



“Spot the Errors”: An Interactive Exercise in Identifying the Analytical Errors Made in Recent Cases Involving Secured Transactions

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Chapter 11

“Spot the Errors”: An Interactive Exercise in Identifying the Analytical Errors Made in Recent Cases Involving Secured Transactions

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**Spot the Errors:
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*Northwest Bankruptcy Institute
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The materials that follow consist of ten problems, each of which presents a slightly simplified version of the facts underlying a recent judicial decision. During the program, the moderators will explain the court's analysis in the case. They will then ask the institute attendees to identify whether the court erred and, if so, in what way or ways. Not every decision covered contains an error.

Problem One

based on *In re Tuscany Energy, LLC*, [561 B.R. 910](#) (Bankr. S.D. Fla. 2016), and *In re Tuscany Energy, LLC*, [2018 WL 549642](#) (Bankr. S.D. Fla. 2018)

Debtor borrowed \$5 million from State Bank and, to secure the debt, granted State Bank a security interest in substantially all of its existing and after-acquired personal property. State Bank perfected the security interest by filing a proper financing statement in the appropriate office. Two months before filing a Chapter 11 bankruptcy petition, Debtor transferred \$200,000 from a deposit account at Local Bank to Law Firm as a retainer for legal services to be rendered in the bankruptcy case.

In the bankruptcy case, Law Firm filed a fee application seeking payment of \$150,000 in fees and expenses, and asking to apply the retainer to the amount that the court approves. State Bank objected to the use of the retainer to pay Law Firm's fees and expenses, claiming the retainer was cash collateral in which State Bank had a perfected, first-priority security interest.

Does State Bank have a prior perfected security interest in the retainer?

Problem Two

based on *In re Delano Retail Partners, LLC*, [2017 WL 3500391](#) (Bankr. E.D. Cal. 2017)

Wholesaler loaned Debtor \$2 million, and to secure the debt received a perfected security interest in Debtor's inventory, equipment, leases, chattel paper, deposit accounts, and other assets. Prior to filing a Chapter 7 bankruptcy petition, Debtor transferred cash proceeds of inventory, totaling \$560,000, to Lawyer, who placed the proceeds in Lawyer's client trust account (a single account for all of lawyer's clients). Debtor also leased equipment to a related entity.

After the petition, Lawyer transferred \$380,000 from the client trust account to the bankruptcy trustee. The trustee also collected \$150,000 from the related entity in post-petition rent. Trustee retains the funds and Wholesaler claims a perfected security interest in them.

Does Wholesaler have a perfected security interest in all or part of these funds?

Problem Three

based on *Fishback Nursery, Inc. v. PNC Bank*, [2017 WL 6497802](#) (Bankr. N.D. Tex. 2017)

BNF Operations, LLC is a Texas entity. Bank acquired and perfected a security interest in all of BNF's farm products. Thereafter, Nursery sold agricultural products to Debtor, shipping them to BNF's facilities in Oregon, Tennessee, and Michigan. The sales agreements selected Oregon law as the governing law and provided that Nursery retained a security interest in the products sold. Nursery promptly filed financing statements in the appropriate offices in Oregon, Tennessee, and Michigan. Each financing statement identified the debtor as "BNF Operations, LLC, abn Zelenka Farms." Nursery also filed a notice of lien in Oregon.

During BNF's bankruptcy, the debtor's assets are sold free and clear, with any liens on the assets sold attaching to the proceeds and retaining their priority. Nursery claims a perfected agricultural lien on the proceeds, with priority over Bank's security interest.

Which creditor, Nursery or Bank, has priority in the proceeds?

Problem Four

based on *ACF 2006 Corp. v. Ladendorf*, [826 F.3d 976](#) (7th Cir. 2016)

In 2008, Lender made a loan to Law Firm, which is organized as a professional corporation. The loan was secured by Law Firm's existing and after-acquired accounts. Lender perfected the security interest at that time.

Previously, Lawyer, a principal of Law Firm, embezzled \$4.5 million from clients' trust funds. In 2014, Client obtained a judgment for theft against Lawyer and Law Firm. Under applicable state law, Client is entitled to lien on Lawyer's property "from the date . . . of the conversion." Another statute in the state provides that "[t]he relationship between a professional corporation performing professional services and the client or patient is the same as between the client or patient and the individual performing the services."

In 2016, Law Firm became entitled to legal fees in a case. As between Client and Lender, whose lien interest in that account has priority?

Problem Five

based on *In re Lexington Hospitality Group, LLC*, [2017 WL 5035081](#) (Bankr. E.D. Ky. 2017)

Debtor borrowed \$6.1 million from Lender to buy a hotel. To secure the debt, Debtor executed a Mortgage and Security Agreement that granted Lender a mortgage on real property and a security interest in Debtor's existing and after-acquired personal property, including accounts and payment intangibles. Lender recorded the mortgage and filed a financing statement that described the collateral as "[a]ll . . . goods, . . . accounts, deposits, . . . and all other property."

Two years later, Debtor filed a Chapter 11 bankruptcy petition. During a dispute about the use of cash collateral, question arose about whether Lender had a perfected security interest in cash and cash proceeds of credit card receivables arising from the post-petition operation of the hotel.

Does Lender have a perfected security interest in such post-petition property?

Problem Six

based on *Bayer Cropscience LP v. Stearns Bank*, [837 F.3d 911](#) (8th Cir. 2016)

In 2002 Bank One acquired and perfected a security interest in Debtor's existing and after-acquired general intangibles. In 2006, Bank Two acquired and perfected a security interest in the Debtor's commercial tort claim against Corporation. In 2012, Corporation agreed to pay \$2.1 million to settle the claim. After a portion of the proceeds were distributed, a priority dispute between the two banks arose. Corporation brought an interpleader action and deposited the remaining amount due – approximately \$1 million – with the court.

