INTERNATIONAL SECURED TRANSACTIONS

UNITED STATES

By

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COMMENTARY

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I. Introduction.

The purpose of this paper is to present an overview of United States secured transactions law -- Article 9 of the Uniform Commercial Code (the "UCC" or the "Code") and to the extent possible, compare Article 9 of the Code with the most current version of the Draft Legislative Guide on Secured Transactions Report of the Secretary-General, composed by the United Nations Commission on International Trade Law, hereinafter, UNCITRAL, Working Group VI (Security Interests).[1]

The UCC resulted from a project, commenced in the 1940's, co-sponsored by the National Conference of Commissioners on Uniform State Laws and the American Law Institute. The Code was originally adopted by jurisdictions in the early 1960's. During the late 1960's and 1970's the UCC underwent major revisions with the goals of promoting uniformity in state enactment and interpretation of the UCC, and evaluating and preparing proposals for revision of the 1962 official text.

From its inception, Article 9 of the Code was perceived as an innovative and practical way of protecting financiers of businesses.

[1] The UNCITRAL Working Group on security interests just completed its third session, which was held at the United Nations in New York, New York from March 3-7, 2003. The next session of the Working Group will be held in Vienna in September 8-12, 2003.

Article 9 effectively extinguished the need for individualized security devices, such as chattel mortgages, and attempted to streamline not only the process of granting a security interest but a secured creditor's ability to realize on its security.

Secured transactions law, Article 9, pertains to any consensual transaction intended to create a security interest in personal property including goods, documents, instruments, Fixtures, general intangibles (e.g.: licenses or partnership interests), chattel paper or accounts and also covers any sale of accounts or chattel paper including pledges, assignments, chattel mortgages, chattel trusts, trust deeds, factor's liens, equipment trusts, conditional sales, trust receipts, other lien or title retention contracts and leases or consignments intended as security.[2] Most of these terms are expressly defined by the UCC. Article 9 does not apply to judgment liens, statutory liens, and other forms of security that arise by operation of law. Article 9 specifically excludes from its application certain liens that arise as a matter of law, but includes certain sales (often called assignments where intangibles are involved). [3]

[2] See, UCC §9-102(1) and (2).

[3] See, UCC §9-109(d)(1)-(13) lists transactions that are not covered by UCC Article 9:

Security interests that arise under Article 9 of the Code are clearly distinguished from statutory or common law liens that arise by operation of law, such as mechanics' liens. UCC security interests arise as a result of a voluntary action taken by a debtor and creditor. That voluntary action becomes effective and enforceable against a debtor and other creditors when the collateral becomes attached, perfected and finally has priority over all other interests in the same collateral.

A. Newly Revised Article 9.

Especially since the enactment of legislation of revised Article 9 of the UCC, effective in all fifty states, the United States now has uniform rules regarding creation, filing, perfecting, searching for and enforcing secured creditors' interests. Notwithstanding the "uniformity" of the Code, practitioners should be well advised that differences do exist from state to state. Thus, when approaching a UCC security interest issue, each state's version of the Code should be consulted.

The drafters of the revised Code tried to make the transfer of security interests easier, more efficient, inexpensive and as reliable as

possible.[4] In revising Article 9, the drafters strove to more visibly protect secured creditors over unsecured creditors, or what the Code calls "Lien Creditors".

B. The Purpose behind the UNCITRAL Working Group on Security Interests.

UNCITRAL's Working Group on Security Interests is in the process of formulating a Legislative Guide meant to guide participating countries in dealing with Secured Transactions law towards the goal of promoting the availability of cost efficient secured credit for commercial enterprises doing business in such countries. The Guide's intent is to be of use to countries that do not have efficient and effective secured transaction laws and to be of use to countries that have workable laws but wish to review or modernize them.[5]

II. Form of Security Agreement.

Generally, Article 9 requires the existence of a signed or "authenticated" Security Agreement that provides a description of the collateral to be secured.[6] A Security Agreement is an agreement

[4] Secured Transactions under the Uniform Commercial Code, Vol. 1, published by Lexis Nexis, §1A.01, pg. 1A-4.

[5] UNCITRAL Guide- Working Group Session 2, Addendum 1 at ¶1.

[6] "Authenticated" means to sign or to execute, or otherwise adopt a symbol or encrypt, or similarly process a record in whole or in part with the present intent of

which establishes a security interest between the debtor and the creditor, who is then termed the secured party. However, a formal Security Agreement is not required for every transaction. There are many agreements for accounts receivables, agreements for oil and gas proceeds, equipment or consumer goods that are not stylized, Security Agreements but rather "Assignments" or "Leases", yet they nevertheless constitute Security Agreements under Article 9.[7] Moreover, a UCC-1 Financing Statement (hereinafter "Financing Statement") (to be discussed *infra*) may qualify as a Security Agreement when read in conjunction with a corporate resolution or when it contains additional language suggestive of a Security Agreement.[8] While these other forms exist, if a Security Agreement is intended, the best practice is to create a formal Security Agreement so as not to rely on the vagaries of other embodiments of agreement.

The Security Agreement must include a description of the obligations secured by the collateral. When the security interest covers crops growing or to be grown or timber to be cut, a description

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the authenticating person to identify the person and adopt or accept a record and allows for the use of electronic signatures.

[7] The Law of Secured Transactions Under the Uniform Commercial Code, Revised Edition, by Warren Gorham Lamont, 1993, ¶ 2.02[1][a] p. 2-9.

[8] Id. §2.02[1][e]), Also see, In re Numeric Corp., 485 F.2d 1328 (1st Cir. 1973) and see, UCC §9-203.

of the land concerned is necessary. The collateral description need not be specific, so long as it reasonably identifies the collateral described.[9] Article 9 of the Code requires that the security be sufficiently described by type, except in certain commercial tort claims and certain commercial transactions.[10] In these instances there are more specific description requirements. The collateral may not be described in the Security Agreement as simply, "all personal property."

The Security Agreement may include a granting clause under which the debtor grants the secured party a security interest in collateral to secure payment of an obligation, however, Article 9 does not require such language. Nonetheless, general "granting" language should be included in a Security Agreement, for example, "Debtors do hereby assign, pledge and grant to the Secured Party a first priority and perfected security interest in and to the Collateral."

Other terms which the parties can include are various warranties guaranteeing that the debtor has good title to the collateral and that the debtor is authorized to execute the agreement; various promises of the debtor, including, not to sell the collateral without the secured party's consent, to pay all necessary taxes and

[9] See, UCC §9-108.

insurance on the collateral, and an after-acquired property clause, which is drawn broadly enough to include collateral that the debtor acquires after the Security Agreement is executed; and a comprehensive list of the events of default.

There are terms which the parties are not permitted to vary in their Security Agreement, most of which deal with enforcement and waiver of rights. The parties cannot vary the following: (i) the secured party's use of the collateral in consumer goods under UCC §9-201(b)(4)(C); (ii) the requirements of dealing with a request for accounting, a list of collateral or statement of account provided under UCC §9-210; (iii) the secured party's duty to proceed in a commercially reasonable manner in enforcing or collecting against the collateral as mandated by UCC §9-607(c); (iv) the application of non-cash proceeds of collection, enforcement or disposition of collateral under UCC §§ 9-608(a) and 9-615(c); (v) accounting for surplus proceeds of collateral under UCC §§ 9-608(a) and 9-615(d); (vi) the requirement that a secured creditor not breach the peace when repossessing collateral as required by UCC §9-609; (vii) how collateral is disposed of under UCC §§9-610(b), 9-611, 9-613, 9-614; (viii) how a deficiency or a surplus is calculated in general under UCC

[10] See, UCC §§9-108(b)(3) and 9-108(e).

§9-616; (ix) how a deficiency is calculated when the disposition of the collateral is made to the secured creditor, someone related to the secured party or a secondary obligor under UCC §9-615(f); (x) the secured party's acceptance of the collateral in satisfaction of the obligation under UCC §§9-620, 9-621 and 9-622; (xi) the borrower's right to redeem the collateral under UCC §9-623; (xii) a change in permissible, post default waivers under UCC §9-624; or (xiii) the secured party's liability for failure to comply with the requirements of the enforcement provisions under UCC §§9-625 and 9-626.

While these terms outlined above cannot be varied, the parties can agree (except for not breaching the peace), as part of the Security Agreement, to change the standards for measuring fulfillment so long as the agreed standards are not "manifestly unreasonable." See, UCC §9-603.

A. UNCITRAL Comparison

The UNCITRAL Legislative Guide (hereinafter, the "Guide") encompasses many secured transactional law regimes and attempts to define what is meant by the term "Security Agreement". Similar, to Article 9, the Guide sets forth the definition of the Security Agreement: an agreement to create a right to security in the present, between the creditor and the debtor or, in cases where security is provided by a third party, the grantor becomes a party having a

security right. However, the Guide contemplates oral Security Agreements, whereas Article 9 excludes oral Security Agreements, except in the instance of an oral pledge.[11] Even though oral Security Agreements are permissible, with respect to third parties, the Guide states that a written Security Agreement may "usefully serve evidentiary purposes and prevent fraudulent antedating, at least with respect to non-possessory security rights."[12]

The Guide makes the point that, "An additional act (i.e.: delivery of possession, notification, registration or control) is required in most, but not all, countries, in some countries, the Security Agreement, accompanied by an additional act, produces proprietary effects against all parties. In those countries, quasi security devices, such as retention-of-title arrangements, produce proprietary effects...which may be even oral. In other countries, the Security Agreement has proprietary effects only between the parties, third-party effects being subject to an additional act."[13]

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[11] A pledge is a bailment, or a delivery of personal goods or a deposit of personal property to a creditor as security for some debt or engagement. A pledge is a personal property security device. There is no requirement under the UCC that the Security Agreement conferring possession of the collateral be in writing, instead a verbal Security Agreement sufficient to create a pledge may be adequate.

[12] UNCITRAL Guide, Addendum 3 at ¶58.

[13] UNCITRAL Guide, Addendum 3 at ¶¶ 48-52.

Similar to Article 9, the Guide suggests that the Security Agreement identify the parties and reasonably describe the obligation to be secured by the encumbered assets, but defers to the country's/state legislature for the particular requirements. However, in the event that a country's/state's legislature does not provide for a minimum requirement, the missing elements may be established through other means.

III. Attachment – Making the Security Interest Enforceable.

A. Generally.

Attachment means that the security interest has become enforceable against the debtor with respect to the collateral. See, UCC §9-203(a). A security interest attaches when: (a) value has been given by the creditor; (b) the debtor has rights in the collateral or the power to transfer rights in the collateral to the secured party; and (c) there is evidence of a Security Agreement. See, UCC §9-203. As used herein, these are called the "Three Factors."

A secured creditor gives value in acquiring the security interest in any of the following three ways, where the security interest is obtained (a) in exchange for a binding commitment; (b) to extend credit or (c) for the extension of immediately available credit or as

security for or in total or partial satisfaction of a pre-existing claim or in return for some consideration.[14]

A debtor has rights in the collateral even if its rights are limited, i.e., short of full ownership. It is important to keep in mind that the secured creditor then only has as much right to the collateral as the debtor has, and by extension the secured creditor can only transfer its interest in the collateral to the extent of the secured creditor's rights.[15]

Evidence of a security interest is shown by the debtor having authenticated a Security Agreement which adequately describes the collateral or by the secured party taking possession of the collateral pursuant to the debtor's Security Agreement (as opposed to an authenticated Security Agreement). The latter alternative is available where the collateral is a certificated security in registered form, delivered to the secured party or its agent or a securities intermediary acting on its behalf or where the collateral is an uncertificated security in possession of the secured party under UCC §9-313 or the collateral are Deposit Accounts, Electronic Chattel Paper, Investment

[14] See, UCC §1-201(44)(a) – (c).

[15] An interest can also attach where the debtor has less than full ownership rights in the collateral, in the case of a bailee.

Property or Letter-of-Credit Rights under the secured creditor's control.

B. Proceeds, After Acquired Property and Future Advances.

When a secured creditor takes a security interest in collateral, the secured creditor, by extension, takes a derivative interest in the collateral flowing from the original collateral. See, UCC §9-315(a)(2).

Proceeds (anything that can be traced to the original collateral) include: (a) whatever is acquired upon the sale, lease, license, exchange or other disposition of collateral, (b) whatever is collected on or distributed on account of the collateral, (c) any rights arising out of the collateral, to the extent of the value of the collateral, (d) claims arising out of the loss, nonconformity or interference with the use of, defects or infringement of rights in, or damage to, the collateral, or to the extent of the value of the collateral and to the extent payable to the debtor or the secured party, (e) insurance payables by reason of the loss or nonconformity of, defects or (f) infringement of rights in, or damage to the collateral.[16]

Cash proceeds include money, checks and Deposit Accounts. Non-cash proceeds include everything else generated by the sale of the collateral, such as accounts, Chattel Paper, instruments, goods,

[16] See, UCC §9-102(a)(64).

documents, and general intangibles.[17] Importantly, a practitioner is well advised to include a proceeds provision in the Security Agreement and ultimately in any Financing Statement.

A Security Agreement and any Accessions (goods that are physically united with other goods in such a manner that the identity of the original goods is not lost, e.g. a tractor and its engine can be Accessions of one another, see *infra* part C herein) may also create rights in a secured creditor of after-acquired property pursuant to UCC §9-204 with only two minor exceptions: consumer goods acquired by the consumer more than ten (10) days after the secured party gives value, except that the clause does apply to Accessions and after acquired commercial tort claims. [18] An after acquired property clause in a Security Agreement, pursuant to UCC §9-204 creates an additional security interest for the secured creditor. "A security interest in after acquired property is not merely an 'equitable' interest; no further action by the secured party, such as a supplemental agreement covering the new collateral is required."[19]

Also important is that a Security Agreement may provide that collateral secures future advances. Future advances cover later

[17] See, UCC §9-315.

