creation of purchase money security interests in consumer goods have not changed substantially under the Revised Article 9. Purchase money security interests in consumer goods are perfected upon attachment. The lender must still comply with consumer laws (e.g., truth in lending). UCC 9-102(26) and Comment 7; UCC 9-309(1) and Comment 3.

g. New Rules on Transfer of Assets. A buyer of assets who assumes the obligations of a debtor or purchases all or substantially all assets (if operative law permits) may automatically be bound by a security agreement as if they were the debtor (UCC 9-203(d) and (e)). Pursuant to Section 9-508 of the UCC, a party may be bound by financing statements filed against the debtor unless those financing statements would be serious misleading, in which case the financing statement would not be effective to perfect a security interest in the collateral acquired by the new debtor following four months after the new debtor becomes bound. UCC 9-508(b). In this case, a new initial financing statement must be filed providing the name of the new debtor. UCC 9-508.

III. The Perfection of Security Interests in Personal Property.

A. Generally. There are at least four methods of perfecting security interests in assets under the Code: (1) filing financing statements; (2) by possession; (3) by control; and (4)



by other methods under state and federal law, which involves the filing of certificates of title or other legal compliance (e.g., motor vehicles, airplane and boats).

B. Filing Financing Statements. For most business assets, the filing of a financing statement (known as a UCC-1 form) in the appropriate location and containing the required information is the method of perfection. As a rule of thumb, if the creditor uses the description of the collateral set forth in the security agreement for collateral ordinarily taken for a commercial debtor (e.g., equipment, goods, inventory, fixtures, accounts, general intangibles, payment intangibles, instruments and goods, etc.), the description will suffice. In addition, the financing statement can recite that it covers "all assets."²

1. Location of Filing. One of the biggest changes in the revised Article 9 is the location where filing is required. Under the Former Article 9, for most tangible property, the financing statements were required to be filed in the state where the property was located. For most intangible assets, the filing jurisdiction was the location of the principal office of the debtor. Under the Former Article 9, in order to perfect a security interest in New York, in most property (other than farm related assets, other special items and fixtures), filing was required in the office of the Secretary of State, and if there was a place of business in more than one county in the State, then with the county clerk. Good practice was, therefore, to file UCC-1 forms with the Secretary of State and the county clerk of every county in which the debtor had assets.

² The "all asset" description may have to be authorized by the security agreement and without this authorization, the filing might be deemed unauthorized. See UCC 9-509; 9-510.



Continuation statements were required to be filed every 5 years. The major change in the Revised Article 9 is that the location of the collateral or the place of business of the Debtor, for most business entities, has become irrelevant. The draftspersons of the Code determined that it was much easier to research the state of residence or organization of the debtor rather than the location of assets or chief executive office, especially when dealing with organized business entities. Therefore, the main focus of perfection by filing in the Revised Article 9 is the location of the Debtor. UCC 9-307; UCC 9-501.

2. Determination of State of Where Filing Is Required.

- a. Registered Business Entities (e.g., corporations, limited partnerships and limited liability companies). State of organization.
- b. Individuals. State of residence.
- c. Unregistered Business Entities. Place of business or, if more than one place of business, the chief executive office.

3. Exceptions to Location of the Debtor. The "location of debtor test" relates predominantly to business assets that are not related to real estate. The following are exceptions:

- a. Assets related to real estate (e.g., fixtures, timber, as extracted minerals). UCC-1 forms are still filed with the county clerk of the county in New York.
- b. Farm Products. Financing statements for farm products were formerly filed in the office of the county clerk where the farm was located. Under the Revised Article 9, they are filed in the state where the farm products are located. UCC 9-



302. However, in New York, a UCC-1 for farm products is not filed with the County Clerk but with the Secretary of State. UCC 9-501(a).