Which bank has priority in the funds deposited with the court?

Problem Seven

based on *BMW Financial Services, N.A., LLC v. Felice*, [75 N.E.3d 368](#) (Ill. Ct. App. 2017)

Debtor executed a retail installment contract for the purchase of a Porsche. The contract granted a security interest in the Porsche to Lender. Shortly thereafter, the state issued a certificate of title for the Porsche, identifying Lender as a lienholder. Debtor, without Lender's knowledge or consent, later submitted a lien release letter to the state, which issued a duplicate certificate of title that did not name Lender as a lienholder. However, the duplicate certificate stated, "This is a duplicate certificate and may be subject to the rights of a person under the original certificate." Debtor then sold the Porsche to Dealer for \$47,000. Dealer subsequently sold the Porsche to Customer for \$59,000.

Lender brought a replevin action to recover the Porsche. Dealer repurchased the Porsche from Customer.

As between Lender and Dealer, who has superior rights to the Porsche?

Problem Eight

based on *In re Story*, [2016 WL 5210572](#) (Bankr. W.D.N.C. 2016)

Debtors purchased a heating and air conditioning unit for household use with financing from Lender, which obtained a purchase-money security interest in the unit. Lender never filed a financing statement. Debtors then installed the unit in their home, at which point the unit became a fixture. After Debtors filed a Chapter 13 bankruptcy petition, Lender filed a proof of claim for a fully secured claim. Debtors proposed a plan that treated the debt to Lender as an unsecured claim. Lender filed an objection.

Is Lender's security interest perfected?

Problem Nine

based on *In re Thornton*, [2016 WL 3092280](#) (Bankr. S.D. Ind. 2016)

Debtor purchased a double-wide manufactured home with financing from Lender. To secure the debt, Debtor granted Lender a security interest in the manufactured home and "all goods that are or may hereafter by operation of law become accessions to it."

After Debtor filed a Chapter 13 bankruptcy petition, the parties disputed the value of the collateral, which depended in part on whether the items listed below, apparently purchased with the home, are subject to Lender's security interest: a fireplace, a smoke detector, a furnace, a water heater, a built-in dishwasher, a shower and tub, a refrigerator, an ice maker, an oven, a gas washer, and a dryer.

In which of those items, if any, does Lender have a security interest?

fireplace	refrigerator
smoke detector	ice maker
furnace	oven
water heater	gas washer
built-in washer	gas dryer
shower and tub	

Problem Ten

based on *In re National Truck Funding LLC*, [2018 WL 543005](#) (Bankr. S.D. Miss. 2018)

Debtor leases trucks to independent trucking companies. Most of the leases are pursuant to a weekly renewable rental program with an option to purchase. Lender has a security interest in many of Debtor's trucks, and that security interest is perfected through compliance with the applicable certificate of title statute. Lender did not file a financing statement.

Debtor filed for bankruptcy protection under Chapter 11 and continued to operate the business as debtor in possession. Debtor receives, postpetition, payment via check and wire transfer from lessees pursuant to prepetition leases.

Does Lender had a perfected security interest in the payments?

A Primer on Secured Transactions

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THE CLASSIFICATIONS OF PERSONAL PROPERTY

Article 9 has numerous different classifications of personal property and virtually all of Article 9's rules – attachment rules, enforcement rules, perfection rules, priority rules, and even some choice-of-law rules – are dependent on the type of collateral. The main reason for this is that industry practices have developed for different types of collateral, and to accommodate these practices, while still having a unitary system of secured credit, different rules are necessary. Regardless of the reasons, however, the classifications appear so pervasively throughout Article 9 that mastery of them is one of the unavoidable challenges of learning Article 9 and contributes greatly to its complexity.

There are twelve main classifications of personal property in Article 9 and numerous subclassifications. To make matters even more confusing, some subclassifications cut across more than one main classification. What follows is a brief overview of the terms.

First, collateral might be tangible – that is, have mass – and thus constitute “goods.” *See* § 9-102(a)(44). All goods must be one of the following, mutually exclusive classifications:

consumer goods	§ 9-102(a)(23)
equipment	§ 9-102(a)(33)
farm products	§ 9-102(a)(34) or
inventory	§ 9-102(a)(48).

In addition to whichever of these four sub-classifications of goods applies, goods might also fall under one or more of the following more specialized terms used in Article 9, some of which are defined and some of which are not:

accessions	§ 9-102(a)(1)
as-extracted collateral	§ 9-102(a)(6)
commingled goods	§ 9-336(a)
crops	
fixtures	§ 9-102(a)(41) or
livestock	
manufactured homes	§ 9-102(a)(53).
timber	

Second, collateral might be either purely intangible or “quasi-intangible,” the latter being an object, such as a piece of paper, that represents an obligation owed to the person owning or possessing the object.¹ Within these groups are:

¹ The terms “intangible” and “quasi-intangible” are not used in Article 9. They are used here merely to help compare and contrast the various types of collateral that Article 9 does recognize.

accounts	§ 9-102(a)(2)
chattel paper	§ 9-102(a)(11)
commercial tort claims	§ 9-102(a)(13)
deposit accounts	§ 9-102(a)(29)
documents (of title)	§§ 9-102(a)(30), 1-201(b)(16)
instruments	§ 9-102(a)(47)
investment property	§ 9-102(a)(49)
general intangibles	§ 9-102(a)(42)
letter-of-credit rights	§ 9-102(a)(51) and
letters of credit	§§ 9-102(b), 5-102(a)(10)
money	§ 1-201(b)(24).

