Chapter 4

The Basics

§ 4:1 Introduction
It is important that documentation touch all of the bases. Too often, an essential element is overlooked. This chapter presents a basic overview of the scheme of Article 9 secured transactions, from which everything else in the book flows.

The parties to a pre-Revision Article 9 transaction were the secured party and the debtor. In a financing transaction, the secured party was the lender, seller, or other person in whose favor there was a security interest. The debtor was the person who owed payment or performance of the secured obligation, and, if not the obligor, the owner of the collateral. Since Article 9 also covers the sale of accounts and chattel paper, in that context “secured party” was the purchaser and seller.

1. Prior U.C.C. § 9-105[m].
2. Prior U.C.C. § 9-105[d].
3. Prior U.C.C. § 9-105[m], [d].

(Hillman, Rel. #13, 3/15)
Article 9 has always created confusion by designating as the “debtor” both the person who owes payment and the owner of any collateral for the obligation.\(^{4}\) The Revision limits “debtor” to a person who has an ownership interest in the collateral, a seller in covered sales of intangibles, and a consignor.\(^ {5} \) The person who owes the obligation is the obligor.\(^ {6} \) The definition of secured party is slightly expanded to cover purchasers of items in sales not formerly covered by Article 9.\(^ {7} \)

A security interest is “an interest in personal property or fixtures that secures payment or performance of an obligation.”\(^ {8} \) It is created by a security agreement, “an agreement which creates or provides for a security interest.”\(^ {9} \)

When a security interest becomes enforceable against the debtor with respect to the collateral, it has “attached.”\(^ {10} \) Attachment has three elements:

1. agreement has been reached;
2. value has been given; and
3. the debtor has rights in the collateral.\(^ {11} \)

§ 4:2 Agreement

Under the former statute, the debtor must have signed an agreement that contains a description of the collateral, the only
exception being when the collateral was in the possession of the secured party.\(^\text{12}\)

It is not possible to circumvent the technical requirements of Article 9 by asserting an equitable lien or the like.\(^\text{13}\)

The mere fact of possession does not imply an oral security agreement;\(^\text{14}\) the intent of the parties to create an oral security agreement must be clear. This requirement is found in the pre-Revision cases\(^\text{15}\) and in the text of section 9-102(a)(7) of the Revision.

The basic criteria to determine the existence of an oral security agreement are that the burden of proof is on the proponent; the language used evidenced a definite intent on the part of both of the parties; and exclusive possession of the collateral passed to the creditor contemporaneous with the oral agreement.\(^\text{16}\)

In some cases (historically those where the originator of a credit was a dealer contemplating sale of the obligation to a lender), forms state that the secured party’s signature—its authorization under the Revision—is a condition prerequisite to effectiveness. The few cases


\(^{16}\) Dzikowski v. Steoppelwerth [In re Boca Arena, Inc.], 237 B.R. 221 [S.D. Fla. 1999], quoting Rubin v. Reorganized Church [In re Chuning], 70 B.R. 98 [W.D. Mo. 1987].
that have addressed the question have held that the absence of the secured party’s signature/authorization is not necessarily fatal.\textsuperscript{17}

To accommodate electronic security documentation, the Revision no longer calls for a writing. Instead, the requirement is that the debtor has \textit{authenticated} a security agreement that provides a description of the collateral, the new term encompassing both written and other forms.\textsuperscript{18}

It is important, once an agreement is found, to determine the outer parameters of that agreement. For example, it must be clear what obligations are secured\textsuperscript{19} and what collateral has been tendered to secure those obligations.\textsuperscript{20}

\section*{§ 4:3 Value}

Value has a broad definition, which specifically includes commitments to lend and acquisition as security for or satisfaction of a pre-existing claim.\textsuperscript{21}

\section*{§ 4:4 Rights in the Collateral}

The U.C.C. does not define “rights in the collateral,” and other law, state and federal, must be consulted to determine the scope of the

\textsuperscript{17} In re \textit{Vic Supply Co.}, 227 F.3d 928 [7th Cir. 2000]; Liquidating Grantor’s Trust v. Finova Capital Corp. (\textit{In re Proteva, Inc.}), 390 B.R. 584, 595–96 [N.D. Ill. 2002].