[18] See, UCC §9-102.

[19] See, UCC §9-204, Official Comment 1.

advances to the debtor which become part of the obligation secured by the collateral without the necessity of entering into a new Security Agreement.

The use of security interests in proceeds, after acquired property, and to secure future advances, establishes the concept of the floating lien over the assets of a debtor. Primarily, secured creditors use floating liens when the collateral are accounts receivables or inventory. Since these types of collateral are always turning over or replenishing themselves, the lien must necessarily cover a broad range of collateral including proceeds and after-acquired property. Because money is always being repaid to the secured creditor and then returned to the debtor, the Security Agreement must secure future advances.

The concept of floating lien arrangements was originally disfavored. The United States Supreme Court in Benedict v. Ratner, 268 US 353 (1925), struck down an assignment of present and future accounts receivable under which the debtor was allowed to collect the accounts, use the proceeds as it saw fit, notify the account debtors of the assignment, and was excused from accounting to the lender. The Court held that such unfettered dominion by the debtor over the collateral and its proceeds was in effect a fraud on other creditors and

was voidable in bankruptcy. UCC §9-205 codifies the repeal of Benedict. The Code validates the use of the floating lien over collateral that shifts hands. "A security interest is not invalid or fraudulent by reason of the debtor's liberty to dispose of the collateral without being required to account to the secured party for proceeds or substitute new collateral."[20]

C. Accessories.

There are also some security interests that are attached to other security interests. For example, the attachment of a security interest in a right of payment or performance (like a promissory note) which is itself secured by a security interest in personal or real property (like a mortgage), a security interest attached to the note is automatically attached to the mortgage. See, UCC §9-203(g). The same is true of the attachment of a security interest in a securities account. Attachment in the securities account is an attachment of a security interest in the security entitlements. See, UCC §9-203(h). A security interest in a commodities account attaches not only to the account but to the commodity contracts in the account. See, UCC §9-203(i).

D. UNCITRAL Comparison.

[20] See, UCC §9-205, Official Comment 9.

As in the formation of the Security Agreement, the Guide encompasses the ideas and structures of various legal regimes in order to provide an overview of how the varied legal systems approach the concept of attachment- making the security interest enforceable as against the debtor. The Guide states broadly, that in some countries a fully effective security interest only comes into effect upon the conclusion of the Security Agreement and completion of an additional act, (i.e.: delivery, possession, notification, registration or control). However, the Guide mentions that in some countries, a retention of title clause is effective vis'-a-vis' third parties upon the conclusion of the sales agreement in which it is contained. A security interest will be effective, under some countries' regimes, where an assignment of receivables is accomplished by way of security (under some countries, this assignment is effective even without notification of the debtor of the receivable).

The Guide stresses the concept of proprietary requirements in making a security interest enforceable as against a debtor. These proprietary requirements give rise to the ability of a grantor of security to convey its security interest – in this situation, a sub-issue arises as to when the grantor does not have the ownership or the power to dispose of the assets, but the secured creditor can nevertheless acquire the security right in good faith. In some legal

systems, the Guide instructs, good faith is determined on a subjective basis and is supported by objective indicia of ownership, e.g.: where the creditor has extended or is about to extend credit to the debtor, or the grantor is registered as the owner of the assets to be encumbered or holds the assets and transfers possession thereof to the creditor.[21]

The Guide outlines four (4) ways of producing proprietary effects of a security interest as against third parties. They are transfer of possession, control, notification and publicity.

Possessory pledges are transferred by a change in the possession of the security interest, either by transfer of ownership through agreement or by a physical transfer. Transfer of negotiable instruments would contemplate a transfer by delivery with an endorsement according to the rules of the particular countries law on negotiable instruments.

Security interests in intangibles are created by agreement and transfer of control in much the same way as UCC Article 9 proscribes.

Transfer of possession of security interests in receivables can occur by agreement and notification. The Guide notes that notification might not be an efficacious way to publicize an

[21] UNCITRAL Guide, Addendum 3 at ¶62. The Authors note that this section was heavily negotiated and discussed during the course of the last working group

assignment because of the inherent problems of identifying the receivables.

Publicity is the fourth way the Guide suggests as a method of enforcing non-possessory security rights in tangibles and in intangibles. The Guide suggests, in several places, the necessity of a public register which would serve to publish the security agreement or a limited amount of information regarding the security interest.[22]

IV. Perfection.

A. Generally.

Simply put, perfection is the action required of a secured creditor to protect itself from the claims of other secured creditors and lienholders claiming an interest in the same collateral. While attachment permits the secured party to enforce its security interest against the debtor, perfection protects the secured creditor from other creditors having some interest in the same collateral. A very important aspect of perfection is that it enables a security interest that has been perfected before a debtor's bankruptcy to prevail despite the bankruptcy, in other words, the security interest held by the secured creditor cannot be avoided by the debtor in possession or

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session.

[22] UNCITRAL Guide, Addendum 3 at ¶¶ 66-70.

bankruptcy trustee under section 544(a) of the Bankruptcy Code. (*infra*, Section VII).

By perfecting its security interest, the secured creditor generally publishes to the world notice of its security interest in the collateral. As a result, the public is put on notice that the secured creditor has a lien on the specific collateral of the debtor.

Perfection may take the form of (a) filing a Financing Statement in the appropriate state or county office (in the case of a Fixture Filing) or (b) "possession" or "control", as those terms are defined by the UCC, of the collateral, which may be the only way to perfect a security interest for certain kinds of collateral, or (c) in limited circumstances, may occur through the automatic transfer of the rights. There is no national filing office for Financing Statements, but, Article 9 dictates a set of rules regarding the situs of the filing of the Financing Statements.

B. Where to file Financing Statements.

The general rule is that the state of the debtor's location governs the perfection by filing of security interests. A debtor's location is determined pursuant to the rules of UCC §9-307. The location of a debtor who is a natural person is the individual's principal residence. If the debtor is an organization, its location is its place of business (the place where the debtor conducts its affairs) or

its chief executive office, if it has more than one place of business. The limitation on this is if the debtor's place of residence, place of business or chief executive office is located in a jurisdiction whose law does not require that information concerning non-possessory security interests be made available. In that case, the debtor is deemed located in the District of Columbia.

If the debtor is a state registered business organization, like a corporation or a limited liability company, it is deemed located in the state where it is registered. Moreover, suspension, revocation, dissolution and the like do not affect the location of the registered business organization debtor. Special rules apply for federal instrumentalities, the United States itself, foreign bank branches or agencies and foreign air carriers.[23]

A secured creditor perfects its security interest in one of five ways: (a) automatically, upon attachment; (b) by attachment; (c) by possession of the collateral; (d) control of the collateral; or (e) by filing of a Financing Statement. It is the latter which is the general rule. See, UCC §9-310(a). The other methods of perfection are the exceptions. See, UCC §9-310(b). It is the type of collateral which dictates the method of perfection. Some security interests can be

[23] See, UCC §9-307.

perfected in more than one way while other security interests may only be perfected in one way.

The security interests perfected upon attachment alone are recited in UCC §9-309. The most important of these are purchase money security interests in consumer goods (other than those covered by a certificate of title) and assignments of accounts or payment intangibles to the same assignee which does not transfer a significant part of the outstanding accounts or payment intangibles, i.e., the small, casual or isolated assignment transaction. Other security interests subject to "automatic" perfections are found in UCC §9-308 (d) - (g).

This next section breaks down, by common type of collateral or transaction how perfection occurs.

C. Chattel Paper, Negotiable Documents, Instruments and Investment Property.

Security interests in all of the above mentioned collateral may be perfected by filing a Financing Statement or by possession. With respect to negotiable documents, if a Financing Statement is not filed, and possession has not occurred, the creditor has a twenty (20) day period of temporary perfection under UCC §9-312(e), to file a Financing Statement or to take possession, so long as attachment is the result of new value under an authenticated Security Agreement.

With respect to goods covered by a negotiable document issued by a bailee, a security interest in the goods may be perfected by perfecting a security interest in the negotiable document. On the other hand, a security interest in goods covered by a bailee's non-negotiable document is perfected by either (i) issuance of a document in the name of the secured party, (ii) the bailee's receipt of notice of the secured party's interest in the collateral or (iii) a filing of a Financing Statement as to the goods. See, UCC §9-312 (c) and (d).

Similarly, a perfected security interest in a negotiable document or goods in possession of a bailee where the bailee has not issued a negotiable document for the goods, is continued for a period of twenty (20) days where the secured creditor gives up possession of the goods or the documents representing the goods to the debtor for ultimate sale or for dealing with the goods in anticipation to the ultimate sale. See, UCC §9-312(f). It is important to remember that the situations where Article 9 allows for twenty (20) day temporary perfections, another form of perfections is necessary before the time runs out.

D. Deposit Accounts

A Deposit Account is a special brand of account that can only be perfected by control.[24] There are three ways to establish control of a Deposit Account, when: (a) the bank where the account is maintained is the secured party so that the secured party automatically has control over the Deposit Account; (b) the debtor, secured party and bank agree that the bank will follow the secured party's instructions directing the funds in the account without obtaining the debtor's consent; or (c) the secured party becomes the bank's customer with respect to the Deposit Account.[25]

With regard to security interests in Deposit Accounts, perfection continues only while in the control of the secured creditor. See, UCC §9-314(b). A security interest in deposit accounts (which are perfected under the law of the bank's jurisdiction), remains perfected until the earlier of (a) the time the security interest would have become unperfected under the law of that jurisdiction or (b) the expiration of four (4) months after a change in the bank's jurisdiction to another jurisdiction. See, UCC §9-316(f).

[24] See, UCC §§9-312(b)(1)

[25] See, UCC §§9-104 and 9-314.

E. Letter-of-Credit Rights.

With regard to Letter-of-Credit Rights, perfection is achieved through control or as a result of the perfection of a security interest in a support obligation.[26] Control of a Letter-of- Credit right is set forth in UCC §9-107, which provides that: "A secured party has control of a Letter-of-Credit right to the extent of any right to payment or performance by the issuer or any nominated person if the issuer or any nominated person has consented to an assignment of proceeds of the Letter-of-Credit under UCC §5-114 or otherwise applicable law or practice."

Like Deposit Accounts, security interests in Letter-of-Credit Rights, perfection continues only while in the control of the secured creditor. See, UCC §9-314(b). And, a security interest in Letter-of-Credit Rights (which are perfected under the law of the issuer's jurisdiction), remains perfected until the earlier of (a) the time the security interest would have become unperfected under the law of that jurisdiction; or (b) the expiration of four months after a change in the issuer's jurisdiction to another jurisdiction. See, UCC §9-316(f).

[26] See, UCC §§ 9-312(b)(2) and 9-308(d).

G. Money.

In the case of money, perfection is accomplished only through possession under UCC §9-313.[27] When money is "possessed" it is generally deposited in a bank account.

H. Property Subject to Statute, Regulation or Treaty.

Article 9 expressly exempts security interests in these kinds of collateral from the requirement of filing of a Financing Statement. See, UCC §9-310(b)(3). The most common form of applicable statutes are titling statutes governing motor vehicles. Usually, a filing and payment of a filing fee with the State Department of Motor Vehicles or other governing body causes the perfection of the collateral supported by the certificate of title. These statutes generally also cover the duration and renewal of the perfected security interest as well as the termination of the interest.

An exception to perfection of a Certificate of Title exists where the collateral, is held as inventory by a debtor who is in the business of selling goods of the kind that are subject to the statute. See, UCC §9-311(d). The simple situation would be where an automobile dealer finances his inventory of new cars – so called "floor planning." In

[27] See, UCC §1-201(24), where money is defined as a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations.

that case, the UCC applies and generally governs perfection of the security interest.

Despite the fact that there is no uniform titling statute contained in the UCC, there are general procedures each state follows when granting and transferring Certificates of Title, these include:

(a) Procedures for acquiring the initial Certificate of Title. These statutes generally require that the owner surrender the certificate of ownership, or the manufacturer's statement of origin, issued by the manufacturer of the vehicle to prove that the new asset is in fact the owner's;

(b) Procedures for transferring title to a certificated asset to a buyer or other transferee of the asset which typically requires the endorsement and delivery of the existing certificate to the transferee and the issuance of a new certificate showing that the transferee has become the owner of the collateral;

(c) Methods of placing liens on the collateral by creditors, which typically involve filing a notice of lien with the issuing department; and

(d) Procedures for perfecting a security interest in the title asset.

Oftentimes, collateral covered under Certificates of Title is transferred from person to person and/or moved from state to state. When a security interest in collateral covered by a Certificate of Title

is perfected, the security interest remains perfected despite a change of jurisdiction. See, UCC §9-316(d). As against a purchaser for value in the new jurisdiction, the perfected security interest in the prior jurisdiction becomes unperfected on the earlier of the time perfection would have ceased under the law of original jurisdiction or the expiration of four (4) months after a change of the debtor's location.[28] Thus, a secured party must re-perfect its security interest in the new jurisdiction, pursuant to the new jurisdiction's titling statutes or lose its perfected security interest as against a purchaser for value.

I. Accounts

A Financing Statement must be filed for a secured creditor to perfect its interest in accounts, both present and future accounts.

J. Health Care Insurance Receivables.

A security interest created by the assignment of a health care insurance receivable to the provider of the health care goods or services is perfected when attachment occurs or the Three Factors are met.

[28] See, UCC §9-316(e).

K. Payment Intangibles.

Sales of Payment Intangibles are automatically perfected, or are perfected upon their sale.[29]

L. Tangible and Electronic Chattel Paper.

A security interest in tangible Chattel Paper can be perfected either by possession or by filing a Financing Statement. On the other hand, a security interest in Electronic Chattel Paper can be perfected by filing of a Financing Statement or by control.