Accounts include some as-extracted collateral and health-care-insurance receivables, § 9-102(a)(6), (46).

Chattel paper might be either electronic or tangible, § 9-102(a)(31), (79).

A document of title might be either electronic or tangible, § 1-201(b)(16). Each type of document of title can also be negotiable or nonnegotiable, § 7-104.

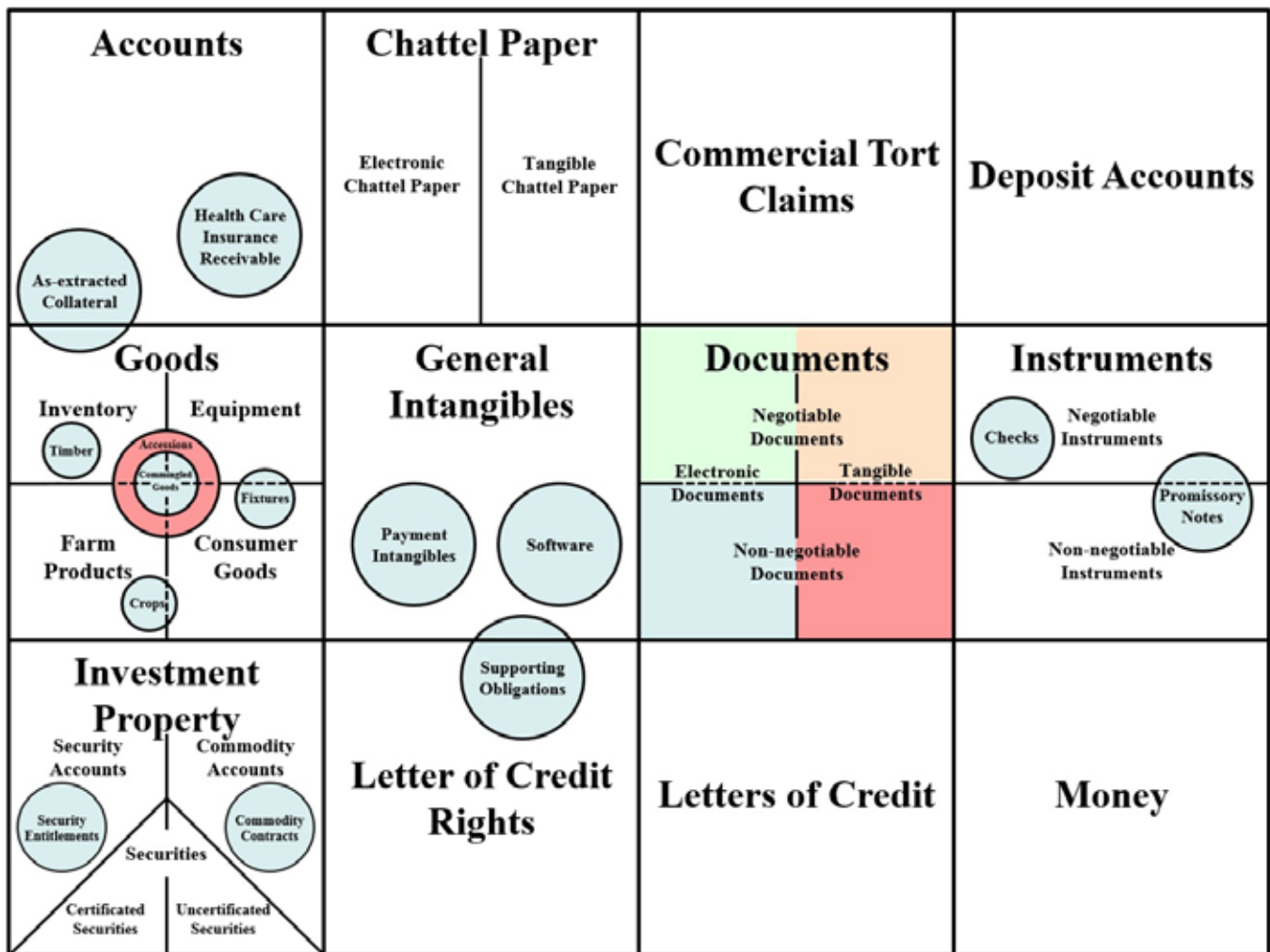
General intangibles include two subcategories: payment intangibles and software, § 9-102(a)(61), (76).

Instruments include checks and promissory notes, §§ 3-104(f), 9-102(a)(65), (b). Instruments may be either negotiable or nonnegotiable, § 3-104.

Investment property consists of: commodity accounts; commodity contracts; security accounts; securities; and security entitlements, §§ 9-102(a)(14), (15), (b), 8-102(a)(15), (17), 8-501(a).

The diagram on the next page depicts the relationship of the classifications and subclassifications of personal property. The following problem illustrates one of the many situations in which the classifications of collateral can be very important.

Chart 1
Article 9 Classifications of Collateral



THE SCOPE OF ARTICLE 9

Subject to a few exceptions,² Article 9 applies to any transaction, regardless of its form, that creates a security interest in personal property. § 9-109(a)(1). Thus, unless an exception applies, Article 9 applies to a transaction that purports to create a security interest as well as to numerous transactions that do not purport to create one.

For example, if a seller of goods on credit retains title to the goods until full payment is received, the transaction creates a security interest.³ The rule can also apply to a transaction structured as a lease of goods. After all, a credit sale of goods can look very similar to a lease. In both, one party transfers rights to and possession of property while the other pays for those rights over time. Because a lessor of goods by definition retains title to the goods, if a transaction is structured as a lease but is in economic reality a sale, the UCC treats the transaction as a sale and, seller – by referring to itself as “lessor” and thereby retaining title – has a security interest.