4. Name of Debtor. The Code requires the creditor to verify the exact name of the debtor in the public record and, therefore, perform a search of the records from the state where the debtor is located. UCC 9-503 (a)(1). Any discrepancies in the name might be deemed fatal. UCC 9-506(b). The omission of a trade name is not fatal and filing in a trade name only is insufficient. UCC 9-503(b), (c). For an entity name, the exact name is required. UCC 9-502(a)(1); 9-503(a). For other names, there is a split of authority. Compare, In re Kinderknecht, 308 B.R. 71 (BAP 10th Cir. 2004); Pankratz Implement Company v. Citizens National Bank, 102 P. 2d 1165 (Kan.App.2004) (exact name required) with In Re Erwin, 203 WL215131158 (B.Ct.Kan.2003) (nickname permitted). The safer approach is that the exact legal name be used. For individuals, this can create complex issues, because many people use more than one name or may use a nickname (e.g. Bill v. William or Tom v. Thomas). The rule of construction is whether the standard search logic used by the Secretary of State will uncover the name. UCC 9-506(c). With nicknames that are fundamentally different than the real name, the search logic may not uncover the name. It may therefore be necessary to review a driver's license, birth certificate and file under several alternative names of the debtor and to file under more than one name. It may also be necessary to obtain a written representation of the name(s) used by debtor.



5. Filing in County Clerk's Office. No filings in the county clerk's office have been accepted after July 1, 2001, except for filings that refer to specific items of real estate (e.g., fixture filings, timber, minerals, and certain cooperative interests).

6. Form of Financing Statement. Copies of the UCC-1 Forms and UCC-3 Forms are attached. These forms are uniform throughout the United States. UCC Section 9-509 provides that a person may file an initial financing statement if the debtor authorizes the filing in an authenticated record. The signature of the debtor on the financing statement is no longer required. By authenticating a security agreement, the debtor authorizes the filing of an initial financing statement setting forth the collateral described in the security agreement. UCC 9-509(b)(1). Amendments (other than amendments that add collateral), known as UCC-3 Forms, may be filed only if the secured party of record authorizes the filing. UCC 9-509(d). This is a change from prior law which required the debtor to authorize the amendment.

7. Duration of filing. UCC-1 forms are still effective for five years, subject to the discussion below. UCC 9-515(a). For certain types of manufactured homes sold to consumers with purchase money financing, the filing period may be 30 years if so indicated on the financing statement. UCC 9-515 (6).

C. Perfection by possession. The Code permits perfection of a security interest by possession for any tangible asset except goods covered by certificates of title (UCC 9-313; 9-313 Comment #2). In addition, certain tangible and intangible assets, such as chattel paper, negotiable documents, instruments or investment property can be perfected both by possession



and filing. With respect to chattel paper, this is a continuation of the rules under the Former Article 9. However, with respect to instruments, documents, and investment property, this is a new rule. Under the Former Article 9, these interests could not be perfected by filing. As to certain of these assets, such as promissory notes and chattel paper, filing gives limited rights but a party perfecting by possession may gain priority. UCC 9-312(a).

D. Perfection By Control. The new Code creates a category of perfection where a secured party can perfect by taking acts that are designated as sufficient for control, even though the Secured Party does not have possession. The categories of assets subject to these requirements are deposit accounts, electronic chattel paper, letter of credit rights and investment accounts. For example, these rules define how the creditor takes a security interest in bank accounts and brokerage accounts. UCC 9-104; 9-314; 9-327.

E. Certificates of Title. The rules regarding certificates of title have not significantly changed, and motor vehicles, boats and airplanes are governed by other state and federal law.

F. Jurisdiction Applicable. The location of the asset test generally applies to security interests where possession or control of the asset is necessary or there is a certificate of title requirement. UCC 9-301(b).

IV. Transition Rules.

A. The revisions to Article 9 established extremely complex transition rules. Because of the complexity of the rules, there may be interpretations that differ from those in this



outline. The transition rules are set forth in UCC 9-701 et seq. The Revised Article 9 applies to transactions created before July 1, 2001, except as to litigation pending before July 1, 2001. UCC 9-702 and Comments. The priorities created under the Former Article 9 continued for at least one year except if a UCC-1 was duly filed prior to July 1, 2001, it could have been effective until June 30, 2006. UCC 9-703; UCC 9-705(c)(2). Many of the transition rules can no longer be implemented after July 1, 2006, but they could be important in determining future priority disputes.

