SECURED TRANSACTIONS: TERMINOLOGY

- **Secured Transaction:** A transaction in which the payment of a debt is guaranteed, or secured, by collateral (1) owned by the debtor or (2) in which the debtor has a legal interest.

    - **Collateral:** Property, including accounts and chattel paper (*i.e.*, a note evidencing a debt secured by personal property), which is **subject to a security interest**.

- **Security Interest:** An interest in personal property or ***fixtures*** – *i.e.*, improvements to real property – which **secures payment or performance** of an obligation.

- **Security Agreement:** An agreement creating or memorializing a security interest granted by a ***debtor*** to a ***secured party***.

    - **Debtor:** A party who owes payment or performance of a secured obligation, *whether or not* she yet owns or has any rights in the collateral.

    - **Secured Party:** A lender, seller, or any other person who is a **beneficiary** of a security interest, including a person to whom accounts or chattel paper has been sold.

TANGIBLE COLLATERAL

- **Tangible Collateral:** Things that are movable at the time the security interest attaches or that are fixtures, including:
  - **Consumer Goods:** Goods bought or used primarily for personal, family, or household purposes;
  - **Farm Products:** Crops, livestock, or supplies produced in a farming operation;
  - **Inventory:** Goods held by a person for sale, raw materials held for production, and work in progress;
  - **Equipment:** Goods bought or used primarily for business purposes, excluding inventory and farm products; and
  - **Fixtures:** Goods that have become so attached to real property that an interest in them arises under real property law.

INTANGIBLE COLLATERAL

- **Intangible Collateral:** Personal property with no inherent value, including:
  - **Chattel Paper:** A writing that evidences both a security interest in goods and a monetary obligation to pay for those goods;
  - **Instrument:** A negotiable instrument or other writing evidencing a right to payment of money, that is not itself a security agreement, and that can normally be transferred by delivery, with any necessary indorsement;
  - **Account:** A right to payment of a monetary obligation, whether or not earned by performance, that is not, *inter alia*, chattel paper;
  - **Deposit Account:** A demand, time, savings, passbook, or similar account maintained with a bank, other than accounts evidenced by an instrument; and
  - **General Intangible:** Any intangible personal property not fitting a more specific definition, including software that is independent from a computer or other good, intellectual property rights, and stocks and bonds.

CREATING A SECURITY INTEREST

■ In order for a creditor's security interest to ***attach*** (*i.e.*, to become enforceable):

(1) the **debtor must have rights** in the collateral; <u>and</u>

(2) the **secured party must give value** (*e.g.*, extension of credit, consideration) in exchange for an interest in the collateral; <u>and</u>

(3) either

(a) the collateral must be **in the secured party's possession**, <u>or</u>

(b) there must be a written or authenticated **security agreement** that

(i) describes the collateral in such a way that it can be **reasonably identified**, <u>and</u>

(ii) is **signed** or authenticated by the debtor.

PERFECTING A SECURITY INTEREST

- **Perfection:** The process by which a secured party protects its security interests in collateral against the claims of third parties who may look to the same collateral to satisfy the debtor's obligations to them.

- For every type of collateral, a secured party may perfect her security interest in one or more of the following ways:

  (1) **filing** a financing statement against the collateral,

  (2) taking physical **possession** of the collateral,

  (3) exercising **control** over the collateral, or

  (4) creating an **automatically perfecting** security interest.

PERFECTION BY FILING

- **Financing Statement:** A document, filed by the secured party to give **notice to third parties** that the creditor claims an interest in the collateral, containing

  (1) the **debtor's name**,

  (2) the **secured creditor's name**, and

  (3) a **description** of the collateral by item or type.

- **Filing Office:** Financing statements against **fixtures, timber to be cut, and collateral to be extracted**, must be filed in the **county** where the collateral is located. **All other financing statements** must be filed with the secretary of state or comparable **statewide** filing office.

- **Proper State:** Financing statements must be filed against

  (1) an **individual** in her state of residence,

  (2) a **corporation** or other registered entity in its state of incorporation or registration, and

  (3) any **other entity** in the state of its place of business or, if it has more than one place of business, in the state of its chief executive office.

PERFECTION WITHOUT FILING

- **Perfection by Possession:** A secured creditor may also perfect its security interest in most types of collateral by taking possession of the collateral until the debtor has paid the debt for which the collateral was pledged.
  - If the secured party possesses the collateral, it must use **reasonable care** to preserve the collateral or will be liable to the debtor for any loss in the collateral's value.
  - Security interests in certain types of collateral – notably accounts receivable and general intangibles – may <u>only</u> be perfected by filing.
- **Purchase-Money Security Interest (PMSI):** A security interest that arises when a creditor extends credit so the debtor can purchase the goods that serve as the creditor's collateral.
  - A PMSI in consumer goods (other than motor vehicles and fixtures) **automatically perfects** at the time of sale.
  - Most states require a **certificate of title** for any automobile, motorcycle, boat, or motor home. In those states, a security interest in the vehicle can only be perfected if it is reflected on the certificate of title.

MAINTAINING PERFECTION

- As a general rule, a financing statement is effective for **five years** from the date it is filed

  - **Continuation Statement:** A statement that, if filed **within six months prior** to the expiration of a financing statement, will extend the financing statement for **five years** from the expiration date of the original statement.

- **Exceptions:** Under certain circumstances, a financing statement will cease to be effective sooner. For example:

  - If the **debtor changes its name, identity, or corporate structure** in such a way that any financing statement filed before the change is made ***seriously misleading***, the secured creditor must amend its financing statement to reflect the change within four months or it will not be perfected as to collateral acquired by the debtor after the four month period expires.