The distinction between a true lease – that is, a transaction structured as a lease and which the law regards as a lease – and a transaction structured as a lease but which in reality and under law is a sale with a security interest is not always easy to draw. The UCC distinguishes between them through a sort of economic reality test. *See* § 1-203. In a true sale, the seller does not expect to get the property back if the buyer pays. In a true lease, the lessor does expect to get the property back after the lessee pays and the lease term expires. Accordingly, the UCC bases the determination on whether there is a reasonable likelihood that the party denominated as “lessor” truly retains a valuable, residual economic interest in the goods. § 1-203(a). This often revolves around whether the lease term equals or exceeds the entire economic life of the goods or whether some provision of the lease agreement is likely to trigger an event that prevents the goods from ever reverting back to the lessor while they still have economic life. If either of these is true, the UCC definitively treats the transaction as a sale with a retained security interest. § 1-203(b). If neither of these things is true, the issue falls back to a test based on all the facts and circumstances, but the transaction is more likely to be regarded as a true lease.

Despite the similarities between credit sales and leases, the law treats the two structures very differently. For example, as the first chart below shows, a lessor need not file a financing statement to protect its residual interest in the goods leased. In contrast, a seller of goods who retains security interest must normally file a financing statement to perfect that security interest. The differences are even more pronounced in bankruptcy, as illustrated by the subsequent chart.

² *See* § 9-109(d).

³ *See* §§ 1-201(b)(35), 2-401(1).

Chart 2
The Significance of the Sale/lease Distinction in General

	Credit Sale (no security interest)	Sale & Security Interest	True Lease
Governing Law	Article 2	Articles 2 & 9	Article 2A
Can Seller/Lessor get goods back for nonpayment?	No	Yes	Yes
Tax/Accounting Realization Event	Yes	Yes	No
Tax/Accounting Depreciation Allowance	Buyer	Buyer/Lessee	Lessor
Tax/Accounting Payments	No Effect	No Effect	Income to Lessor & deduction to Lessee
Rights of Creditors of Buyer/Lessee	Can potentially get the goods	Can potentially get the goods if Lessor/Seller did not perfect a security interest ⁴	Cannot get the goods but might be able to attach lessee's leasehold interest
Must Lessor/Seller file a financing statement to protect its interest	Not applicable, because no interest is retained	Yes ⁵	No

⁴ Some transferees can take free of even a perfected security interest. *See, e.g.*, § 9-320(a), (b).

⁵ No filing is needed to perfect a purchase-money security interest in consumer goods. § 9-309(1).

Chart 3
The Significance of the Sale/lease Distinction in Bankruptcy

	Lease	Security Interest
Pre-Bankruptcy Termination of Debtor's Interest in Property	Effective upon notice properly given in accordance with lease contract.	Effective upon completion of Article 9 foreclosure process.
Treatment Options	Reject, assume, or assume and assign lease contract in its entirety. 11 U.S.C. § 365(a), (f).	Sell collateral free of lien with lien attaching to proceeds, retain items of collateral subject to lien and pay value of such collateral to secured creditor; or surrender/abandon some or all of the collateral.
Deadline For Debtor's Exercise of Treatment Options	The earlier of the date set by the court upon request of the lessor or the date of the order confirming the plan. 11 U.S.C. § 365(d)(2)	The earlier of the date the collateral is no longer property of the estate or the date of the order confirming the plan.
Conditions to Exercise of Treatment Options	If a monetary default under the lease contract has occurred, assumption requires that the debtor cure that default, compensate the lessor for any pecuniary loss resulting from the default and provide adequate assurance of future performance of obligations under the lease. 11 U.S.C. § 365(b)(1). Court approval is required for either assumption or rejection of lease contract. 11 U.S.C. § 365(a).	No statutory precondition other than realistic prospect of effective reorganization.
Right to Receive Scheduled Payments	Lessor is entitled to receive scheduled lease payments first due 60 days after the petition date. 11 U.S.C. § 365(d)(10).	No right to receive scheduled payments.
Contract Interest	Included in payment required under 11 U.S.C. § 365(d)(10).	Right to contract interest only to the extent collateral value exceeds claim. 11 U.S.C. § 506(b). Creditors have no right to receive interest on an undersecured claim unless the confirmed plan provides otherwise.

	Lease	Security Interest
Adequate Protection	Granted upon request to the extent necessary to protect the lessor's interest in the leased property during first sixty days of proceeding. 11 U.S.C. § 363(e).	Granted upon request to the extent necessary to protect the secured party against diminution in value of its interest in collateral. 11 U.S.C. § 363(e).
Sale by Debtor of Property	Not permitted.	Permitted under 11 U.S.C. § 363(b), (c), (f).
Amount of Claim	Contract claim without regard to value of leased property.	Claim is secured to the value of collateral, unsecured as to any amount in excess of such value. 11 U.S.C. § 506.
Priority of Claim	Priority claim for: (i) lease payments due 60 days after petition date and prior to rejection of lease contract, (ii) all amounts due under lease contract assumed by debtor. 11 U.S.C. § 365(d)(10). General unsecured claim for amounts due as result of rejection. 11 U.S.C. § 365(g)(1).	When the court orders adequate protection of a creditor's interest in collateral, super administrative priority is granted to any administrative claim arising from the debtor's retention, use, sale or lease of such collateral to the extent the creditor's interest is not protected. 11 U.S.C. § 507(b).
Aircraft Equipment and Vessel Financing	Generally, lessor and secured creditor treated similarly with respect to possession and cure, pursuant to 11 U.S.C. § 1110.	Generally, lessor and secured creditor treated similarly with respect to possession and cure, pursuant to 11 U.S.C. § 1110.