\textsuperscript{18} “Authenticate” means: [A] to sign; or [B] to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record. U.C.C. § 9-102(a)(7). “Record,” a broader term than “writing,” means information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form. U.C.C. § 9-102(a)(70). In the absence of a security agreement, a “naked” financing statement is not authorized. Scotto Rest. Grp., LLC v. Mission Valley Bank (\textit{In re Scotto Rest. Grp., LLC}), 2012 WL 3070351 (Bankr. W.D.N.C. July 30, 2012).


\textsuperscript{20} See \textsc{Thomas S. Hemmendinger}, \textsc{Hillman on Commercial Loan Documentation} §§ 10:1–10:4 [PLI 5th ed. 2000 & Supp. 2013].

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phrase. The Revision adds an alternative satisfaction of the requirement if the debtor holds “the power to transfer rights in the collateral to a secured party.” This is consistent with the pre-Revision cases holding that “an owner’s permission to use goods as collateral creates rights in the debtor sufficient to give rise to an enforceable security interest.”

Most of the following cases were decided under the pre-Revision statute but should retain their vitality.

A debtor may have rights in collateral without title or ownership. The debtor’s rights may be subject to the rights of others, such as setoff. Ordinarily mere possession or the unexercised option to buy goods does not give rights in the collateral, but possession by the debtor is not necessary if other rights in the collateral exist.

22. Foothill Capital Corp. v. Clare’s Food Mkt., Inc. [In re Coupon Clearing Serv., Inc.], 113 F.3d 1091 (9th Cir. 1997).
A broker does not have rights in the goods offered for sale.\textsuperscript{29} But possession with contingent rights of ownership\textsuperscript{30} or voidable title\textsuperscript{31} has been held adequate.\textsuperscript{32} The test has been said to be the extent to which possession is supplemented by control factors.\textsuperscript{33} A partner may not have a sufficient interest in partnership assets to pledge them for a personal debt.\textsuperscript{34} A corporation or limited liability company has no interest in an asset owned by its shareholders.\textsuperscript{35}

When the seller retains possession, and the buyer has only the "special property" that arises on identification to the contract under section 2-401(a), the buyer does not have an interest in the goods sufficient to support a security interest of his creditor.\textsuperscript{36} The related issue of whether the debtor has rights in the collateral is directly related to the issue of the debtor’s identity, discussed in chapter 9.
Under the older statute, it was held that a third-party owner of property could authorize the debtor to offer it as collateral to a secured party. This created interesting issues as to the identity of the person who must sign the financing statement and security agreement. One court required the signature of the actual owner; another said that the proper signatory was the person having the rights in the collateral. Perhaps similar issues will be raised as to authentication under the Revision.

§ 4:5 Validity

The attached security interest is valid as between the parties, has priority over a general creditor, but, unless perfected, is subject to the rights of many others acquiring interests in the property.

§ 4:6 Perfection

To acquire rights valid against third parties, it is necessary that the security interest be perfected. The available methods of perfection depend upon the nature of the collateral—that is, the U.C.C. classification into which it falls.

The place of perfection will be controlled by the location of the debtor. If the debtor’s location subsequently changes to another
jurisdiction, perfection will continue (absent filing in the new jurisdiction) for only four months.\textsuperscript{46}

\textbf{§ 4:6.1 Perfection Under the Revision}

The following chart enumerates the various types of collateral under the Revision and the methods available for perfection of security interests in those types. Also included in the chart are certain non-Code interests that are mentioned in the Revision and generally excepted from its perfection provisions.

One small point on perfection by possession, a permissible technique under both versions of the Code:\textsuperscript{47} As noted below, third-party possession, pre-Revision, must be by an agent not under the control of the debtor. A “dual agent” fails the test.\textsuperscript{48} Under the Revision it is possible for a dual agent to act as the agent of the secured party for perfection purposes.\textsuperscript{49}

<table>
<thead>
<tr>
<th>Type of Collateral</th>
<th>How to Perfect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts</td>
<td>Filing\textsuperscript{50}</td>
</tr>
<tr>
<td>Assignment for the Benefit of Creditors</td>
<td>Automatic\textsuperscript{51}</td>
</tr>
<tr>
<td>Beneficial Interest in Decedent’s Estate</td>
<td>Automatic\textsuperscript{52}</td>
</tr>
</tbody>
</table>

\textsuperscript{46.} U.C.C. § 9-316(a)(2); Prior § 9-103(3)(e). The effect of a bankruptcy filing on this period is the subject of conflicting decisions. See, e.g., Expeditors Int’l v. Liquidating Trust (\textit{In re Schwinn Cycling & Fitness, Inc.}, 313 B.R. 473 [D. Colo. 2004]; Whitaker v. CIT Grp./Equip. Fin., Inc. (\textit{In re Crowell}), 304 B.R. 255 [W.D.N.C. 2004]).