  - A perfected security interest in goods remains perfected for up to four months after the **debtor moves to** (or up to one year after the debtor reincorporates in) **another state**. After that time, the secured creditor must re-perfect in the new state in order to retain the priority of her interest on the collateral.

SCOPE OF SECURITY INTERESTS

- In addition to covering collateral already in the debtor's possession, a security interest can cover other types of property, including:

  - **Proceeds:** Money or other valuable assets received when collateral is sold or otherwise disposed of (*e.g.*, a check received for the sale of inventory).

  - **After-Acquired Property:** Property acquired by the debtor after the execution of the security agreement (*e.g.*, replacement inventory).

  - **Future Advances:** Often a debtor will arrange with a bank to have a continuing line of credit under which the debtor can borrow funds as needed. Future advances against that line of credit are subject to a properly perfected security interest in the same collateral that secures the initial loan.

  - **Floating Lien:** A security interest in collateral that is retained even when the collateral changes in character, classification, or location.

PRIORITIES AMONG CREDITORS

- **Conflicting Perfected Security Interests:** When two or more secured parties have perfected security interests in the same collateral, generally the **first to perfect** (or to file and subsequently perfect) has priority.

  - Under certain circumstances, a **PMSI can "trump"** a prior-perfected non-PMSI in the same collateral.

- **Perfected vs. Unperfected Security Interests:** When one secured party has a perfected security interest in collateral and another secured party has an unperfected security interest in the same collateral, the **perfected interest prevails**.

- **Conflicting Unperfected Security Interests:** When two or more secured parties have unperfected security interests in the same collateral, generally the **first to attach** has priority.

- **Secured vs. Unsecured Creditor:** Secured creditors prevail against unsecured creditors and judgment creditors who have not begun legal process to collect on their judgment.

- **Secured Party vs. Lienholder:** A perfected security interest prevails against a lienholder's claim that arose after perfection. On the other hand, a lienholder generally has priority over a later-perfected security interest.

BUYERS VS. SECURED CREDITORS

- **Buyer in the Ordinary Course:** A person who buys goods in **good faith** and **without knowledge** that the sale is in violation of a third party's ownership rights or security interest, from a person who is **in the business of selling goods of the kind**, will take the goods **free of any security interest**, even if

  (1) the security interest is **perfected**, and

  (2) the **buyer knows** of its existence.

- **Buyer Not in the Ordinary Course:** A person who buys goods other than in the ordinary course of the seller's business will take the goods **free of any unperfected security interest**, but subject to any perfected one.

- **Second-Hand Buyer of Consumer Goods:** A person who, purchases goods for personal, family, or household use, **without knowledge** of a prior security interest, from a seller who held the goods for personal, family, or household use, takes **free of any unfiled security interest** – including any automatically perfected PMSI.

DEBTORS' AND CREDITORS' RIGHTS

- **Information Requests:** A party who is considering taking a security interest is entitled by the UCC to obtain a certificate from the relevant filing office identifying all perfected financing statements on file for that debtor.

- **Assignment and Release:** A secured party may, at its discretion, **assign** part or all of a security interest to another party or **release** part or all of the collateral covered by a security interest.

- **Amending a Financing Statement:** A filed financing statement may be amended. The amendment must be agreed to and signed by <u>both</u> the debtor and the secured party.

- **Accounting:** A debtor may request that the secured creditor confirm the debt remaining or the collateral covering the remainder of the debt.

- **Termination:** When a secured debt is fully paid, the secured party generally must send a **termination statement** to the debtor and file a copy with the appropriate filing office.

- **Default:** A debtor's **failure to pay** a debt when due or otherwise perform as required by the security agreement.

REMEDIES ON DEFAULT

- **Repossession:** A secured party can take possession of the collateral and either

  (1) **retain** it for satisfaction of the debt, or

  (2) **resell** it and apply the sale proceeds to the remaining debt.

  - A creditor wishing to retain the collateral must ***after default*** (a) obtain a written waiver of sale from the debtor and (b) in the case of non-consumer goods, notify certain other creditors that the secured party intends to retain the collateral, subject to the debtor's (or other interested party's) right to object in writing and demand that the collateral be sold.

- A secured party can relinquish its security interest and proceed to judgment on the underlying debt. If successful, the secured party will proceed to:

  - **Execution:** The process of carrying out the effect of a court decree or judgment; and

  - **Levy:** Seizure and sale of property, subject to a writ of execution, to satisfy a debt.

SALE PROCEDURES AND PROCEEDS

- A secured party who chooses to sell the collateral must

  (1) sell it in a **commercially reasonable** manner, and

  (2) **notify** the debtor of the time and place of the sale.

- **Proceeds** from the sale must be applied as follows:

  (1) reasonable expenses stemming from **retaking, holding, or preparing for sale** (which may include attorneys' fees and other legal expenses);

  (2) satisfaction of the **balance** due to the secured party;

  (3) satisfaction of **other secured creditors** from whom written demand for proceeds has been received; and

  (4) any **surplus to the debtor**.

- If the debt remains unsatisfied after the collateral has been sold, the secured party may obtain a **deficiency judgment** against the debtor.

- **Strict Foreclosure:** A secured party who elects to retain the collateral in satisfaction of the outstanding debt <u>may</u> <u>not</u> seek a deficiency judgment against the debtor.

REDEMPTION

- At any time before the secured party disposes of the collateral, enters into a contract for its disposition, or discharges the debtor's obligation by retaining the collateral after notice and consent, the debtor or any other secured creditor of the debtor may **redeem** the collateral by

  (1) tendering performance of **all obligations** secured by the collateral, and

  (2) paying any **expenses** reasonably incurred by the secured party in retaking and maintaining the collateral.