Article 9 also applies to several transactions that do not resemble secured transactions. Chief among these are many consignments of goods, *see* §§ 9-102(a)(20), 9-109(a)(4), and to most sales of accounts, chattel paper, payment intangibles, and promissory notes, *see* § 9-109(a)(3), (d)(4)–(7). Thus, the term “debtor” in Article 9 includes not merely the owner of collateral, but also a consignee of goods and a seller of receivables. *See* § 9-102(a)(20). Similarly, the term “secured party” includes a consignor and a buyer of receivables. *See* § 9-102(a)(73).

ATTACHMENT OF A SECURITY INTEREST

IN GENERAL

Assuming that Article 9 applies to the transaction, section 9-203 tells how to create the security interest so that it is enforceable against the debtor. This process is called "attachment" of the security interest. It might be helpful to think of it as a giant, invisible hand (the lien) grabbing on (attaching) to particular pieces of the debtor's property (the collateral) to secure obligations owed to the creditor.

Subsection (b) contains the three requirements for attachment of a security interest:

- There must be a security agreement that, in most cases, is authenticated by the debtor and reasonably describes the collateral. A description of collateral by its Article 9 classification is generally sufficient, *see* § 9-108(b), (e).
- Value must be given. "Value" is a defined term, *see* § 1-204, and includes any consideration sufficient to support a contract or a preexisting debt. In general, though, it is useful to think of the value given as the secured obligation (*i.e.*, the debt that the collateral secures).
- The debtor must have rights in the collateral or the power to transfer such rights to the secured party.

These three requirements may be satisfied in any order, but attachment does not occur until *all three* are met. Upon attachment, the consensual lien (that is, the *in rem* liability of the collateral) arises.

One implication of the foregoing is that a security interest can attach to property that the debtor does not own at the time the debtor authenticates the security agreement but which the debtor acquires later. In fact, Article 9 states this rule expressly. Subject to some minor exceptions, a security interest may attach to after-acquired property: that is, to property acquired after the security agreement is authenticated. *See* § 9-204(a), (b). The security agreement simply has to specifically refer to after-acquired property. This is a very important rule, particularly when the collateral consists of inventory or accounts, which are likely to constantly and frequently turn over. Were the rule otherwise, the secured party would need the debtor to authenticate a new or amended security agreement every time the debtor acquired new property that the parties intended to serve as collateral, something that might occur on a daily or intra-day basis.

Article 9 similarly allows collateral to secure not only an obligation existing or created when the debtor authenticates a security agreement, but also loans or other advances that the secured party makes in the future. *See* § 9-204(c). Some secured parties make new advances or otherwise extend credit, particularly under a revolving credit facility, at very frequent intervals. If the law required a new security agreement for each advance, it would severely hamper legitimate and routine commercial transactions.

PROCEEDS & OTHER SPECIAL RULES

If an Article 9 security interest attaches to collateral, it will also attach – automatically – to four additional things:

- Identifiable proceeds of the collateral, *see* §§ 9-102(a)(64), 9-203(f), 9-315(a)(2). This includes whatever is received from the sale, lease, license, exchange, or other disposition of the collateral.
- Supporting obligations, *see* § 9-102(a)(78), 9-203(f). This includes a guaranty of a receivable in which there is a security interest.
- Supporting liens, *see* § 9-203(g). For example, if a mortgage secures a right to payment and the mortgagee/creditor grants a security interest in that right to payment,⁶ the secured party also acquires a security interest in the mortgage.
- "Commingled goods," that is, a product of mass that results when collateralized goods is physically united with other goods in such a way that their identity is lost in a product or mass, *see* § 9-336(a), (c).

The first of these rules is by far the most important. "Proceeds" is a very broad concept, but it is not limitless. In structuring a secured loan, it is vital for the lender's attorney to understand what assets the debtor has or is likely to acquire, and to make sure that all such assets that are intended to serve as collateral are either described in the security agreement or will necessarily constitute identifiable proceeds of other collateral.

ANTI-ASSIGNMENT RULES

When a contract that creates rights also purports to make those rights non-assignable, two fundamental principles of law come into conflict: the principle of freedom of contract and the principle that property rights should be freely alienable. Article 9 sides strongly in favor of free alienability. It does this through a wonderful bit of alchemy. It transforms many non-assignable contract rights into assignable rights, thereby allowing the owner to convey a security interest in them. *See* §§ 9-406 *through* 9-409. Moreover, it purports to do the same with respect to legal restrictions on assignment. It purports to allow the right-holder to create a security interest in the right despite other law to the contrary.

However, these anti-assignment rules do not always give the secured party the ability to enforce the security interest by compelling the counter-party to render performance to the secured party. Specifically, for some types of property – *e.g.*, accounts and chattel paper – the

⁶ Remember, Article 9 applies to most sales of a right to payment and treats the interest of the buyer as a "security interest."

anti-assignment rules of Article 9 fully trump contractual and legal restrictions on assignment. The secured party can therefore acquire a security interest in the property and can fully enforce the debtor's rights against the account debtor. For other types of property – *e.g.*, general intangibles – the anti-assignment rules might permit a security interest to attach, and therefore potentially come ahead of the debtor's bankruptcy trustee, *see* § 9-408 cmt. 7, but leave the secured party without the right to enforce the obligation of the account debtor. *See* § 9-408(d) cmt. 2.

Article 9's anti-assignment rules are cumbersome and difficult to decipher. The chart that follows depicts most of them, organized by the nature of the restriction and by type of property involved. For each type of restriction – contractual or legal; applying to a sale of the property or applying to the use of the property as collateral for a loan – it indicates for each of various types of collateral whether the rules completely override the restriction (rendering it "ineffective" to limit or affect an assignment of the property), do not apply (leaving the restriction "unaffected by Article 9"),⁷ or do something in between: override the restriction but leave the secured party with little ability to enforce its rights to the property ("partly ineffective").