There are six ways a creditor must display that it has obtained control over its interest in Electronic Chattel Paper. The Chattel Paper must be created, stored and assigned in such a manner that:

i. A single authoritative copy (meaning that the tangible copies must bear some marking such as "Copy" or "Not the Original" to show that the electronic version is the true Chattel Paper) of the record exists which is unique, identifiable and unalterable;

ii. The authoritative copy identifies the secured party as the assignee of the record or records;

iii. The authoritative copy is communicated to and maintained by the secured party or its designated custodian;

[29] See, UCC §9-309(a)(3).

iv. Copies or revisions that add or charge the identified assignee of the authoritative copy can be made only with the participation of the secured party;

v. Each copy of the authoritative copy and copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

vi. Any revision of the authoritative copy is readily identifiable as an authorized or unauthorized revision.

M. General Intangibles.

A security interest in General Intangibles is perfected by filing a Financing Statement. However, Payment Intangibles are perfected upon attachment without the requirement of a filing.[30] Likewise, a sale of a Payment Intangible is automatically perfected, as is the sale or transfer of a promissory note.[31]

N. Farm Products.

Perfection of security interests in Farm Products are considered Agricultural Liens and occurs through the filing of the Financing Statement in the jurisdiction where the Farm Products are situated.[32]

[30] See, UCC §9-309(3).

[31] See, UCC §109(a)(3).

[32] See, UCC §9-302.

O. Inventory.

Perfection of a security interest in Inventory occurs by filing a Financing Statement. A financier that deals in the Inventory of a debtor sometimes establishes a "field warehouse" on the debtor's premises, which allows the secured creditor the ability to closely monitor the inventory-collateral while permitting the debtor to have use of the inventory-collateral. By notice to the field warehouseman, the secured creditor perfects its interest in the inventory-collateral.

P. Investment Property.

Investment Property includes a security whether certificated or uncertificated, security entitlement, securities account, commodity contract or commodity account. Perfection depends on the type of investment property forming the collateral and who the secured creditor is.

Certain security interests in Investment Property are perfected automatically such as a security interest in a commodity contract or a commodity account created by a commodity intermediary or a security interest in Investment Property created by a broker or securities intermediary. See, UCC §9-309(10) and (11).

Generally, however, perfection of a security interest in Investment Property may occur by filing. See, UCC §9-312(a). But

such a security interest can also be perfected by control. See, UCC §9-314(a).

Control is defined according to the type of Investment Property. Control with respect to certificated securities in bearer form means delivery. If the certificated security is in registered form, control occurs by delivery and indorsement to the secured creditor or in blank by being registered in the name of the secured party. Control of an uncertificated security is obtained by delivery or by agreement stating that the issuer will comply with the instructions by the secured creditor without further consent by the registered owner.

Control of a security entitlement occurs when the secured creditor is the actual holder; a securities intermediary has agreed to comply with the secured creditor's direction without further consent of the debtor; or another party in control of the security entitlement on behalf of the secured creditor acknowledges that it has control for the secured creditor. See, UCC §§9-106(a), 9-314(a) and 8-106(a)-(c).

A secured creditor has control of a commodity contract if the secured creditor is the commodity intermediary or the commodity customer where the secured party and commodity intermediary have agreed that the value distributed will be distributed as directed by the secured party without further consent by the debtor. See, UCC §9-106(b).

Control of a securities account or a commodities account is established by control over all of the security entitlements or commodity contracts carried in the respective accounts. See, UCC §9-106(c). Even if control is ceded to the debtor, with respect to certificated securities, temporary perfection is available to the secured creditor for twenty (20) days if the certificate is given to the debtor for the purpose of sale or exchange or given for presentation, collection, enforcement, renewal or registration of transfer. See, UCC §9-312(g). The practitioner should bear in mind that before the twenty (20) day period expires, perfection by another method should be accomplished.

With respect to securities interests granted in securities accounts and commodities accounts, perfection also perfects and interest in the security entitlements associated with the security account as well as the commodity contracts carried in the commodity account. See, UCC §9-308 (f) and (g).

Generally, a security interest in Investment Property perfected by control continues until the secured party no longer has control. If the collateral is a certificated security, the security interest terminates when the debtor obtains possession of the certificate. If the collateral is an uncertificated security, the security interest ends when the debtor is named as the registered owner. If the collateral is

a security entitlement, the security interest continues until the debtor becomes the entitlement holder. See, UCC §9-314(c). If the securities intermediary, issuer or commodities intermediary changes jurisdiction (recall that this is the jurisdiction governing perfection) the security interest remains perfected until the earlier of (a) the time the security interest would have become unperfected under the law of to outgoing jurisdiction; or (b) the expiration of four (4) months after a change in the applicable jurisdiction to another jurisdiction.[33] Failure to perfect in the new jurisdiction within this time frame results in a loss of perfection and is deemed to have never been perfected as against one who purchases the collateral for value.

Q. Fixtures

A Fixture Filing is used to perfect secured creditors' interests in goods that are or are to become Fixtures, (i.e.: to become attached to a parcel of real property). These filings are generally recorded in the office where a mortgage or deed of trust on the applicable real property would be recorded. A secured creditor is well advised to also file in the central filing office. It may file the Financing Statement in the state where the collateral exists in the Article 9 records or it may

[33] See, UCC §9-316(f).

file the Financing Statement as a Fixture Filing in the office in which a record of a mortgage on the related property would be filed.[34]

A Fixture Filing must show that it covers the Fixtures, recite that it is to be filed for recording in the real estate records and contain a description of the real estate. In cases in which the debtor does not have an interest of record in real estate, the filing must show the name of the record owner. In addition, the Fixture Filing must also contain the same elements as a Financing Statement (i.e.: names and addresses of the debtor and the secured party, description of the property, and signature of the debtor).[35]

The description of the property will be sufficient if the Fixture Filing recites that the collateral is or is to become a Fixture; i.e., any language that can associate the Fixture with the property upon which it is affixed.[36] The secured creditor must also state on the face of the Fixture Filing that the filing concerns real property. If such statement does not appear on the Financing Statement, a filing officer, who is a ministerial employee of the county or state, may reject the filing for lack of sufficiency or completeness. The reasoning behind this, is that

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[34] See, UCC §9-501 Official Comment 4.

[35] See, UCC §9-502.

[36] See, In re Galvin, 39 B.R. 1016, 39 U.C.C. Rep. Serv. 343 (B. Ct., D.N.D. 1984).

Fixture Filings are attached to the real estate filings and give notice to all prospective real estate claimants.

When the debtor is a transmitting utility special rules govern the place and manner of filing a Fixture.[37] These Fixture Filings must also meet the requirements of a Financing Statement (see *infra*).

Q. Consignment.

For consignment transactions, perfection occurs in the same way ordinary goods are perfected, by filing a Financing Statement in the state where the goods are located, not where the goods might have originated from by the consignor. See, UCC §9-505.

R. UNCITRAL Comparison.

In the Guide, there is no separate topic entitled "Perfection," like under Article 9 of the UCC. Instead, the Guide's approach to perfection is subsumed in the concept of creation of a security interest.

IV. Filing System

The Article 9 filing system is considered a notice filing system; by filing a Financing Statement the creditor notifies the world that the creditor has a security interest in the collateral.[38] Since UCC Article 9

[37] See, UCC §9-501(b).

[38] In most cases, a Financing Statement is filed to put the world on notice that a particular creditor has a security interest in something, the creditor is then considered a secured creditor.

was revised, the filing aspect of security interests has become more simplified.

The initial Financing Statement has a duration of five (5) years, however, Financing Statements filed in connection with a "public-finance transaction" or a "manufactured-home transaction," Financing Statements are effective for thirty (30) years.[39] Before the five (5) year term has elapsed the secured creditor may file a Continuation Statement to continue its security interest in the collateral. There are subsequent filings that can be made after the initial filing such as the Amendment, the Release or the Termination Statement.

The drafters of the UCC have adopted a uniform Financing Statement with addendums as well as a uniform Termination Statement. Copies of these documents are included as part of the Appendix.

The Financing Statement must contain certain key elements, including, the names and addresses of the debtor and the secured party. Here, the name of the debtor must be exact. In particular, if the debtor is a registered business organization, it must state the name of the debtor as is shown in the public records. The failure to properly name the debtor makes the Financing Statement seriously

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[39] See, UCC §9-515(b).

misleading, causing the Financing Statement to lose its effectiveness. See, UCC §9-506(b). On this basis, it is important to obtain copies of the debtor's organizational filings which show its exact name, as well as a certification from the borrower as to its exact name, address and principal place of business at the time the Security Agreement is signed. In many jurisdictions, registered entities, like corporations, are assigned organization numbers. The Financing Statement includes a space for such identifiers which should be used in jurisdictions where applicable.

The Financing Statement must indicate the types or describe the items of collateral. Unlike the Security Agreement, a sufficient description of collateral may include "all personal property", however, it is good practice to describe the collateral with as much specificity as possible, matching the description contained in the Security Agreement and include a "catch all" clause if appropriate. There must also be authentication by the debtor (i.e.: its permission to file a Financing Statement). This is not to say that the debtor must sign the Financing Statement, but that the debtor must authorize the filing. This authorization is generally given in the Security Agreement and includes authorization for filing Amendments and Continuation Statements.

One of the major advances in secured transactions law are the revisions to Article 9 dealing with central filing. Now, filings are centralized at the state level.[40] Fixtures or collateral that is to become a Fixture, collateral is as-extracted collateral or collateral as timber to cut require filings at the county or local level.[41] By comparison, former Article 9 afforded states the choice to have secured creditors file in three places, at the state level (Secretary of State), the local level (County Clerk's Office) and in some instances both places.

As noted above, Financing Statements need not be signed by the debtor and can be electronically filed, if the filing office permits. Under UCC §9-516(b) there are certain instances where a filing, either a Financing Statement, or an Amendment to the Financing Statement will be rejected by the filing office, they include:

A. The record is not communicated by a method or medium of communication authorized by the filing office;

B. The incorrect filing fee was tendered;

C. The debtor's name and or mailing address does not appear on the Financing Statement;

[40] See, UCC §9-501(a)(2).

[41] See, UCC §9-501(a)(1).

D. In the case of an Amendment or a Correction Statement, the original Financing Statement is not identified or the Amendment or Correction Statement identifies a Financing Statement that has lapsed;

E. The debtor's filing status as an individual, corporation, partnership, etc. is not mentioned; or

F. The collateral is not sufficiently described.

In addition to filing Financing Statements, the UCC permits Amendments to the Financing Statements. (See the Appendix for the reproduction of this form). See, UCC §9-512. Amendments can add or change debtors, change secured creditors and allow for adding, deleting or changing collateral. As to the latter, such an Amendment is only effective as to the added collateral from the date of filing the Amendment. An Amendment purporting to delete all of the debtors without naming a new debtor, or purporting to delete all of the secured creditors without providing a new secured creditor, is ineffective. See, UCC §9-512(e)(1) and (2).

Just as the Financing Statement is filed when the security interest is created, when the obligation secured is satisfied, the secured creditor must file a Termination Statement. The filing of a Termination Statement depends on the nature of the transaction. In consumer goods transactions, the Termination Statement must be

filed by the secured creditor within one (1) month after the cessation of the secured obligation or within twenty (20) days after the secured creditor receives an authenticated demand to do so from the debtor. In all other transactions, generally within twenty (20) days after receipt of an authenticated demand, the secured creditor must give the debtor a Termination Statement that the debtor files or in some cases that the secured creditor files. The best practice would be for the secured creditor to file the Termination Statement immediately after satisfaction.

A. UNCITRAL Comparison.

The Guide covers a number of areas with regard to the creation of a filing system in each countries' secured transactions law regime, including: (i) the authorization of the grantor, as opposed to a requirement of a signature, (ii) whether the filing system will be a notice or a document filing, (iii) the importance of identifying the entry by the grantor as opposed to categorizing the filing system by other identifiers, (iv) proper identification of the secured creditor, (v) adequate description of the assets covered in the notice, (vi) including the maximum amount of secured credit, (vii) pre-filing requirements, (viii) the potential for the creation of a domestic and foreign grantor filing system, (ix) the duration of effectiveness of a filed notice (either unlimited duration, a fixed term set by the filer and subject to

extension, or a common statutory fixed term, subject to extension), (x) public access to the information contained in the filing system, (xi) applicable fees, (xii) the administration by a public or private operator, (xiii) and the effect of a filing system error and the allocation of the risk of loss due to error.[42]

VI. Rights and Duties of the Parties.

Once the security interest has been created, attached and perfected, and while in the executory period, the debtor and secured creditor have certain rights as against each other and duties owed to one another.

A. The Duty of Care of a Secured Party in Possession.

A secured creditor in possession of collateral must use reasonable care in the custody and preservation of the collateral it holds. See, UCC §9-207(a). Reasonable expenses for things like insurance and taxes for the collateral are chargeable to the debtor. See, UCC §9-207(b)(1). In the instance of a casualty to the collateral, the debtor is responsible for any deficiency after payment of the insurance proceeds. See, UCC §9-207(b)(2). The secured creditor

[42] UNCITRAL Guide, Addendum 6 at ¶¶1,5,8-15, 28, 34, 37, 42, 43. The Guide uses the term, "Filing System" instead of the term "Registry" to refer to the centralized system recommended for use by countries that does not take the place of a formalized registry where real property rights are recorded and derive their substantive value.

must keep the collateral identifiable unless the collateral is fungible, then it may be commingled. See, UCC §9-207(b)(3). Finally, a secured creditor may not use the collateral except for the purpose of its preservation, as permitted by the court and, in the case of consumer goods, in the manner agreed to by the debtor. See, UCC §9-207(b)(4).

If the collateral is chattel paper and instruments, reasonable care means that the secured party will take all necessary steps to preserve its rights against prior parties. See, UCC §9-207(a).