\textsuperscript{48.} See text at section 4:6.1, note 94, infra.

\textsuperscript{49.} U.C.C. § 9-313, cmt. 3. Of course, the fact that the flat statement of the rule is in a comment rather than the statutory text may give room for some judicial flexibility.

\textsuperscript{50.} U.C.C. § 9-310(a). “An assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor’s outstanding accounts or payment intangibles” is automatically perfected. U.C.C. § 9-309(2). For an application of this rule, see St. Paul Mercury Ins. Co. v. Merchs. & Marine Bank, 882 So. 2d 766 [Miss. 2004].

\textsuperscript{51.} U.C.C. § 9-309(12).

\textsuperscript{52.} U.C.C. § 9-309(13).
<table>
<thead>
<tr>
<th>Type of Collateral</th>
<th>How to Perfect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certificate of Title Laws, Goods Subject to</td>
<td>Certificate of title unless held as inventory</td>
</tr>
<tr>
<td>Certificated Securities</td>
<td>Temporary automatic; filing</td>
</tr>
</tbody>
</table>

53. U.C.C. § 9-311(a)(2). “The relevant provisions, sections 310 and 311 of Article 9, establish a rule, an exception to that rule, and an exception to the exception. The rule is that a financing statement must be filed . . . to perfect a security interest in property; the exception to the rule is that a financing statement need not be filed to perfect a security interest if the collateral is subject to a state certificate-of-title statute; and the exception to the exception is that a financing statement must be filed if the collateral . . . is held as inventory by a seller of goods of that kind.” Arthur Glick Truck Sales, Inc. v. Sutphen E. Corp., 914 F. Supp. 2d 529, 539 [S.D.N.Y. 2012] (footnote omitted). See In re Lloyd, 511 B.R. 657 [Bankr. D. Ariz.]; CIT Grp./Equip. Fin., Inc. v. M&S Grading, Inc. [In re M&S Grading, Inc.], 457 F.3d 898 [8th Cir. 2006]; CT&T EV Sales, Inc. v. 2AM Grp., LLC, 2012 WL 1576761 [D.S.C. May 2, 2012]; Farmer v. LaSalle Bank [In re Morgan], 291 B.R. 795 [Bankr. E.D. Tenn. 2003]. Some states authorize the filing of a “notice of security interest” [NOSI] to perfect an interest prior to the issuance of the certificate of title. If the title certificate fails to include the lien, perfection ceases. Morris v. Hicks [In re Hicks], 491 F.3d 1136 [10th Cir. 2007]. A snowmobile has been held not to be a motor vehicle and is a consumer good subject to automatic perfection for a purchase money security interest. In re Lance, 59 U.C.C. Rep. Serv. 2d 632 [Bankr. W.D. Mo. 2006]. A security interest in a certificated motor vehicle ceases to be perfected when the interest is released in error. In re Lortz, 344 B.R. 579 [Bankr. C.D. Ill. 2006]. The U.C.C. rules that affect errors in the debtor’s name, discussed in chapter 9, infra, do not apply to errors on the certificate of title. Gugino v. GMAC [In re Laursen], 391 B.R. 47 [Bankr. D. Idaho 2008]. Mere possession of the certificate of title does not perfect a security interest in the vehicle. State v. Pressley, 100 So. 3d 1058 [Ala. Ct. Civ. App. 2012]. Minor defects in certificate will not invalidate perfection. In re Klein, 486 B.R. 853 [Bankr. E.D. Mich. 2012].