Two caveats are in order. First, while a secured party can comfortably rely on the rules in Article 9 to override contractual and common-law restrictions on assignment, one cannot blithely assume they these rules will override state statutory restrictions.⁸ Moreover, Article 9's rules will undoubtedly not override legal restrictions on assignment arising under federal or international law. Second, some states have very important non-uniform variations on these rules.⁹ Consequently, care must be taken if there is any chance the law of one of those jurisdictions might apply.

⁷ If the restriction on assignment is unaffected by Article 9's anti-assignment rules, the restriction will usually be effective. On occasion, however, other law might invalidate a restriction. For example, a term in a partnership agreement that prohibited partners from assigning their partnership interests to anyone of a particular race or gender would likely be unenforceable.

⁸ *See* Fenway Fin., LLC v. Greater Columbus Realty, LLC, 995 N.E.2d 1225 (Ohio Ct. App. 2013) (§ 9-406 did not override Ohio statute that prohibits a brokerage from paying real estate commission to a creditor of a broker). *Compare* Texas Lottery Comm'n v. First State Bank of DeQueen, 254 S.W.3d 677 (Tex. Ct. App. 2008), *aff'd*, 325 S.W.3d 628 (Tex. 2010) (§ 9-406(f) trumps a Texas statute prohibiting assignment of state lottery winnings even though the lottery statute was more recent and more specific because § 9-406(f) makes clear that it takes precedence over other law), *with* Stone Street Capital, LLC v. California State Lottery Comm'n, 80 Cal. Rptr. 3d 326 (Cal. Ct. App. 2008) (the California Lottery Act, which restricts the assignment of lottery winnings, trumps § 9-406(f) because the specific rules in the Lottery Act control over the more general rules in Article 9, even though Article 9 was enacted more recently).

⁹ *See* N.Y. Uniform Commercial Code §§ 9-406, 9-408 (McKinney) (omitting uniform § 9-406(f) and § 9-408(c)); *See* Del. Stat. tit 6, §§ 9-406(i)(5), 9-408(e)(4) (excepting from such rules assignments of any interest in a partnership or limited liability company).

Chart 4
Article 9's Anti-Assignment Rules

			Accounts & Chattel Paper	Payment Intangibles & Prom.	General Intangibles	Health-Care-Insurance Receivables
Contractual Restriction	Regarding Sale	Prohibits or Requires Consent	Ineffective § 9-406(d)(1)	Partly Ineffective § 9-408(a)(1), (d)	Unaffected by Article 9	Partly Ineffective § 9-408(a)(1), (d)
		Makes a Default	Ineffective § 9-406(d)(2)	Ineffective § 9-408(a)(2)	Unaffected by Article 9	Ineffective § 9-408(a)(2)
	Regarding Encumbrance	Prohibits or Requires Consent	Ineffective § 9-406(d)(1)	Ineffective § 9-406(d)(1)	Partly Ineffective § 9-408(a)(1), (d)	Partly Ineffective § 9-408(a)(1), (d)
		Makes a Default	Ineffective § 9-406(d)(2)	Ineffective § 9-406(d)(2)	Ineffective § 9-408(a)(2)	Ineffective § 9-408(a)(2)
Legal Restriction	Regarding Sale	Prohibits or Requires Consent	Ineffective § 9-406(f)(1)	Partly Ineffective § 9-408(c)(1), (d)	Unaffected by Article 9	Partly Ineffective § 9-408(c)(1), (d)
		Makes a Default	Ineffective § 9-406(f)(2)	Ineffective § 9-408(c)(2)	Unaffected by Article 9	Ineffective § 9-408(c)(2)
	Regarding Encumbrance	Prohibits or Requires Consent	Ineffective § 9-406(f)(1)	Partly Ineffective § 9-408(c)(1), (d)	Partly Ineffective § 9-408(c)(1), (d)	Partly Ineffective § 9-408(c)(1), (d)
		Makes a Default	Ineffective § 9-406(f)(2)	Ineffective § 9-408(c)(2)	Ineffective § 9-408(c)(2)	Ineffective § 9-408(c)(2)

PERFECTION OF A SECURITY INTEREST

IN GENERAL

Once a security interest attaches, it is enforceable against not only the debtor, but also generally effective against creditors of the debtor and purchasers of the collateral.¹⁰ That general rule, however, is subject to many, many, exceptions. To truly be protected against such third parties – and to be entitled to protection if the debtor becomes the subject of a bankruptcy proceeding – a security interest must be perfected.

Perfection of a security interest requires just two things: attachment plus satisfaction of one other applicable step. *See* § 9-308(a), (b). That applicable step – known as a perfection method – is in many instances the provision of some form of notice to the commercial world of the secured party's interest in the collateral. It is the rough equivalent for personal property of what recording a mortgage is for real property.

Except to the extent other law preempts Article 9's perfection rules,¹¹ Article 9 permits a security interest to be perfected in five principal ways:

- By filing in the appropriate office a financing statement that identifies the debtor, the secured party, and the collateral;
- By taking possession of the collateral, which includes obtaining an agreement from a bailee of the collateral to retain the collateral for the secured party's benefit;
- By taking "control" of the collateral, a term defined differently for different types of collateral;¹²
- By complying with a certificate of title statute;¹³ and
- Automatically, simply by having the security interest attach.¹⁴

For some types of collateral, the secured party may perfect in only one of these ways. For other types of collateral, the secured party has the option of multiple ways to perfect, although the method used might affect the priority of the security interest. Unfortunately, instead of organizing the perfection rules by type of collateral, Article 9's perfection rules are organized primarily by perfection method,¹⁵ with the result that it is somewhat cumbersome to ascertain which methods apply to which

¹⁰ *See* § 9-201(a).