1. Perfected Security Interests Remain Perfected. Section 9-703 provides that if a security interest was perfected prior to July 1, 2001, it remained perfected for one year but this rule does not appear to be applicable to security interests created by filing. See Comment #4 to UCC 9-705. UCC 9-703(b)(1). Thereafter, the security interest was required to be both enforceable and perfected under Revised Article 9. UCC 9-703(b)(2),(3); UCC 9-705. The main variables in determining whether the security interest continued beyond the one year were the nature (e.g., individual or entity) of the debtor, the debtor's location, the location of collateral, and the manner in which the Revised Article 9 perfects security interests in assets as compared to the Former Article 9.

2. Examples.

a. New York Debtor-New York Assets. A debtor incorporated in New York with an office in Onondaga County granted a security interest in inventory located at all times in New York. The secured creditor properly filed a UCC-1 with the



New York Secretary of State and the Onondaga County Clerk on June 20, 2001. The financing statement perfected the interest for 5 years from June 20, 2001 or June 20, 2006 and could have been continued under the Revised Article 9. UCC 9-703(a); 9-705(d) and Comment #4, Example 3.

b. Non New York Debtor-New York Assets. In the same example as above, the debtor had its principal place of business in New York but was incorporated in Delaware. The UCC-1 would have expired 5 years after the UCC-1 was filed but could not have been continued. UCC 9-705(c)(1). An initial Financing Statement in Lieu of Continuation Statement was required.

3. Initial Financing Statement In Lieu of Continuation Statement. To protect creditors potentially affected by the transition rules, a new variation of the UCC-1 form was created, known as an Initial Financing Statement In Lieu of Continuation Statement. UCC 9-706. This was permitted to be filed at any time before the lapse of the UCC-1 filed under the Former Article 9. This filing had to identify the original financing statement by jurisdiction and index number and state that the original filing remains effective. It also had to satisfy the requirements of an initial financing statement. UCC 9-706(c). This filing allowed the secured creditor to record evidence of the filing of the original financing statement in a new jurisdiction and maintain its effectiveness. It appears that Initial Financing Statement In Lieu of Continuation Statement was to be effective for five years following filing. UCC 9-706(b)(2) and Comment #1; UCC 9-515.



4. Effect of Perfection as a Result of Revised Article 9. An interest that was unperfected on June 30, 2001 may have become perfected because of the enactment of Revised Article 9. UCC 9-704(c)(1). For example, a secured creditor filed a UCC-1 with respect to a security interest in inventory with the New York Secretary of State. The debtor was located in only one county, and on June 30, 2001, was unperfected because the creditor failed to file the UCC-1 form with the county clerk. The security interest apparently became perfected on July 1, 2001, because only filing with the Secretary of State was required at that time. UCC 9-501; 9-704(c)(1).

5. Sufficiency of description. When reviewing Initial Financial Statements In Lieu of Continuation Statements or otherwise examining security interests created under the Former Article 9, both the financing statement and the security agreement must include the desired collateral and satisfy the Revised Article 9. Otherwise, the security interest may have become unperfected, even it was duly perfected under the Former Article 9. See Comment #6 to UCC 9-705, Examples 6 and 7.

6. Other Transition Rules. See UCC 9-702(b) (Transactions not governed by Former Article 9 but now governed by Article 9); UCC 9-704 (Security interest unperfected before the effective date); UCC 9-707 (Amending Pre-Effective Date Financing Statements).

V. Enforcement of Security Interests. The enforcement of security interests is governed by Part 6 of the Revised Article 9. UCC 9-601 et seq.



A. Collection and Enforcement by Secured Party. After default (or as otherwise agreed prior to a default), a secured party may notify an account debtor or person obligated on collateral to render payment or performance to the secured party and exercise other rights as defined by statute. UCC 9-607. The secured party is permitted to undertake commercially reasonable collection action and may deduct the expenses of collection, including reasonable attorney's fees. UCC 9-607 (c), (d).