If the secured creditor has possession or control of a Deposit Account, Electronic Chattel Paper, Investment Property or a Letter-of-Credit Right, then it has additional duties and rights. It may hold proceeds as additional security, except for money or funds received from the collateral which it must apply to the outstanding obligation unless remitted to the debtor. The secured creditor may create a security interest in the collateral by re-pledging the collateral. See, UCC §9-207(c).

Where there are no further amounts owing to the secured creditor and the secured creditor is no longer obligated to make any further advances, a secured creditor still has additional duties in certain situations. See, UCC §9-208. If the secured creditor has control over a Deposit Account, the account must be released either by the secured party informing the bank holding the deposit to release it,

or the bank may release the deposit itself. If the secured party is responsible for releasing the account, it must pay the balance of the account to the debtor or deposit the funds into the debtor's account. If the secured creditor has control of Electronic Chattel Paper, it must be returned to the debtor. If the secured creditor has control over Investment Property, the secured creditor must send the securities or commodities intermediary an authenticated release, releasing the intermediary from further obligations to the secured creditor. If the secured creditor has control over a Letter-of-Credit Right, the secured creditor must send an authenticated release to each person obligated under the Letter-of-Credit Right, releasing the obligated persons from any further obligation to pay or deliver proceeds.

Under UCC §9-209, if the collateral is accounts, and the account debtor has received notice of an assignment to the secured creditor, the secured creditor must send a release to the account debtor releasing the account debtor from any further obligation to the secured creditor and must due so within ten (10) days of receiving an authenticated demand from the debtor.

UCC §9-210 grants the debtor the right to request certain information from the secured party. A debtor can request the following from the secured creditor: (i) an accounting or statement of the unpaid obligations secured by the collateral; (ii) a list of collateral

and that the secured party approve or to correct a list of collateral compiled by the debtor which the debtor believes to be all of the collateral securing the obligation; and (iii) a statement of account or the secured creditor's approval or a statement of correction indicating what the debtor believes to be the amount owed as of a particular date.

Generally, a secured creditor has fourteen (14) days from receipt of such a request to respond by an authenticated response to the debtor. This includes a reply where no interest is claimed in the collateral. Consignors and secured creditors secured by accounts, chattel paper, payment intangibles or promissory notes, do not have this obligation. The secured creditors may not charge for a request made in a six (6) month period but may charge up to $25.00 for any additional requests. See, UCC §9-210(f).

i. Banks and Deposit Accounts

With respect to Deposit Accounts, banks, and holders of Deposit Accounts have certain rights and obligations. In general, banks, if they are not secured parties, have a right of set-off or recoupment against a party secured by a Deposit Account. See, UCC §9-340(a). That being said, the bank's right of setoff does not exist where a secured creditor has perfected its security interest by becoming the

bank's customer and the bank's set-off is based on a claim against the debtor. See, UCC §9-340(c).

A bank's rights and duties with respect to a Deposit Account are unimpaired by a security interest, the bank's knowledge of a security interest, or the instructions of a secured creditor, unless it has agreed to change its rights and duties in an authenticated record, (including the situation where the secured creditor has become the bank's customer). See, UCC §9-341. The UCC does not require a bank to enter into an agreement with the customer/debtor and the secured creditor of a Deposit Account and oblige the bank to accept the instructions of a secured creditor without further instructions from the customer/debtor. If the bank enters into such an agreement, it is not required to confirm or deny the existence of such an agreement to anyone unless the customer/debtor requests that it does so. See, UCC §9-342.

B. Rights of Third Parties

While the usual secured transaction has two parties, the debtor and the secured creditor, the UCC grants certain rights to third parties.

UCC §9-401(a) states the general rule that a debtor's rights of transfer in collateral is governed by law other than UCC Article 9. But, UCC §9-401(b) also makes clear that any agreement between the

debtor and the secured creditor, that a transfer of the debtor's rights causing a default, does not prevent the transfer from being effective. So, to the extent no other law precludes the transfer of the debtor's rights, Article 9 does not invalidate a transfer by the debtor, even if it is violative of their Security Agreement. See, UCC §9-401, Official Comment 5.

Similarly, a term in an agreement between an account debtor and a debtor/assignor or a term found in a promissory note that restricts the right of assignment or requires the account debtor or the obligor's consent, is ineffective. See, UCC §9-406(d). Similar restrictions are placed on laws, statutes and regulations which require the consent of the government, governmental body or an official or an account debtor for an account or Chattel Paper. Many terms limiting the alienability of interests in lease agreements are likewise ineffective.

C. UNCITRAL Comparison.

The Guide focuses on two policy issues that dictate the parties' obligations towards one another and towards third parties. These two principles are: (a) party autonomy and the extent to which the parties should be free to fashion their own Security Agreement containing their own pre-default remedies and (b) the type and number of default rules to be included in the Security Agreement.

The first principle UNCITRAL suggests following stems from the initial vision of the working group, to allow the parties to a secured transaction to create a long-lasting, un-restrictive secured transaction to meet their own needs and circumstances, within certain limitations, emanating from the precepts of good faith and fair dealing.[43]

There are certain default guidelines presented in the Guide which define a set of policies to be used by each participating country. For instance, similar to what is legislated by Article 9, the party in possession of the encumbered asset should have a duty of preservation and care in order to preserve the value of the encumbered collateral. Also, as under the strictures of Article 9, there is a duty imposed upon the debtor to bear the reasonable expenses incurred by the secured creditor.

Other duties required under Article 9 of the Code are included in the Guide, such as: (a) the right to make reasonable use of the encumbered asset; (b) the duty to keep the encumbered assets identifiable; (c) the duty to take steps to preserve the debtor's rights, (d) the duty to allow inspection by the debtor; (e) the right to impute revenues for the payment of secured obligations; (f) the right to

[43] UNCITRAL Guide, Addendum 8 at ¶7.

assign the secured obligation and the security right; (g) the right to re-pledge the encumbered asset; (h) the right to insure against loss or damage of the encumbered asset; (i) the right to pay taxes on behalf of the debtor; and (j) specifically in the case of non-possessory security interests, the right to mix, commingle and process encumbered assets.[44]

VII. Priority.

When speaking of priority, the general rules are that a perfected security interest is superior to an unperfected security interest and, as between perfected security interests, the secured creditor that is the first in time to perfect has priority over all other secured creditors' rights in the same collateral.[45] This being said, Article 9 provides a plethora of variations and exceptions of which the practitioner must be wary.

A. Priority as Between Unperfected Security Interests and Third Parties.

The unperfected security interest is one where the interest has attached, but the act of the creditor to perfect has not taken place, i.e.,

[44] Id., at ¶¶16-35.
[45] See, UCC §9-322(a)(1).

filing, possession or control. As stated previously, the unperfected security interest is subordinate to the perfected one. See, UCC §9-317(a)(1) and (2).

Lien Creditors also have special rules of priority over unperfected security interests. A Lien Creditor is defined by Article 9 as a creditor that has acquired a lien by judicial act (a levy or execution), an assignee for the benefit of creditors, or a bankruptcy trustee as of the date of filing the bankruptcy or a receiver from the time of appointment. A Lien Creditor's interest is superior to the interest of a secured creditor's, until such time as the secured creditor's interests become perfected. However, if the security interest has been granted by an authenticated agreement, though no value has been given or the debtor has no rights in the collateral – in other words the security interest has not attached – but there has been a filing of a Financing Statement, the rights of the secured creditor remain superior to that of the Lien Creditor. See, UCC §9-317(a)(2)(B).

Buyers of tangible Chattel Paper, documents, goods, Instruments or a security certificate take free of an unperfected security interest so long as the buyer gives value and receives delivery of the collateral without knowledge of the security interest. Lessees of goods also take

free of an unperfected security interest under the same circumstances. Licensees of general intangibles as well as buyers of accounts, Electronic Chattel Paper, General Intangibles or Investment Property (other than certificated securities) also take free of an unperfected security interest so long as they give value without knowledge of the security interest. For this class of buyers and Licensees of goods, taking delivery without notice is not a requirement. See, UCC §9-317(b)-(d).

An exception to the unperfected security interest rules are rules governing the Purchase Money Security Interest (hereinafter, the "PMSI"). A PMSI holder is granted a twenty (20) day window in which to perfect and still take priority over an intervening buyer, Lessee, or Lien Creditor whose interest arises between the time the PMSI attaches and the time of filing. Of course, if the PMSI creditor fails to perfect in the twenty (20) days, it will lose its priority status. See, UCC §9-317(e).

B. Priority as Between Perfected Security Interests and Third Parties.

At times, even if a security interest has been perfected, others are granted superiority over that interest under limited circumstances.

i. Buyers of Goods

A buyer of goods who purchases in the ordinary course of business takes free of a perfected security interest granted by the seller even if the buyer has knowledge of the security interest. The exception to this rule is a buyer of farm products. See, UCC §9-320(a).

Likewise, a similar rule exists for a purchaser of goods from a consumer. In that case, the buyer takes free of a perfected security interest if the buyer purchases goods, without knowledge of a prior security interest for value and for a consumer purpose before a Financing Statement is filed. This rule comes into play where the security interest in the consumer goods is a PMSI which perfects upon attachment and where no filing occurs. Once a filing occurs, then a purchaser from a consumer cannot take free and clear of a security interest, PMSI or otherwise. The lesson here is that the secured creditor in consumer goods, despite any automatic perfection, is well warned to also perfect by immediate filing of a Financing Statement. See, UCC §9-320 (a) and (b).

As an additional exception to the rights of a buyer, if the security interest is perfected by the secured creditor's possession, then the buyer of the goods does not take free of the security interest. See, UCC §9-320(e). This includes circumstances in which the secured

creditor is deemed to be in possession of the collateral even if actual possession is in the hands of a third party.

ii. Licensees and Lessees

Licensees and Lessees are granted certain rights as against perfected security interests. Under a non-exclusive license, a Licensee in the ordinary course of business takes free from the Licensor's security interest in a general intangible even if the security interest is perfected and the Licensee knows about the security interest. Important to remember here is that a Licensee in the "ordinary course of business" is defined to be a person who becomes a Licensee of a general intangible without knowledge that the license violates the rights of another person in the general intangible and who receives the license from a person in the business of licensing general intangibles of the kind licensed. It is also required that the license comport with the customary practice for the granting of such licenses or the Licensor's usual practice in granting such licenses. Thus, a Licensee who knows that the conveyance of the license would violate a secured creditor's rights, does not take free of the security interest.

Similarly, a "good deal" license or "sweetheart" license may also result in the Licensee taking subject to a security interest because the license does not comport with customary practices. In representing a Licensee, the practitioner is well advised to assume that a Licensor's

granting of a non-exclusive license in a general intangible will violate the security interest and should require that the secured creditor authorize the license transaction. See, UCC §9-321(a) and (b).

Like Licensees, Lessees in the ordinary course of business take their leaseholds free of a perfected security interest in goods even if the Lessee knows of the existence of the security interest. See, UCC §9-321(c). Just as with a Licensee, the practitioner representing a Lessee should assume that the Lessor's grant of a lease violates the security interest and should require that the secured party authorize the lease. This provision is meant to operate in the same way as with Licensees in the ordinary course of business. See, UCC §9-321 Official Comment 3.

iii. Chattel Paper Purchasers

Purchasers of Chattel Paper have priority in certain instances over security interests. Following the "good faith" and the "ordinary course of business" concepts, a purchaser of chattel paper has priority over a security interest in the chattel paper in the following instances: (a) where the secured creditor claims the chattel paper as the proceeds of Inventory encumbered by the security interest; (b) if the purchaser has acquired the Chattel Paper in good faith and in the ordinary course of the purchaser's business; (c) if the purchaser gives

new value for the collateral; and (d) takes possession or control of the Chattel Paper. See, UCC §9-330(a) and (b).

The purchaser's priority is unaffected, even if the above conditions have been met, where the Chattel Paper shows that it has been assigned to someone other than the purchaser. Where a secured creditor does not claim that the Chattel Paper is the proceeds of inventory subject to a security interest, a purchaser of that chattel paper can still take free of the security interest under the same circumstances if, in addition to the above mentioned criteria (a) – (d), the purchaser acquires the Chattel Paper without knowledge that the purchase violates the rights of the secured party. See, UCC §9-330(c). Generally, if the Chattel Paper purchaser has been granted priority over a secured party, the purchaser has priority in the proceeds of that Chattel Paper.

iv. Instrument Purchasers

The purchaser of an instrument has priority over a security interest granted in the instrument in some circumstances. This can occur where the security interest is perfected by a method other than possession if the purchaser gives value and take possession of the instrument in good faith and without knowledge that the purchase violates the rights of a secured party. See, UCC §9-330(d). This section makes clear that if an instrument indicates that it has been

assigned to an identified secured party, then the purchaser is deemed to know that the purchase violates the rights of the identified secured party.

v. Money

Special priority rules apply to beneficiaries of money. A transferee of money, or of funds in a Deposit Account take free of a perfected security interest unless the transferee is acting in collusion with the debtor in violating the secured parties rights. See, UCC §9-332 (a) and (b).

C. Priority Between Perfected Security Interests.

Perfected security interests rank according to their time of perfection. In short, first to perfect has priority. If the competing security interests are not perfected, then they rank in the order of attachment. For purposes of priority, the time of perfection of a security interest is the same time used for perfection of a security interest in its proceeds and in collateral supported by a supporting obligation.

i. Deposit Accounts.