¹¹ *See* § 9-311.

¹² *See* §§ 9-104, 9-105, 9-106, 9-107.

¹³ *See* § 9-311(a)(2), (d).

¹⁴ Automatic perfection can be for a temporary period, typically 20 days, *see, e.g.*, § 9-312(e), (f), (g), § 9-315(c), (d), of it can be permanent.

¹⁵ *See* §§ 9-309 through 9-313.

types of collateral. The chart below addresses this problem. It identifies the secured party's perfection options with respect to each classification of collateral.

Chart 5
Perfection Method by Type of Collateral

	Filing	Possession	Control	Automatic
Accounts	✓			✓ (if not a significant portion of accounts or a sale of lottery winnings)
Certificated Securities	✓	✓	✓	✓ (temporary or if secured party is the broker or securities intermediary)
Chattel Paper	✓	✓ (if tangible)	✓ (if electronic)	
Commercial Tort Claims	✓ ¹⁶			
Consumer Goods^{17 18}	✓ ¹⁹	✓		✓ (PMSI or security interest arising under Arts. 2 or 2A)
Deposit Accounts			✓	✓ (if secured party is the depository bank)
Documents of Title	✓	✓ (if tangible)	✓ (if electronic)	✓ (temporary)
Equipment^{17 18}	✓	✓		✓ (security interest arising under Arts. 2 or 2A)

¹⁶ A description only by type of collateral is insufficient in a financing statement. *See* § 9-108(e)(1).

¹⁷ Except for motor vehicles covered by a certificate of title statute. Perfection in such goods is accomplished by having the security interest noted on the certificate.

¹⁸ Except when a federal filing system preempts Article 9's filing system, such as when the collateral is aircraft, ships, copyrights or rolling stock.

¹⁹ A description only by type of collateral is insufficient in a financing statement with respect to a consumer transaction. *See* § 9-108(e)(2).

	Filing	Possession	Control	Automatic
Farm Products	✓	✓		✓ (security interest arising under Arts. 2 or 2A)
General Intangibles¹⁸	✓			
Goods Held By Issuer of Nonnegotiable Document	✓	✓ ²⁰		
Goods Held by Bailee	✓	✓ ²¹		
Health Care Insurance Receivables	✓			✓ (if granted to the health care provider)
Instruments	✓	✓		✓ (temporary; permanent for sales of promissory notes)
Inventory¹⁸	✓	✓		✓ (security interest arising under Arts. 2 or 2A)
Investment Property (other than Certificated Securities)	✓ ¹⁹		✓	✓ if secured party is the broker or securities intermediary)
Letter of Credit Rights			✓	
Money		✓		
Payment Intangibles	✓			✓ (if a sale)
Software¹⁸	✓	✓ (if embedded in goods)		
Supporting Obligations				✓

²⁰ Can be obtained by the bailee's receipt of notification of the secured party's interest. § 9-312(d).

²¹ Can be obtained by the bailee's authenticated acknowledgment that it holds for the secured party's benefit. § 9-313(c).

WHERE TO FILE A FINANCING STATEMENT

If a security interest is to be perfected by filing a financing statement in the appropriate state office, rather than by filing in a federal office, complying with a certificate of title statute, or taking possession or control of the collateral, then the secured party will need to know where to file. The following charts explain where.

Basic Rule: Subject to a few exceptions, in order to perfect a security interest by filing a financing statement, the financing statement must be filed in the jurisdiction where the debtor is "located."

Chart 6
Where to File – Exceptions to the Basic Rule

Type of Collateral	Where to File	Code Section
Goods subject to a fixture filing ²²	Jurisdiction where the goods are located	§ 9-301(3)(A)
Goods consisting of timber to be cut	Jurisdiction where the goods are located	§ 9-301(3)(B)
As-extracted collateral	Jurisdiction where the wellhead or minehead is located	§ 9-301(4)
Farm products (with respect to an agricultural lien)	Jurisdiction in which the farm products are located	§ 9-302

Caveat 1: One note of caution is in order. For transactions in intermediated securities that involve a choice between the laws of different nations, the UCC's choice-of-law rules are both reinforced and partially preempted by the Hague Convention on The Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary. The Hague Convention's rules can be triggered if, among other things, any of the parties to a securities account, the issuer of any of the securities credited to the account, or an adverse claimant to the securities is located in a different nation. They can also be triggered if the terms of the account agreement select as governing law the law of a nation other than the U.S. Consequently, a cautious lawyer must always proceed on the assumption that the Convention might apply, if not at the inception of a planned transaction, at least sometime thereafter.

²² A security interest in goods may be perfected by filing a financing statement where the debtor is located, even if that is not where the fixtures are located. A fixture filing is needed for additional priority protection.

For the most part, the Convention's rules are designed to work well with Article 9 and to point to the same state's or nation's law as Article 9 does. However, in some situations and for some transactions, the Convention might point to a different state's or nation's law. When it does, the Convention supersedes Article 9's choice-of-law rules pursuant to the Supremacy Clause in the U.S. Constitution. Familiarity with the Convention is therefore essential when seeking to perfect a security interest in investment property.²³

Location of the Debtor: For the purpose of the Basic Rule, the debtor's location depends upon the type of entity the debtor is.