B. Application of Proceeds of Collateral. The proceeds of Collateral are applied as follows: (i) first, to costs and expenses, and, if allowed by contract, reasonable attorney's fees; (ii) second, to the obligations to the secured party; (iii) third, to the claims of those subordinate secured parties if the senior secured party receives an authenticated notice from the subordinate party prior to completion of distribution and the subordinate party provides reasonable proof of its position (if requested); (iv) fourth, to pay any surplus to debtor. The Debtor is generally liable for a deficiency, unless otherwise released or waived. UCC 9-608 and Comment No. 3.

C. Repossession and Foreclosure.

1. **Repossession.** The secured creditor can take possession of collateral without judicial process after default "without breach of the peace". UCC 9-609. In New York, judicial process involves resorting to a proceeding under Article 71 of the CPLR.

2. **Disposition.** The secured party may sell, lease or otherwise dispose of the collateral as long as the disposition is commercially reasonable, whether at a public or private proceeding. A secured party may purchase collateral at a public sale or at a private sale, only if



the collateral is of the kind sold on a recognized market or the subject of widely distributed standard price quotations. UCC 9-610(a), (b). A sale includes warranties unless otherwise disclaimed in accordance with the statute. UCC 9-610 (d), (e).

3. Notification.

- a. The statute requires notification to the debtor, any secondary obligor, and if the goods are other than consumer goods, to any person who requests notification and asserts a claim of an interest in the collateral. In addition, and as a change from prior law, notice must be given to any person who 10 days prior to notification, had a security interest perfected by a financing statement that identified the collateral, was indexed under debtor's name, and was filed in the correct office. UCC 9-611(c)(3)(B). In addition, notice must be given to parties who are perfected in accordance with statute, treaty or regulation. UCC 9-611(c)(3)(C).
- b. The notification rules are not applicable to perishable collateral, collateral that threatens to decline in value, or is a type that is sold on a recognized market. UCC 9-611(d).
- c. The statute sets forth the timing and nature of the search of the record that will satisfy the statute. UCC 9-611(e).
- d. The statute sets forth the form of notification required (UCC 9-613) and provides specific notification rules for consumer goods. UCC 9-614.



e. The statute sets forth rules for application of proceeds of a disposition of collateral. UCC 9-615.

f. The statute requires an explanation of calculation of surplus or deficiency in a consumer goods transaction and sets forth the required information. UCC 9-616. The statute imposes a penalty for non-compliance. UCC 9-616 and Comment No. 4; UCC 9-625(b),(c) and (e)(6).

D. Rights of Transferee of Collateral. A transferee for value obtains the rights of a secured party and discharges the security interest under which the transfer is made and most subordinate security interests. A good faith transferee takes free and clear even if the secured party fails to comply. UCC 9-617. The statute permits execution of a transfer statement to create a record of the disposition, but the transfer statement is not itself a disposition. UCC 9-619.

E. Retention of Collateral in Total or Partial Satisfaction. If the statutory procedure is followed, the secured party may retain the collateral in total or partial satisfaction, except for certain consumer goods, where mandatory disposition is required. UCC 9-620; 9-622. The statute establishes time limits for mandatory disposition (UCC 9-620(e)) and also provides forms for notification to debtor and other secured parties of a proposed retention of collateral. UCC 9-621.

F. Actions Involving Determinations of Surplus and Deficiencies. The statute establishes the burdens of pleading and proof and certain circumstances in which a sale is



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deemed commercially reasonable. In non-consumer transactions, the statute rejects the standard recognized by some states under prior law that a sale that is not commercially reasonable automatically causes elimination of a deficiency claim and instead gives the debtor credit for the amount that would have been received if the sale had been commercially reasonable (if more than the amount actually received by the secured party). UCC 9-626(a)(3)(B) and Comments No. 3 and 4. However, there is a rebuttable presumption that the secured party would have recovered enough to pay the entire debt, and the secured party has the burden of rebutting this presumption. UCC 9-626(a)(4). The statute does not address the standard for consumer transactions. UCC 9-626(b).

G. Statutory Liability. The statute creates a potential claim against a secured party who does not follow the proper procedures for persons aggrieved by violation of the statute, but also places limitations on this liability. UCC 9-625, 9-628.

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