54. The exception applies when the inventory is “held for sale or lease by a person or leased by that person as lessor and that person is in the business of selling goods of that kind.” U.C.C. § 9-311(d). A car rental company that has no license to sell vehicles and that disposes of its fleet by wholesale auction at the end of their useful life is not in the business of selling goods of that kind. Union Planter Bank v. Peninsula Bank, 897 So. 2d 499 [Fla. Dist. Ct. App. 2005]. See also U.C.C. § 9-311 cmt. 4.

55. To the extent of new value, U.C.C. § 9-312(e), or when made available to the debtor under U.C.C. § 9-312(g).

56. U.C.C. § 9-313(a); § 8-301.

57. U.C.C. § 9-312(a).
### Type of Collateral | How to Perfect
--- | ---
Chattel Paper | Possession (tangible); control (electronic); filing (either)
Commodity Contract/Account | Automatic
Consignments | Filing and notice to seniors
Consumer PMSIs | Automatic
Deposit Accounts | Control
Documents | Possession
Fixtures | Fixture filing
General Intangibles | Filing

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58. U.C.C. § 9-313(a); FDIC v. Kipperman (*In re* Commercial Money Ctr., Inc.), 392 B.R. 814 [B.A.P. 9th Cir. 2008].
59. U.C.C. § 9-314(b).
60. U.C.C. § 9-312(a).
62. U.C.C. § 9-310[a].
63. U.C.C. § 9-324[b].
64. U.C.C. § 9-309[1]. Exempted are titled vehicles and other goods subject to supervening statutes. See U.C.C. § 9-311. Filing is necessary to protect against a sale to another consumer. See U.C.C. § 9-320[b].
66. U.C.C. § 9-313[a].

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§ 4:6.1 DOCUMENTING SECURED TRANSACTIONS
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<table>
<thead>
<tr>
<th>Type of Collateral</th>
<th>How to Perfect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods</td>
<td>Filing; possession^69^</td>
</tr>
<tr>
<td>Healthcare Insurance Receivable</td>
<td>Automatic if to the provider;^71^ filing^72^</td>
</tr>
<tr>
<td>Instruments</td>
<td>Temporary automatic;^73^ possession;^74^ filing^75^</td>
</tr>
<tr>
<td>Inventory</td>
<td>Filing;^76^ possession^77^</td>
</tr>
<tr>
<td>Investment Property</td>
<td>Automatic;^78^ control;^79^ filing^80^</td>
</tr>
<tr>
<td>Letter-of-Credit Rights</td>
<td>Control^81^</td>
</tr>
<tr>
<td>Lien Securing Right to Payment</td>
<td>Automatic^82^</td>
</tr>
</tbody>
</table>

69. Except goods subject to other statutes and treaties, such as certificate of title laws. See U.C.C. § 9-311.


71. U.C.C. § 9-309[5].

72. U.C.C. § 9-310[a].

73. To the extent of new value, U.C.C. § 9-312[e], or when made available to the debtor under U.C.C. § 9-312[g].

74. U.C.C. § 9-313[a].


76. U.C.C. § 9-310[a]. See In re Hurst, 308 B.R. 298 [Bankr. S.D. Ohio 2004] [motor vehicle inventory]. There may be issues as to whether particular vehicles are held as inventory or not. See, e.g., In re Skagit Pac. Corp., 316 B.R. 330 [B.A.P. 9th Cir. 2004].

77. U.C.C. § 9-313.

78. If created by broker or securities intermediary. U.C.C. § 9-309[10].

79. U.C.C. § 9-314[c].


82. If the security interest in the collateral was perfected. U.C.C. § 9-308[e]. See also U.C.C. § 9-203[g].

(Hillman, Rel. #13, 3/15) 4–11
### Type of Collateral | How to Perfect
---|---
Manufactured Home | Certificate of title (if applicable),\(^{83}\) otherwise filing\(^{84}\)
Money | Possession\(^{85}\)
Negotiable Instruments | Temporary automatic;\(^{86}\) possession;\(^{87}\) filing\(^{88}\)
Proceeds | Automatic\(^{89}\)
Supporting Obligations\(^{90}\) | Automatic\(^{91}\)

Possession may be through an authorized agent of the secured party, but the bailee must not be under the control of the debtor.\(^{92}\) It has been held that possession is not interrupted by a police seizure of the

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84. U.C.C. § 9-515[b]. Effective period is thirty years.