Perfected security interests in Deposit Accounts have special priority rules. See, UCC §9-327. A security interest in a Deposit Account perfected by control has priority over a security interest in a

deposit account perfected in any other way. Also, conflicting security interests, both perfected by control, rank according to the time that control was established. See, UCC §9-327(2). A security interest in a Deposit Account that the secured creditor has perfected by becoming the customer of the bank takes priority over a security interest in the Deposit Account held by the bank. Other than this, a security interest held by a bank where the Deposit Account is maintained is superior to a conflicting security interest held by another secured party. See, UCC §9-327(3) and (4).

ii. Investment Property

As a general rule, a secured party that perfects its security interest in Investment Property only by filing will not have priority as against a secured party that later perfects by control, even if the second secured party knows of the prior perfected security interest.[46]

A secured party that has perfected its security interest by control in the Investment Property is superior to a secured party in the investment property which has perfected by a different method. If competing secured creditors have both perfected by control, then

[46] See, UCC §9-328(1) and §9-329(1).

priority is ranked according to the time control is taken but also depends upon the type of Investment Property used as collateral: if an investment security, by the time of taking control; if a security entitlement carried in a securities account, depending upon how control is taken under UCC §8-106; and if the collateral is a commodity contract carried with a commodities intermediary, at the time that the commodity customer, secured party and intermediary agree that the intermediary will apply any distributed value as directed by the secured party with the consent of the debtor/commodity customer. See, UCC §9-328(2).

Securities intermediaries and commodities intermediaries are granted special priority over other secured creditors. Security interests held in security entitlements, securities accounts, commodity contracts, or commodity accounts maintained with the securities intermediary have priority over a conflicting security interest held "by any other secured party." See, UCC §9-328(3) and (4). Conflicting security interests between securities intermediaries, brokers and commodities intermediaries which are perfected without control are ranked equally.

Finally, a security interest granted in a certificated security in registered form perfected by delivery under UCC §8-301 (as opposed

to control) has priority over a conflicting security interest perfected over any other method other than control. See, UCC §9-328(e).

iii. Letter-of-Credit Rights.

If a secured party has perfected its Letter-of-Credit Rights by control that secured interest has priority over a conflicting security interest that is not obtained by control. Priority of competing security interests in Letter-of-Credit Rights perfected by control is determined by the priority in time of taking control.

iv. Proceeds, Supporting Obligations and Future Advances.

The practitioner should be aware that where a security interest in collateral has priority over other security interests (under the special rules for Deposit Accounts (UCC §9-327), Investment Property (UCC §9-328), Letter-of-Credit Rights (UCC §9-329), priority of purchasers of Chattel Paper or Instruments (UCC §9-330) or priority of rights of purchasers of Instruments, documents and securities under other articles (UCC §9-331)), the security interest may also have priority over a conflicting security interest in the proceeds of these categories of collateral. These rules, found at UCC §9-322 (c) and (d) contain limitations based on the type of collateral, method of perfection and are subject to other sections of the UCC.

Limited special priority rules exist for securing future advances. In sum, the only time priority of a security interest in a future advance is based on the time of the advance is when the security interest is perfected upon attachment pursuant to UCC §9-309 or temporarily perfected pursuant to UCC §9-312 (e) through (g) and if the future advance is not made pursuant to a credit commitment entered into while the security interest was perfected by another method. Once a different method of perfection is used, as would normally be the case, then the normal priority rules of UCC §9-322, first to file or perfect, would apply. See, UCC §9-323. Once again, these special priority rules are subject to exceptions and the rights of others including buyers of receivables, buyers of goods and lessees of goods.

v. PMSIs.

Generally, a PMSI in goods (except inventory and livestock) has priority over a conflicting security interest in the same goods, and in its identifiable proceeds, if the PMSI is perfected when the debtor receives possession of the collateral or within twenty (20) days thereafter. See, UCC §9-324(1). To the extent that more than one security interest qualifies as a PMSI, two rules apply.

First, a security interest securing an obligation incurred as all or part of the price of the collateral has priority over a security interest

which secures an obligation for value given to enable the debtor to acquire rights in or to use the collateral. The security interests given priority are those which secure loans given by the sellers. Second, in all other cases, normal first to file rules of UCC §9-322(a) apply to the competing PMSIs. See, UCC §9-324(g)(2). The practitioner should bear in mind that special rules apply for PMSIs in Inventory and livestock. See, UCC §9-324(d) and (e).

Similarly there are special priority rules for PMSI's in software. A PMSI in software is a PMSI only to the extent that the security interest also secures a purchase money obligation with respect to goods in which the secured party also holds a PMSI. Then, only if the debtor acquired the software with the goods and for the principal purpose of using the software in the goods. See, UCC §9-103(c). Under these circumstances, a PMSI in the software has priority over a competing security interest in the same collateral in its identifiable proceeds. See, UCC §9-324(f).

vi. Transferred Collateral. (UCC §9-325)

With regard to transferred collateral, the problem arises where a debtor grants a security interest in the collateral, then transfers the collateral outside the ordinary course of business to another. The UCC establishes the general rule that the security interest granted by the transferor debtor has priority so long as the transferee debtor

acquired the collateral subject to the perfected security interest granted by the transferor debtor and there is no period thereafter where the security interest by the transferor debtor goes unperfected.

vii. Fixtures. (UCC §9-334)

Fixtures are those goods which become part of real property. Generally, a security interest granted in Fixtures is subordinate to a conflicting interest in the real property to which the Fixture is annexed. But, this rule is abrogated if the debtor has an interest in or possession of the real property and the security interest in Fixtures is perfected before a conflicting interest of an encumbrancer or owner comes of record. The general rule is also abrogated in instances where the collateral is factory or office equipment, (equipment that is not of the kind ordinarily used in operation of the real property or is the replacement of consumer domestic appliances), so long as the security interest is perfected (by any method) before the good becomes a Fixture (i.e.: readily removable). If the conflicting interest is a judgment lien, the Fixture security interest is superior if perfected before the judgment lien attaches. Of course, the owner or encumbrancer is free to agree that its interest is subordinate. In this case, the Fixture security interest becomes superior. The same result exists where the debtor has the right to remove the goods as against

the competing enumbrancer or interest holder. For the benefit of the secured creditor, the superiority of the security interest is continued for a reasonable time after the right of the debtor to remove the Fixtures ends.

A PMSI granted in Fixtures is another exception This security interest has priority over the conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest in, or is in possession of, the real property and the interest of the encumbrancer or owner arises before the goods become Fixtures and the security interest is perfected by a Fixture Filing before the goods become Fixtures or within twenty (20) days thereafter.

viii. Crops. (UCC §9-334(i))

A perfected security interest in crops growing on real property has priority over a conflicting interest of an encumbrancer or owner of real property if the debtor has an ownership interest in the real property or is in possession of the real property.

ix. Accessions. (UCC §9-335)

Accessions are goods that are physically united with other goods in a way that the identity of the original goods is not lost. This is different from commingled goods where the goods are physically united with other goods of the same kind and the identity of the original goods is lost.

A security interest can be created in an Accession and that security interest continues in the collateral that becomes an Accession. So, if a secured creditor perfects a security interest in collateral that becomes an Accession, the security interest remains perfected. Priority of a security interest in an Accession is left to the priority provisions of Article 9, except that a security interest in an Accession is subordinated to a security interest in the whole which is perfected pursuant to a certificate of title statute. As a remedy, a secured creditor is allowed to remove the Accession in which the secured creditor has a security interest from the whole, provided that the secured creditor has priority over all claims as a whole. This is, of course, subject to Section 6 of Article 9 governing enforcement and the rights of a secured creditor to engage in self-help.

In addition, a secured creditor who removes an Accession from the whole, must reimburse an owner or holder of a security interest in the whole for any physical damage to the whole, other than diminution in value, and can be required to provide adequate assurance (i.e., post a bond) to the owner of, or holder of a security interest in the whole.

x. Commingled Goods. (UCC §9-336)

As noted above, Commingled Goods, unlike Accessions, are goods which are combined with other goods in such a way that their

identity is lost in a product or mass. An example is ball bearings. In the first instance, a security interest does not exist in commingled goods even though a security interest can attach to the mass or the product that results when goods become commingled. If a security interest is obtained and attaches to goods which become commingled, the security interest attaches to the mass or product to which the collateral becomes commingled. An example of the latter is bread flour which becomes part of a loaf of bread. Similarly, if a security interest is perfected in goods which become commingled, then the security interest is perfected in the mass or product to which the collateral becomes commingled.

As to priority of competing security interests, a security interest perfected in goods before they commingle has priority over a security interest unperfected at the time the collateral becomes commingled. If more than one security interest is perfected before the collateral becomes commingled, then the security interests rank equal in proportion to the amount of debt secured to the value of the collateral at the time of commingling. Except for these special rules, priority is determined by the perfection rules of Article 9.

D. UNCITRAL Comparison.

The Guide suggests formulating priority rules based upon either the First-to-file priority rule (identical to the Article 9 primary rule), priority based on possession or control (in the case of possesory security rights) or an alternative priority rule (a rule priority based upon when the security interest was created, or when the third party is notified of the security right, rather than when the interest was first filed, or perfected, under the UCC Article 9 term.)[47]

The Guide does go into some detail in this section regarding different types of secured lending situations and attempts to set forth certain firm guidelines and rules to refer to. Nevertheless, the Guide does support the idea of freedom of contract and permits, in the area of priority subordination agreements.

In the case of Purchase Money Security Rights, the equivalent of the PMSI of Article 9, the grantor of this security has priority over all other creditors, as is the general rule under Article 9. The Guide also introduces the concept of reclamation rights and asks that some consideration be given to allow a supplier that sells goods on unsecured credit to reclaim the goods from the buyer within a specified period of time if the supplier discovers within that time that the buyer is insolvent. Without delving into the specifics of a parallel

[47] UNCITRAL Addendum 7, at ¶¶ 6,11 and14.

process under Article 9, suffice it to say, that the concept does exist. See Section IX, The Secured Party and Bankruptcy (*infra*).[48]

The Guide also broaches the area of sales outside the ordinary course of business of the grantor by addressing that in many countries sales of encumbered assets outside the ordinary course of business of the grantor does not destroy any security rights that the secured creditor has in the assets, unless the secured creditor consents. A similar concept appears under Article 9, see *supra*.

As for sales of inventory made in the ordinary course of business of the grantor, there is a commercial expectation that the buyer of the encumbered asset will take free and clear of any existing security rights.

i. Judgment Liens.

The Guide recognizes that a security interest that is reduced to a judgment gives an otherwise unsecured creditor the equal right of priority over the encumbered asset.[49] There are exceptions to this general rule when it is applied to future advances. While a previously filed security right customarily will have priority over a judgment security right with respect to credit advanced prior to the date that the judgment becomes effective, the judgment security right will not

[48] Id., at ¶25.

have priority over credit advanced after the date the judgment becomes effective.[50]

As to statutory liens, the Guide cannot create a rule of guidance because each country's laws differ as to the priority these liens are granted. However, the Guide instructs that each country assess their societal goals to assess whether granting priority to a statutory lien furthers this goal.[51]

Some legal systems, the Guide notes, give creditors who improve or fix encumbered assets, such as equipment, or creditors who warehouse or store encumbered assets, have priority over other security claims in the encumbered asset.[52]

Insolvency administrators are often given preferential claims to effectively compensate them for their work done in the insolvency proceeding, the trustees in bankruptcy obtain their administrative fees from administering the bankruptcy estate.[53]

ii. Priority in Future Advances and After-Acquired Property.

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[49] Id., at ¶¶33 – 34.

[50] Id., at ¶36.

[51] Id., at ¶¶38-39.

[52] Id., at ¶¶ 40-41.

[53] Id., at ¶ 43.

The Guide surveyed legal systems where priority of the creditor was limited to the amount of the debt that existed at the time of the creation of the security right, limited to the amount of the credit as publicized and a limitation based upon the initial debt plus any extensions of credit, even those made after the creation of the security right.[54]

A creditor in after-acquired property possesses the same rights in the after-acquired property as it does in the original property without a need to go through any additional steps to obtain those rights.[55] Likewise with regard to priority in proceeds.[56] However, the Guide raises some considerations to be taken into account, such as, whether the right of the secured creditor in the proceeds of its original encumbered asset is effective not only against the grantor but also as against competing claimants and third parties and if the right is effective as against third parties, how will the third party learn of the pre-existing right.[57]

E. Default and Remedies.

[54] Id., at ¶ 46.

[55] Id., at ¶ 49.

[56] Id., at ¶¶ 52

[57] Id., at ¶¶ 51-56.

A. Generally.

The UCC allows the parties to a secured transaction to decide how defaults occur and what remedies will be available to them.

What constitutes default is left to the whim of the parties to define under their Security Agreement. See, UCC §9-601 Official Comment 3. Of course, non-payment is the most notable default trigger. Other defaults might include the failure to insure and the failure to protect ownership rights in the collateral. Secured parties and debtors can agree in two separate Security Agreements to cross-default provisions as well.

Even though the rights of a secured party are left to the parties in their Security Agreement, many of the statutory enforcement terms may not be varied or waived. See, UCC §9-602. These terms are described *infra*. There are some very important post default waivers that can be included in a Security Agreement despite the strictures of UCC §9-602. See, UCC §9-624. A debtor or secondary obligor can waive its right to notification of disposition of the collateral as required by UCC §9-624(a), but only by an authenticated agreement to that effect entered into after default. A debtor can waive its right to require disposition of the collateral under UCC §9-624(b) but again only by an authenticated agreement entered into after default. Finally, except with respect to a consumer goods transaction, a debtor

or secondary obligor can waive its right to redeem the collateral granted under UCC §9-624(c), but again, only by an authenticated agreement entered into after default.

As to a secured party's remedies, the secured party may reduce its claim to judgment as part of the plenary proceeding, foreclose on its lien interest, or use any other available judicial procedure. See, UCC §9-601(a)(1). A secured party may utilize these remedies simultaneously. See, UCC §9-601(c). Where the secured party reduces its claim to judgment and has a sheriff or other authorized official levy an execution against the collateral, the lien of the judgment generally relates back to the earlier of the date of perfection or the date of the filing of the Financing Statement. See, UCC §9-601(e).