86. To the extent of new value. U.C.C. § 9-312[e].

87. U.C.C. §§ 9-313, 9-312[a]. For the application of this provision where a note is secured by a real estate mortgage, see Provident Bank v. Cmty. Home Mortg. Corp., 498 F. Supp. 2d 558 [E.D.N.Y. 2007].

88. U.C.C. § 9-310[a].

89. If the security interest in the original collateral was perfected. U.C.C. §§ 9-315[e], 9-203[f].

90. “A letter-of-credit right or secondary obligation that supports the payment or performance of an account, chattel paper, a document, a general intangible, an instrument, or investment property.” U.C.C. § 9-102[a][78].

91. If supported obligation is perfected. U.C.C. §§ 9-203[f], 9-308[d].

property.\textsuperscript{93} A termination statement filed in error will terminate perfection and cannot be undone.\textsuperscript{94}

\section*{§ 4:6.2 Perfection Before the Revision}

The perfection scheme prior to the Revision was somewhat easier to deal with than that which succeeded it:

\begin{tabular}{|l|l|}
\hline
Type of Collateral & How to Perfect \\
\hline
Accounts & Filing \\
\hline
Certificated Securities & Possession\textsuperscript{95} \\
\hline
Goods & Filing/possession\textsuperscript{96} \\
\hline
Consumer PMSIs\textsuperscript{97} & Automatic \\
\hline
Fixtures & Filing \\
\hline
\end{tabular}


\textsuperscript{96} In the case of a motor vehicle required to be registered, perfection was by notation on the certificate of title only. Prior U.C.C. § 9-302[3][b]. Possession of the certificate without the notation is a nullity. \textit{See}, e.g., Bradley v. K&E Invs., Inc., 847 S.W.2d 915 [Mo. Ct. App. 1993]. The same is true of mere retention of the manufacturer’s certificate of origin. Laurel Motors, Inc. v. Airways Transp. Grp., Inc., 672 N.E.2d 785 [Ill. App. Ct. 1996]. \textit{But see In re Jones}, 206 B.R. 569 [M.D. Ala. 1997], which involved the “constructive pledge” of automobiles to a pawnbroker where the debtors retained possession of the vehicles.

\textsuperscript{97} This provision did not apply to motor vehicles required to be titled.
<table>
<thead>
<tr>
<th>Type of Collateral</th>
<th>How to Perfect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Documents</td>
<td>Possession(^{98})</td>
</tr>
<tr>
<td>Chattel Paper</td>
<td>Filing/possession(^{99})</td>
</tr>
<tr>
<td>General Intangibles</td>
<td>Filing(^{100})</td>
</tr>
<tr>
<td>Inventory</td>
<td>Filing/possession(^{101})</td>
</tr>
<tr>
<td>Investment Property</td>
<td>Possession/filing/control(^{102})</td>
</tr>
<tr>
<td>Letter of Credit Proceeds</td>
<td>Possession of the letter of credit(^{103})</td>
</tr>
<tr>
<td>Money</td>
<td>Possession</td>
</tr>
<tr>
<td>Instruments</td>
<td>Filing/possession(^{104})</td>
</tr>
</tbody>
</table>

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98. See Marlow v. Rollins Cotton Co. \(\text{In re Julien Co.}\), 146 F.3d 420 (6th Cir. 1998) [possession by bailee].

99. A purchaser of chattel paper who took possession in the ordinary course of business and without knowledge of the security interest had priority over the holder of a security interest in the chattel paper perfected only by filing. Prior U.C.C. § 9-308(a). This principle has been taken over and expanded to other forms of collateral under the Revision. See section 19:3.3, infra.

100. For perfection of security interests in book-entry U.S. Treasury securities, see 31 C.F.R. § 306.118.

101. When the inventory consists of motor vehicles, perfection was by filing and not by notation on the certificate of title. Prior U.C.C. § 9-302(3)[b].


103. Prior U.C.C. §§ 9-304 and 9-305 [via Prior U.C.C. §§ 9-104(m) and 9-106] if the Article 5 revisions were adopted.

104. Prior U.C.C. §§ 9-302[1][b], 9-305. See Omega Envtl., Inc. v. Valley Bank, 219 F.3d 984 (9th Cir. 2000).

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