Where there is a sale pursuant to an execution or other judicial procedure and the secured party acquires the collateral at that sale, the secured party holds the collateral free of the requirements of UCC Article 9 for a sale disposition of collateral. See, UCC §9-601(f). If the security interest is in documents, the secured party may also enforce its remedies either as to the documents or as to the goods covered by the documents. See, UCC § 9-601(a)(2).

Oftentimes, a transaction contains collateral comprised of both real property and personal property. Sometimes, the two join so that

the personal property (movables) becomes affixed to the real property as a Fixture. UCC §9-604 sets forth the procedures that a secured party can use to realize on its security. Where the collateral is both real property and personal property, the UCC makes clear that the secured creditor may enforce its remedies against the personal property without prejudice to any rights in the real property – the secured party, by taking this action would not waive its rights as to the real property. The secured party is also permitted to foreclose its interest in the real property and include the personal property with that proceeding, making the enforcement provisions of the UCC inapplicable.

Where the collateral has become attached to real property, creating a Fixture, but the secured party's interest only extends only to the Fixture, the UCC gives the secured party two choices. First, it can proceed in accordance with its rights in the real property under applicable local real property law or the secured party can proceed under UCC Article 9, either before or after removal of the Fixture. The secured party may remove the Fixture if it has priority over all owners and encumbrancers of the real property and pays the owner or encumbrancer (other than the debtor) for the costs of repairing any physical damage caused by the removal. The secured party does not have to pay for diminution in value caused by the removal of the

goods. A person entitled to reimbursement may withhold permission to remove a Fixture until the secured party gives adequate assurance of its obligation to reimburse the debtor for any physical damage associated with the removal of the Fixture.

B. Default and Remedies as to Deposit Accounts.

If the secured party holds a security interest in a Deposit Account perfected by control, the secured party may apply any balance of the account it holds to the secured obligation or may instruct the bank holding the deposit to pay the balance to or for the benefit of the secured party. See, UCC § 9-607(a)(4) and (5). Where the collateral has been converted into proceeds, the secured party may take the proceeds to which it is entitled to under its Security Agreement. See, UCC §9-607(a)(2). If the security is the accounts of the debtor, the secured creditor can enforce the obligations of the debtor and exercise the rights of the debtor to compel payment or performance of the account obligor. See, UCC §9-607(a)(3). The secured party must act in a commercially reasonable manner where either it seeks to collect from an account debtor of the obligor or the secured party. The secured party is entitled to charge back uncollected collateral so as to increase personal recourse to the debtor or another obligated to pay under the Security Agreement. The secured creditor can also charge

to the debtor its expenses of collection, including reasonable attorneys' fees and legal expenses.

If a secured creditor enforces any remedy it has as against Deposit Accounts, proceeds or accounts of the debtor, UCC §9-608 sets out the application of the fruits of collection and the liability for a deficiency and the obligor's right to a surplus. The cash proceeds of collection under UCC §9-607 are applied in the following order: (i) reasonable expenses of collection including reasonable attorneys' fees, subject to any limitations in the Security Agreement; (ii) satisfaction of the obligations secured under which enforcement was taken; and (iii) satisfaction of subordinate security interests if the collecting secured party receives a demand from the proceeds from the subordinate secured party. Non-cash proceeds need not be credited or paid over unless the failure to do so would be commercially unreasonable. The statute does not define commercially unreasonable and leaves that determination to the finder of fact.

A secured party has the obligation to account to the obligor. Generally, the secured party must pay the obligor any surplus and the obligor is liable for any deficiency. However, where the underlying transaction is the sale of accounts, Chattel Paper, payment intangibles or promissory notes, the debtor is not entitled to a surplus nor is the obligor liable for a deficiency. See, UCC §9-608(b).

C. The Secured Party's Right To Take Possession.

Where the secured party is not already in possession of the collateral, the UCC grants it the right to take possession on default. Possession can be taken by acquiring the collateral or, without removing the collateral from the debtor's possession, rendering it unusable and disposing of the collateral at a sale. See, UCC §9-609(a). This is usually done where the collateral is heavy equipment and the like. The secured party has the right to take possession by using judicial process or without judicial process so long as it can do so without breaching the peace. See, UCC §9-609(b). Generally, under a Security Agreement, and even in the absence of one, the debtor can be required to collect the collateral and make it available to the secured party at a reasonable and mutually convenient place. See, UCC §9-609(c).

Once the secured party has the collateral in its possession, the secured party may sell, lease, license or otherwise dispose of the collateral in its then current condition or after adequately preparing the property for sale, lease, license or other disposition. The key behind the disposition is that "every aspect' of the disposition of the collateral must be "commercially reasonable." See, UCC §9-603. Thus, method, time, place, manner and terms must meet the test. If

commercially reasonable, public or private proceedings are acceptable. The secured party can use a single or multiple contracts to sell the collateral either in parcels or as a unit. The only real limitation is that the secured party and anyone related to the secured party, must acquire the collateral at a public disposition. Though, if the collateral is of a kind which is usually sold on a recognized market or subject to widely distributed standard pricing, the secured party or someone related can acquire the collateral at a private sale. A contract for the sale of the collateral includes warranties of title, possession, quiet enjoyment and similar warranties but can be disclaimed by a manner sufficient under contract law, by communicating the disclaimer to a purchaser or include express disclaimers.

Generally, before a disposition under UCC §9-610 can occur, the secured creditor must give notice of the disposition. In three instances, notice is not required – where the collateral is (a) perishable, (b) threatens to quickly decline in value or (c) is customarily sold on a recognized market. See, UCC §9-611 (d). In all other instances, a notice of the disposition must be given.

Recipients of the notice are: (1) the debtor/principal obligor; (2) any secondary obligor, and (3) if the collateral is other than consumer goods, (a) any person who provides a notice of claim to the secured

party before notice of disposition is sent; (b) any other secured party that ten (10) days before the disposition notice is sent filed a Financing Statement which identified the collateral that was indexed in the debtor's name and was properly filed; and (c) any person who, ten (10) days before the disposition notice is sent, has a statutory lien on the collateral under UCC §9-311(a). Remember, that as to the debtor and any secondary obligor, notice can be waived by an authenticated agreement entered into after default.

In determining who receives notice, UCC §9-611(e) offers a dispossessing secured party a safe harbor. A secured party is deemed to have fulfilled its notification requirements if, between twenty (20) and thirty (30) days before sending its dispossession notification to the debtor, the secured party requests a search of the "proper" recording office. If the secured party receives a response to the request for a search then it must send its dispossession notification to each secured party or lien holder named in the response. Compliance with this provision exonerates the foreclosing secured party its failure to give notice. But, the dispossessing secured party must determine the "proper" recording office, a difficult task as the proper office may be a local county official, a state recording office, or such an office in another state. The secured party should take great care in making this determination or, in abundance of caution, search all relevant,

possible recording offices. UCC §9-611(b) mandates a "reasonable authenticated notification of disposition", but leaves open the question of any requirement of a second notice in the event that the dispossessing secured party knows that the debtor did not receive notice. The UCC has left this fact open to judicial determination.

Another aspect of the reasonable notification requirement is the timing of when such notice is sent. UCC Article 9 mandates that whether notification is sent in a reasonable time is a question of fact. But, the UCC grants secured parties a safe-harbor here too, in non-consumer transactions. UCC §9-612(b) answers the question of reasonableness by providing that notice is reasonable if sent after default and ten (10) or more days before the earliest disposition noticed in the dispossession notice.

D. Content of the Disposition Notice.

Under the newly revised Code there is a prescribed statute dedicated to describing the content of a reasonable notice. UCC §9-613 sets forth the content of a notice for non-consumer based notifications. The notice must describe (a) the debtor and secured party; (b) the collateral subject to disposition; (d) the method of disposition; (e) the debtor is entitled to an accounting of the unpaid indebtedness and the charges, if any, for the accounting; and (f) the

time and place of a public disposition or the time after which any other disposition is to be made. The rule goes on to state that if a notice does not include any of these elements, a trier of fact will determine the sufficiency of the notification. Moreover, a dispossession notice is sufficient if it substantially includes all the required information even though it includes information not specified or includes minor errors which are not seriously misleading. While a particular phrasing is not required, the UCC sets forth a form of notification which, when completed, provides sufficient notification. The form is included as part of the Appendix.

UCC §9-614 sets forth the notice content for a consumer goods transaction. This provision incorporates all of the requirements of UCC §9-613 but adds the following requirements: (a) a description of any liability for a deficiency of the person to whom the notice is sent; (b) the secured party's telephone number at which the debtor can acquire the amount to pay for purposes of redemption; and (c) the secured party's telephone number or mailing address so that the debtor can obtain additional information regarding the disposition and the obligation secured. Like the non-consumer transaction, no particular phrasing is required, but a form provided in Article 9, when completed, provides sufficient information. The form is provided in the Appendix.

Such notification is sufficient even if additional information appears at the end of the form and it includes errors in information not required by UCC §9-614, unless the errors are misleading as to rights arising out of the UCC Article 9. If the official form is not used, then law, other then the UCC, determines the effect of including information not required by UCC §9-614. In short, the practitioner should always use the mandated form, or a form substantially close to it, whether dealing with consumer or non-consumer goods transactions.

Similar to UCC §9-608, regarding the application of collection proceeds when a secured creditor enforces against collateral it holds or controls, UCC §9-615 sets forth the application of proceeds of a disposition. Proceeds from a disposition are to be applied in the following order: (a) the reasonable expenses of re-taking, holding, preparing for selling and selling the collateral and, (b) if allowed by law or agreement, the secured creditor's reasonable attorneys' fees; (c) expenses to satisfy the secured obligation under which the disposition was made; (d) then expenses to satisfy any subordinate security interests if the foreclosing secured party receives a demand for payment before distribution of the proceeds is made and is superior to any lien of any consignor; and (e) expenses to satisfy any consignor who demands payment before distribution of proceeds is

completed. As to a subordinate lien interest, the foreclosing secured party can request reasonable proof of the interest. If no such proof is provided within a reasonable time, the foreclosing secured party need not comply with the demand.

Sometimes, on a disposition sale, a foreclosing secured party receives non-cash proceeds. The situation that arises is this: the disposition sale is held; the purchaser lacks cash to complete the sale and the foreclosing secured creditor gives a loan to the disposition sale purchaser. The foreclosing secured creditor would have some cash proceeds from the sale but also non-cash proceeds (e.g., the new purchaser's promissory note). A secured party who receives non-cash proceeds from a disposition under UCC §9-610 need not apply the non-cash proceeds unless the failure to do so would be commercially unreasonable and, if the foreclosing secured party does apply non-cash proceeds to the original debtor's obligation, it must do so in a commercially reasonable manner. Article 9 again does not define commercially reasonable, leaving the determination to the Court and the finders of fact.

After the sale and the application of sale proceeds as allowed, the debtor and any guarantor, is liable for any resulting deficiency. Moreover, the secured party must account for, and pay to the debtor any surplus unless the cash proceeds must be paid over to a consignor.

As noted above, there is a special rule of surplus and deficiency if the underlying transaction is the sale of accounts, Chattel Paper, payment intangibles or promissory notes. In those cases, the debtor is not entitled to any surplus and the obligor is not liable for any deficiency.

Sometimes, the disposition is to a person related to the secured party or a subordinate secured party. In that case, when calculating a deficiency or surplus, the debtor is given a kind of a fair market value credit under certain circumstances. Where the transferee is related to the foreclosing secured party or is a subordinate secured party and the amount of the proceeds is significantly below the amount that would have been realized in a disposition to an unrelated person would have brought, the surplus or deficiency is calculated based on the amount of proceeds that would have been realized had such a disposition taken place.

Finally, if a subordinate lienor receives proceeds from a disposition in violation of a lien interest that is superior, but does so in good faith (i.e.: without knowledge that another lien interest is superior), then that subordinate lien holder can keep the proceeds received and need not pay the other lien, except for any surplus it holds.

The transferee at the sale acquires all of the debtor's rights in the collateral free and clear of the foreclosed security interest as it is

discharged, and any subordinate security interest except those not discharged under other law. See, UCC §9-617. The transferee's rights are free and clear, so long as the transferee has acted in good faith, even if the foreclosing secured party failed to comply with Article 9 or any judicial proceeding. A transferee is entitled to a "Transfer Statement" which entitles the transferee of the sale to have record title of the collateral in any official filing, recording or certificate of title covering the collateral. The Transfer Statement is a record authenticated by the secured party stating that the debtor has defaulted on its obligations, that the secured party has exercised its post default remedies with respect to the collateral, that by reason of the exercise, the transferee has acquired the rights of the debtor in the collateral. The Transfer Statement must also contain the names and mailing addresses of the secured party, the debtor and the transferee.

Any other acquisition by a transferee is subject to the rights of the debtor and any secured party. UCC §9-618 makes clear that an assignment from a secured creditor is not a disposition under UCC §9-610 and the assignee becomes obligated to perform the duties of the assigning secured party upon receiving: (a) an assignment of the secured obligation; (b) receiving a transfer of the collateral; (c) by both parties agreeing to accept the duties of the secured creditor; or

(d) by the transferee becoming subrogated to the rights of the secured party with respect to the collateral. Once the assignment is made, the original secured party is relieved from further duties under Article 9. Finally, under UCC §9-619(c), a transfer of record to the secured party before it exercises its remedies is not a disposition of the collateral and does not relieve the secured party of its duties.

Only in the instance of a consumer goods transaction does UCC Article 9 impose a duty on the foreclosing secured party to provide a post sale explanation and calculation of surplus or deficiency. See, UCC §9-616. In a consumer goods transaction where the consumer debtor is entitled to a surplus or a consumer obligor is responsible for a deficiency, a foreclosing secured creditor must send an explanation of the surplus or the deficiency either within fourteen (14) days after the receipt of a request, defined as a record authenticated by a debtor or consumer obligor requesting an explanation after disposition of the collateral pursuant to UCC §9-610; or when the foreclosing secured party accounts to the debtor and pays the surplus or makes its first written demand for payment of the deficiency. It is important to remember that a foreclosing secured party who does not attempt to pay any surplus, or make a written attempt to collect on a deficiency, need not give this explanation. See, UCC §9-616, Official Comment 2.

In addition, where a consumer obligor is liable for a deficiency, fourteen (14) days after a request, the foreclosing secured party must send a record waiving its right to a deficiency. See, UCC §9-616(b)(2).

E. The Post-Sale Notice.

The post-sale notice must include the following information in the following order: (i) the aggregate amount of obligations secured by the security interest and, if the amount reflects a rebate of unearned interest or credit service charge, an indication of the calculation as of not more than thirty-five (35) days before the secured party takes or receives possession of the collateral if the foreclosing secured party takes possession of the collateral after default or not more than thirty-five days (35) before the disposition of the collateral if the secured party take possession of the collateral before default or if the secured party never takes possession; the amount of the proceeds from the disposition; the amount of the aggregate adjustments after deducting the proceeds; an accounting of expenses in aggregate or by type; the amount, in aggregate or by type of credits to the debtor; and the amount of any surplus or deficiency. See, UCC §9-616(c).

As with other notices upon the sale of the disposition, particular phrasing of the explanation continued in the post-sale notice is not required and an explanation, substantial compliance with the

requirements is sufficient, even if it includes minor errors that are not seriously misleading. See, UCC §9-616(d). The debtor is entitled to one explanation without charge. After that, the creditor may charge for the statements, but not more than twenty-five ($25.00) dollars.

F. Acceptance of the Collateral in Full or Partial Satisfaction.

As an additional remedy, a secured creditor has the ability to accept the collateral in full or partial satisfaction of the debt. While the remedy sounds simple, as shown below, its exercise is highly circumscribed. First and foremost, the remedy of accepting the collateral in partial satisfaction is not available in consumer based transactions. See, UCC §9-620(g).

A secured creditor may only accept the collateral in full or partial satisfaction of the debt if certain conditions are met. First, the debtor must consent, but in the manner proscribed by Article 9. The limitations on a debtor's consent are divided in two categories depending on whether the consent is to an acceptance in full or partial satisfaction of the obligation.

A debtor's consent to acceptance of collateral in partial satisfaction can only be accomplished by an authenticated record agreeing to the terms, after the default. The debtor's consent to acceptance of collateral in full satisfaction of an obligation can be

done in the same way. But, in the instance of acceptance as full satisfaction, the debtor's consent can also be accomplished by the secured creditor sending to the debtor, again after default, an unconditional proposal or a proposal conditioned only that collateral not in the possession of the secured party be preserved or maintained, and the secured creditor does not receive the debtor's notification of an objection to the proposal within twenty (20) days after the proposal is sent. In short, a proposal to accept the collateral in full satisfaction of the debtor's silence is equivalent to consent.

A secured creditor seeking to accept collateral in full or partial satisfaction of its obligation must give others notice of its intent as well. See, UCC §9-621. These parties include: (a) any party who provides the secured party with authenticated notification of a claim to the collateral before the debtor consents; (b) any party holding a subordinate security interest in the collateral ten (10) days before the debtor consents to the acceptance of collateral and who perfects its security interests by filing a Financing Statement which identifies the same collateral, is indexed under the debtor's name as of that date and is properly filed in the correct filing office. The secured party must also give notice of its intention to accept collateral, ten (10) days before the debtor's consent, to any other secured party that held a

security interest perfected by statute, regulation or treaty. See, UCC §9-621(a)(3).

The secured party must also give notice of its intention to any other person holding an interest in the collateral which is subordinate to its security interest. Finally, if the proposed acceptance is for partial satisfaction, the secured party must give notice to any secondary obligor, like a guarantor.

These recipient parties have twenty (20) days from when the notice is sent to file an authenticated objection with the secured creditor. These parties must then send their objection to be received by the secured creditor within twenty (20) days after the last person under UCC §9-621 is given notice, or if no notification pursuant to UCC §9-621 is given, before the debtor consents. Once an objection is timely received, the secured creditor is precluded from exercising its self-help remedy.

As another condition, if the collateral is consumer goods, the collateral cannot be in the hands of the debtor when the debtor consents to the acceptance of the collateral in satisfaction. See, UCC §9-620(a)(3).

Also, if the collateral is consumer goods, the secured creditor cannot exercise this remedy, and must instead sell the collateral pursuant to UCC §9-610 if the consumer has paid sixty percent (60%)

of the original cash price in the case of a PMSI in consumer goods or sixty percent (60%) of the original principal amount of the obligation has been paid in the case of a non-PMSI. See, UCC §9-620(e). If either of these two conditions exist, then the secured party must dispose of the collateral under UCC §9-610 within ninety (90) days of taking possession or at another time frame agreed upon by the debtor and all secondary obligors after default. Remember that this requirement can be waived by the debtor in an authenticated agreement entered into after default.

Assuming the secured party has wended its way though the notice provisions without receiving any timely objection to acceptance of the collateral, UCC §9-622 sets forth the effect of acceptance of the collateral. First, acceptance discharges the secured obligation to the extent consented to by the debtor – in full or partial satisfaction. Acceptance transfers to the secured creditor all of the debtor's rights in the collateral. Acceptance also discharges the security interest that is the subject of the debtor's consent and any subordinate security interest or lien. This does however leave intact any superior lien interest. Also of note is that the subordinate interests are discharged even if the secured party accepting the collateral does not comply with the requirements of UCC §9-620. The secured party should bear

in mind that while the subordinate interests are discharged, the secured party may be liable under the UCC as described below.

G. The Debtor's Right of Redemption.

Just as the secured party has rights and remedies, the UCC grants the debtor, any secured obligor, and any other secured party or lien holder (consensual or non-consensual) at least one very important right, the right to redeem the collateral from the secured obligation under UCC §9-623. In order to redeem the collateral, the party having the rights of redemption must fulfill all of the secured obligations – pay all amounts due thereunder – and pay the secured party's reasonable expenses and attorneys' fees. Any redemption, if it is to occur, must occur before the collateral is collected under UCC §9-607, disposed of, the secured party enters into a contract to dispose of the collateral under the sale provisions of UCC §9-610, or before the secured party has accepted the collateral in full or partial satisfaction under UCC §9-622.

Again, the right of redemption by the debtor or a secondary obligor can be waived only by an authenticated agreement entered into after default. See, UCC §9-624.

H. The Teeth Behind Non-Compliance by the Secured Creditor.

Unlike prior versions of the UCC, the newly revised Code at §§9-625 through 9-628 allows for the enforcement against secured party's non-compliance with Article 9.

UCC §9-625 sets forth two basic remedies. First, an aggrieved party can obtain injunctive relief if it is established that a secured party is not proceeding in accordance with Article 9. Also available are damages in the amount of any loss caused by the failure to comply with Article 9. These damages can include any loss resulting from the debtor's inability to obtain, or the increased costs of alternative financing. Proper plaintiffs are debtors, obligors or persons holding security interests or other liens on the collateral at the time of the failure. In addition, if the collateral is consumer goods, a person that was a debtor or a secondary obligor can acquire a minimum amount of damages, an amount not less than the credit service charge plus ten percent (10%) of the principal amount of the obligation or the "time price differential" plus ten percent (10%) of the cash price. Bear in mind that most of these terms are not defined by the UCC and are left to judicial interpretation to effectuate the public policy of providing a minimum recovery to the consumer goods debtor or secondary obligor.

In addition to the general damages provision of UCC §9-625(b), subsection (e) and (f) grant statutory damages for violations of

specific Article 9 provisions -- $500.00 per occurrence – for violations of UCC §§ 9-208 (failure to exercise reasonable care of collateral in the secured creditor's possession), 9-209 (failure to give account debtor notification that no further amounts are due), filing an unauthorized Financing Statement under 9-509, failing to file a Termination Statement and violating 9-616(b)(1) and (b)(2) (providing and explanation of a deficiency or surplus); and failing to comply with a UCC §9-210 request for an accounting, etc.

UCC §9-626 places a heavy burden on instances by the secured party of non-compliance in non-consumer based transactions where the amount of a deficiency or surplus are at issue. Under this section, a secured party need not prove its compliance with UCC §§9-601 et seq. But, if non-compliance becomes an issue then the secured party has the burden of proving compliance. If the secured party fails to make such a showing then, the debtor's or secondary obligor's liability for a deficiency is limited to the difference between the sum secured and the greater of the proceeds from the enforcement or the amount that could have been realized had there been compliance.

There is a presumption that the amount that would have been realized is equal to the amount of the secured obligation, reducing the deficiency to zero, unless the secured party rebuts the presumption. See, UCC §9-626(a)(4). Also, if the amount of a deficiency or surplus

is calculated under UCC §9-615(f) – sale to a party related to the secured party – then the debtor or a secondary obligor that has the burden of establishing that the amount of the proceeds is below the range of prices that a complying disposition to someone other than the secured party or a related party would have brought. These presumptions do not have any impact on consumer based transactions.

As shown many times herein, the applicable standard under Article 9 is one of commercial reasonableness. UCC §9-627 offers insight into its meaning. First and foremost, the fact that a greater disposition amount could have been obtained at a different time, place or method of enforcement, is not, by itself, sufficient to show commercial unreasonableness. Similarly, some dispositions are commercially reasonable – if done in a usual manner on a recognized market, or at a current price in any recognized market at the time of disposition or in conformity with the reasonable commercial practices of dealer of the property that was disposed of. So, too, a disposition is commercially reasonable if it has been approved in a judicial proceeding, by a creditors' committee in bankruptcy, by a representative of creditors or by an assignee for the benefit of creditors but these approvals are not required and the lack of approval does not make the disposition commercially unreasonable.

Notwithstanding the possible liability of a secured party to other parties, UCC §9-628 offers a secured party a safe harbor from liability. In sum, a secured party cannot be held liable to unknown persons or persons with whom the secured creditor cannot communicate. Similarly, a secured party is not liable to the level of dealing with a consumer in a consumer transaction if the secured party has a reasonable belief that the transaction is a non-consumer based transaction and the belief is based upon the debtor's or other obligor's representation. Article 9 is to be applied based on the facts as reasonably believed. A secured party cannot be held liable for damages for its failure to comply with UCC §9-616 for giving an inadequate or no explanation of a surplus or deficiency and cannot be held liable for statutory damages more than once for each secured obligation.

I. UNCITRAL Comparison.

If notice of default is to be given by a particular creditor in a given regime, the Guide recommends providing a minimum contents to be contained in a notice of default, describing the manner in which the notice and the timing of such notice. The Guide also explores prior notice to interested parties and filing of the notice in a

registry.[58] The Guide merely assesses the values of notice to the debtor and other interested parties in protecting the debtor's and the creditor's rights as far as redemption of the debtor's rights to the encumbered assets.[59]

Following a default a secured creditor may accept the encumbered assets in full or partial satisfaction as is the case under UCC Article 9.[60] The Guide examines the secured creditor's enforcement of its security rights upon default; it suggests that "reasonable creditors should periodically review their debtor's business activities or the encumbered assets and communicate with debtors who show signs of financial difficulty.[61]

The Guide mentions the concept of curing a default and proscribes that it be consistent with the general law of obligations or special debtor protection legislation of the jurisdiction.[62]

As to removing encumbered assets from the grantor's control upon a debtor's default, the Guide instructs that in order to avoid dissipation or misuse of the assets, the assets could be placed in the

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[58] UNCITRAL Guide, Addendum 9 at ¶15.

[59] Id., at ¶14.

[60] Id., at ¶26.

[61] Id., at ¶¶ 1 and 3.

[62] Id., at ¶8.

hands of a court or state official, utilizing only peaceful means.[63] Where there is a sale or other disposition of the encumbered assets, the Guide recognizes that it is the objective of all parties involved to maximize the value of the encumbered assets by using commercially reasonable means or by using the prudent businessperson standard.[64] Allocating the proceeds of a disposition are most often handled, the Guide instructs, by the payment first of reasonable enforcement costs and then paying the secured obligation.[65]

IX. The Secured Party and Bankruptcy

A. Generally.

In the normal course of a bankruptcy, the petitioner/debtor files its bankruptcy petition. Such petitions are generally filed as Chapter 7 liquidations, Chapter 11 reorganizations, or in the case of an individual debtor who meets certain debt and income limitations, a Chapter 13 individual reorganization. Creditors usually receive some notice from either the debtor or the Bankruptcy Court that the proceeding has commenced and that the Automatic Stay is imposed. From that point on, creditors must work inside the bankruptcy proceeding. Creditors are well advised to file a Proof of Claim with

[63] Id., at ¶30.

[64] Id., at ¶¶ 32-33.

[65] Id., at ¶35.

the Bankruptcy Court and appear in the proceeding to obtain notice of all proceedings therein. Usually, there is a meeting of creditors where the debtor is questioned by the representative of the Office of the United States Trustee. This is also an opportunity for the creditors to ask some questions of the debtor. During the bankruptcy proceeding, there may be skirmishes over the amount of creditors' claims or a creditor's request for relief from the Automatic Stay. Also, there may be preference proceedings, all of which are discussed below.

Ultimately, in the case of a Chapter 7 liquidation, the United States Trustee sells the assets of the debtor having equity so as to pay claims. This occurs unless the debtor redeems the collateral or reaffirms the debt by reaffirmation agreement. The latter causes the debtor to lose the protection of the bankruptcy filing vis' a vis' the reaffirmed debt. In a reorganization, a trustee may be appointed, although, more likely, the debtor remains in possession of its property to administer the reorganization. Usually the debtor develops a plan of reorganization to which the creditors have the opportunity to object. The Bankruptcy Court makes determinations as to the creditors' objections, or the debtor and creditors negotiate an accommodation, and the plan of reorganization is confirmed by the Bankruptcy Court. From that point, as to pre-petition obligations, the debtor and creditors operate within the terms of the reorganization

plan and the Bankruptcy Court usually retains jurisdiction to resolve disputes over performance of the terms of the plan of reorganization.

The above is a simplistic view of bankruptcy. There are a few key concepts which the practitioner must keep in mind when faced with a bankruptcy filing – the Automatic Stay, the debtor's use of collateral, preferences to lenders and the amount and characterization of a secured creditor's claim.

B. The Automatic Stay – 11 U.S.C. §362.

Important to remember is that once a debtor files its bankruptcy petition, the Bankruptcy Code's Automatic Stay is imposed. The Automatic Stay requires that all activities by the creditors with respect to pre-petition debts cease. The spectrum of activities stayed is far reaching: commencement or continuation of any proceeding to recover a claim against the debtor; enforcement of a judgment; any act to obtain possession of property of the debtor; any act to create, perfect or enforce a lien on the debtor's property; any act to collect or recover a claim against the debtor that arose pre-petition; and the exercise of any right of set-off.

After a bankruptcy filing, a secured creditor cannot correct mistakes in its Security Agreement or attempt to obtain more collateral. A secured creditor cannot send any default notices allowed

under its Security Agreement. Of course, all forms of enforcement proceedings allowed by Article 9 are enjoined. It is questionable whether a secured creditor can refuse to make further advances under loan documents. In some jurisdictions, cutting off credit after commencement of a bankruptcy is akin to an enforcement action and is void. Other jurisdictions seem to allow the termination of advances while another view allows the secured creditor to turn off the credit flow but also allows the debtor to go to Bankruptcy Court and challenge the termination of credit. Even then, some jurisdictions require Bankruptcy Court intervention before the secured creditor's interests advance.

There are some notable exceptions to the Automatic Stay. Under 11 U.S.C. §362(b)(3), the Automatic Stay does not apply to "any act to perfect, or to maintain or continue perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under Section 546(b) of this title or to the extent that such act is accomplished within the period provided under Section 547(e)(2)(A) of this title." This provision allows a secured creditor to file a continuation statement, as when, for example, the five (5) year life of a Financing Statement is coming to an end, without running afoul of the Automatic Stay. This provision also allows a secured creditor a ten (10) day grace period to perfect the

security interest after attachment and to have the perfection be effective despite the bankruptcy filing and allows a secured creditor to take advantage of UCC grace periods for perfection without violating the Automatic Stay.

Violation of the Automatic Stay can be devastating to a secured creditor. Under 11 U.S.C. §362(h), for a willful violation of the Automatic Stay, the Bankruptcy Court can award the debtor actual damages, including costs and attorneys' fees. In the instance of "egregious intentional misconduct" the Bankruptcy Court can award punitive damages. Oftentimes the effect of a violation of the Automatic Stay is for the Bankruptcy Court to hold that the act taken is legally ineffective or void.

A secured creditor can request that the Bankruptcy Court provide relief from the Automatic Stay. A Bankruptcy Court may grant a creditor relief from the Automatic Stay "for cause". This relief can be attributable to the debtor's failure to make payments under a confirmed plan and mismanagement, or most commonly where the secured creditor is not adequately protected. The concept of adequate protection is one which protects the value of the secured creditor's interest in the collateral during the pendency of the bankruptcy. Where the value of the secured creditor's claim is declining, or the value of the collateral is far less than the security interest, the

secured creditor can ask for relief from the Automatic Stay for cause unless some other means of protection is found. Oftentimes, these arguments whittle down to a question of the value of the collateral where the debtor argues that there is an "equity cushion" in value (i.e.: the collateral is worth more than the lien so that the secured creditor is adequately protected).

But, an equity cushion is only one way to provide adequate protection. Sometimes the debtor will argue that the value of the collateral is stable at a level so that, even if there is no equity cushion, the secured creditor is still protected. A Bankruptcy Court can require a trustee or debtor in possession to make a cash payment, or periodic cash payments, to a secured creditor. Sometimes, replacement liens (the "indubitable equivalent") are provided to a secured creditor in property in which the debtor has equity.

The other way of obtaining relief from the Automatic Stay, requires a showing that the debtor has no equity in the collateral and the property is not necessary to an effective reorganization. Showing that the debtor has no equity is the secured creditor's burden. The second requirement, that the property is necessary to an effective reorganization, is the debtor's burden. As pointed out by the United States Supreme Court in United Savings Ass'n v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 108 S.Ct 626 (1988), "Once the

movant under §362(d)(2) establishes that he is an undersecured creditor, it is the burden of the debtor to establish that the collateral at issue is 'necessary to an effective reorganization.'" The Court goes on to say "What this requires is not merely a showing that if there is conceivably to be an effective reorganization, the property will be needed for it 'but that the property is essential for an effective reorganization that is in prospect. This means, . . . that there must be a 'reasonable possibility of a successful reorganization within a reasonable time.'" Id., at 375.

Generally, when a secured creditor is granted relief from the Automatic Stay, it can then pursue all of its rights and remedies with respect to the collateral. Of course, the Bankruptcy Court need not grant complete relief and can fashion an order making relief conditional or require further Bankruptcy Court intervention as enforcement occurs.

C. The Debtor's Use of the Collateral.

The secured creditor must remember that, subject to adequate protection, during the pendency of a bankruptcy, a debtor (or the trustee) may use, sell or lease property protected by the Automatic Stay. This is not to say that such use, sale or lease is unfettered. See, 11 U.S.C. § 363. In short, without a Bankruptcy Court order, a trustee

or debtor in possession cannot use cash collateral and cannot use, sell or lease collateral property outside the ordinary course of business. If the trustee or debtor-in-possession is allowed to operate a business, then it can use, sell or lease collateral property in the ordinary course.

D. Avoidance Powers.

The Bankruptcy Code gives a trustee, or debtor-in-possession, the ability to avoid certain transactions. Of particular interest to the secured creditor is the "strong arm" provisions of 11 U.S.C. §544(a). While this provision invalidates certain "secret" interests granted by the debtor, unperfected security interests fall within this category. Thus, subject to other provisions of the Bankruptcy Code, if a security interest is meant to be perfected but is not, the security interest can be voided. There are some exceptions. As noted above, UCC Article 9 security interests in Deposit Accounts and Letter-of-Credit Rights perfected by control, and not having any public notice, cannot be avoided under the strong arm provisions. *supra*.

Avoidance powers are also relevant when certain kinds of payments are made on an antecedent debt just prior to a bankruptcy filing. For instance, a debtor who makes a payment out of the ordinary course of business or gives some other benefit to a preferred

creditor in anticipation of a bankruptcy filing, the transaction will be avoided under 11 U.S.C. §547.

Under 11 U.S.C. §547(b), a transfer of property of the debtor for the benefit of a creditor on account of an antecedent debt while the debtor is insolvent within the preference period which betters the position of the creditor receiving the benefit is subject to avoidance. The basic policy of preference avoidance is to stop one creditor from obtaining an advantage at the expense of other creditors.

A prohibited transfer, must be a transfer of property of the debtor. A transfer as far as a preference is concerned can be anything of value from cash payments, disposition of collateral and an acceptance of the collateral in satisfaction of the debt.

The transfer must be for the benefit of a creditor. The term creditor is defined very broadly as someone who has a claim against the debtor. A "claim" is defined to include a right to payment, whether or not such right is reduced to judgment, liquidated or unliquidated, fixed, contingent, matured, unmatured, disputed or not, legal, equitable or unsecured. The payment can be made for the creditor's benefit, not directly to the creditor. Thus, a payment to a third party for the account of the creditor can be included.

The transfer must be for an antecedent debt, one that exists before the transfer occurs or one where no new value is given. The

transfer must occur within the preference period -- ninety (90) days before the filing of a bankruptcy petition. If the creditor is an "insider" the preference period is extended to one year. An insider is defined to be a relative of an individual debtor. An insider, as to a corporate debtor, includes an officer or director or any person in control of the corporation.

The transfer must take place while the debtor is insolvent. Bear in mind that under the Bankruptcy Code, a debtor is presumed to be insolvent during the ninety (90) day period prior to the bankruptcy filing. Thus, the burden is on the creditor who has benefited from the transfer to show the debtor was solvent.[66]

Finally, the transfer must improve the position of the benefited creditor. The improvement is based on a hypothetical liquidation pursuant to Chapter 7. If the transfer gives the benefited creditor more than it would receive in the hypothetical liquidation under Chapter 7, the receiving creditor has received a benefit which improves its position.

The Bankruptcy Code provides some safe harbor protections from preference avoidance. A transfer of a debtor's other property which is contemporaneous to the giving of new value is excluded.

Stated differently, 11 U.S.C. §547(c)(1) excludes a transaction which is intended by the debtor and the creditor to be the contemporaneous exchange for new value and the transaction is in fact substantially a contemporaneous exchange. Also given safe harbor are ordinary payments- the transfer of other property are excluded from this safe harbor. Preference avoidance is barred where the secured creditor can show that the transfer was in payment of a debt incurred by the debtor in the ordinary course of its business and in the ordinary course of the business of the transferee and either: (i) the payment itself was made in the ordinary course of business by both the debtor and the transferee; or (ii) the transfer was made according to ordinary business terms. See, 11 U.S.C. §547(c)(2). Still other safe harbor provisions include such provisions for enabling loans (11 U.S.C.§547(c)(3)), which are loans to allow the debtor to acquire new property. Still other limited protections are found at 11 U.S.C. §547 (c)(4) and (5) where the creditor gives "new value" and for inventory, farm products and receivables. The latter protects the Floating Liens, described *supra*.

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[66] Insolvency is shown when the debtor's debts exceed its assets at a fair valuation. See 11 U.S.C. §101(31). Fair valuation means that the assets are valued at an obtainable price in the market if prudently sold over a reasonable time period.

E. The Amount and Characterization of a Secured Creditor's Lien.

As noted above, soon after the commencement of a bankruptcy proceeding, and certainly before the date the Bankruptcy Court sets as the last day for the filing of claims (the so called "Bar Date"), a creditor should file a Proof of Claim with the Bankruptcy Court. A secured creditor's claim is often characterized in two parts. While a secured creditor may assert that all of its claims are secured, 11 U.S.C. §506(a) dictates a different result for the undersecured lender. Under that section, an allowed claim of a creditor secured by a lien on property in which the bankruptcy estate has an interest is a secured claim to the extent of the value of such creditor's interest and is an unsecured claim to the extent of the remaining creditor's interest.

A secured creditor's claim is divided into two parts, a secured part and an unsecured part with the latter receiving plan treatment like other unsecured creditors, more often than not that creditor will only be entitled to receive pennies on the dollar. Thus, it is important for a secured creditor to be vigilant in making certain that the value of its collateral is equal to or greater than the amount of the debtor's obligation. It is also important to keep in mind that a secured creditor can be denied post-petition interest on its claim, costs, fees

and charges unless the value of the collateral is greater than the secured claim. See, 11 U.S.C. §506(b).

Value, in this context, by statute, is to be determined in light of the purpose of the valuation and of the proposed disposition or use of such property. See, 11 U.S.C. §506(a). At one time, value determined under this provision was a conglomeration of determinations ranging from foreclosure value to value determined on a case-by-case basis. In 1997, the United States Supreme Court settled on replacement value as the benchmark. See, Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S.Ct. 1879 (1997). Despite this ruling though, the Supreme Court left to the Bankruptcy Courts the issue of how to determine replacement cost. See Id., at fn. 6. Thus, the question of value in this regard remains an open question to be determined by a trier of fact.

Important to the secured creditor with respect to this section is the ability of the debtor to "cram down" a plan over the objection of a secured creditor. The Bankruptcy Court determines the value of the collateral. The Bankruptcy Court then determines the present value of a stream of payments over the life of the proposed plan utilizing an interest rate also determined by the Bankruptcy Court. If the present value of the payment stream is equal to the value of the collateral, the

proposed plan can be confirmed over the objection of the secured creditor.

F. UNCITRAL Comparison.

At the outset of this portion of the Guide, mention is made that the Addendum involving Insolvency should be read in conjunction with the UNCITRAL Legislative Guide on Insolvency Law which addresses the issues identified in the Addendum in the broader context of Insolvency Law.[67]

The key objectives of the Guide on Insolvency Law are to address the rights of a secured creditor when insolvency proceedings have been commenced and how to facilitate enforcement, establish clear priority rules and recognize party autonomy. An integral part of a discussion on Insolvency Law is to determine whether to include encumbered assets in the Bankruptcy Estate and if so, what effects will there be. The Guide alerts the reader to the fact that some insolvency laws require that all assets be part of the Bankruptcy Estate, while others allow the separation of the encumbered assets from the Bankruptcy Estate where there is proof of harm or prejudice to the secured creditor's rights. To this end, the Guide instructs that Insolvency Law should balance competing interests of the creditor's

[67] UNCITRAL Guide, Addendum 10 at ¶1.

ability to enforce its security rights which may have an adverse impact on the cost and availability of credit.[68]

X. Conclusion.

United States secured transactions law has been, in many ways, simplified and streamlined by the advent of Article 9, through the elimination of all individual security devices for different types of collateral and each state's own special interpretation of secured transactions. Article 9 provides secured creditors a measure of certainty and a methodology to clearly define their rights, their priorities as against other lienors and their remedies. Nonetheless, some differences from state to state remain and the general rules of secured transactions are pockmarked with exceptions. The practitioner is well advised to exercise care in evaluating any secured transaction in the United States.

[68] Id., at ¶¶7,12, and 16.