Chart 7
Location of the Debtor

Type of Debtor	Location of the Debtor	Code Section
Individual (including a sole proprietorship) whose principal residence is in the United States	Jurisdiction of the individual's principal residence.	§ 9-307(b)(1)
Individual whose principal residence is not in the United States	If the debtor's principal residence is in a jurisdiction whose law affords public notice of security interests, the law of the jurisdiction of the individual's principal residence governs (and the secured party must comply with "perfection" requirements in that jurisdiction rather than file a financing statement under the UCC). If the foregoing is not applicable, the District of Columbia.	§ 9-307(b)(1), (c)
"Registered organization" organized under the law of a State ²⁴ of the United States	The State in which the organization is registered.	§§ 9-102(a)(71), 9-307(e)
"Registered organization" organized under the law of the United States	1. In the state that the law of the United States designates, if the law designates a state of location. 2. In the state that the registered organization designates, if the law of the United States authorizes the registered organization to designate its state of location. 3. In the District of Columbia, if neither paragraph (1) nor (2) applies.	§§ 9-102(a)(71), 9-307(f)

²³ For a brief discussion of the Convention, see Carl S. Bjerre and Sandra M. Rocks, *Say Hello to the Hague Securities Convention*, 7 THE TRANSACTIONAL LAWYER 1 (Feb. 2017).

²⁴ "State" includes the District of Columbia, Puerto Rico, the U.S. Virgin Islands, and any other territory or insular possession of the United States. § 9-102(a)(77).

Type of Debtor	Location of the Debtor	Code Section
Organization (other than a registered organization organized under the law of a State or of the United States)	<ol style="list-style-type: none"> 1. If the debtor has only one place of business and that place of business is in the United States, the jurisdiction of its place of business. 2. If the debtor has more than one place of business, and its chief executive office is in the United States, the jurisdiction of its chief executive office. 3. If the debtor's sole place of business or chief executive office, as applicable, is located in a jurisdiction whose law affords public notice of security interests, the law of the jurisdiction of the organization's sole place of business or chief executive office, as applicable.²⁵ 4. If none of the above is applicable, the District of Columbia. 	§§ 1-201(a)(25), (27), 9-307(b)(2) & (3), & (c)
A branch or agency in the United States of a bank that is not organized under the law of the United States or a State	<p>In the State in which the branch or agency is licensed, if all branches and agencies of the bank are licensed in only one state. If not all branches and agencies of the bank are licensed in only one state:</p> <ol style="list-style-type: none"> 1. In the state that the law of the United States designates, if such law designates a state of location. 2. In the state that the branch or agency designates, if the law of the United States authorizes the branch or agency to designate its state of location. 3. In the District of Columbia, if neither paragraph (1) nor (2) applies. 	§ 9-307(f) & (i)
Foreign air carrier under the Federal Aviation Act of 1958, as amended	The jurisdiction of the designated office of the agent upon which service of process may be made on behalf of the carrier.	§ 9-307(j)
United States	In the District of Columbia.	§ 9-307(h)
Unusual Situations	<p>A person that ceases to exist, have a residence, or have a place of business continues to be located in the jurisdiction specified by § 9-307(b) & (c) (<i>i.e.</i>, the general rules on location of debtor).</p> <p>A registered organization continues to be located in the jurisdiction specified by § 9-307(e) or (f) notwithstanding: (1) the suspension, revocation, forfeiture, or lapse of the registered organization's status as such in its jurisdiction of organization; or (2) the dissolution, winding or cancellation of the existence the registered organization.</p>	§ 9-307(d) & (g)

²⁵ In such a case, the secured party must comply with "perfection" requirements of that foreign jurisdiction, rather than perfect by filing a financing statement under the UCC.

Caveat 2: A non-U.S. forum might not be bound by the Article 9 choice-of-law rules outlined above. Thus, even though the Article 9 choice-of-law provisions point to the law of a state in the United States as the law governing perfection of a security interest – and thus provide, indirectly, where to file – a non-U.S. forum might reach a different conclusion and not recognize as effective any perfection obtained under the UCC. In addition, a transaction or debtor might not have sufficient contacts with any state or the United States to make the application of Article 9 appropriate. Therefore, in a transaction with contacts to a non-U.S. jurisdiction (e.g., a debtor or property located outside the United States) the requirements (including the choice-of-law rules) of the law of the other jurisdiction should also be reviewed.

Where within the Applicable State to File: In general, the financing statement should be filed in the central office designated for that purpose by the applicable state. § 9-501(a)(2). However, in cases involving certain realty-related collateral, the financing statement should be filed in a different office.

Chart 8
Exceptions to Centralized State Filing

Type of Collateral	Where to File	Code Section
As-extracted collateral or timber to be cut	The office designated for the filing or recording of a record of a mortgage on the related real property	§ 9-501(a)(1)(A)
The financing statement is filed as a fixture filing and the collateral is goods that are or will be fixtures	The office designated for the filing or recording of a record of a mortgage on the related real property	§ 9-501(a)(1)(B)
Transmitting Utility	The office designated by the applicable state	§ 9-501(b)

CONTENTS OF A FINANCING STATEMENT

Article 9 requires that a filed financing statement list the name of the debtor, the name of the secured party or its representative, and a description of the collateral. § 9-502(a). If the collateral consists of as-extracted collateral or timber to be cut, a financing statement that is to be filed as a fixture filing must also provide a description of the real property to which the collateral is related. § 9-502(b).

An error in any of this required information will potentially undermine the efficacy of the financing statement. The governing standard is in § 9-506(a), which provides that a financing

statement is effective despite minor errors or omissions if those error or omissions do not render the filing seriously misleading. However, there are more detailed rules with respect to an error in the debtor’s name. *See* § 9-506(b), (c). That is because the debtor’s name is most critical information in a financing statement. Financing statements are indexed under – and searched for by – the debtor’s name. An error in the debtor’s name can make the financing statement difficult or impossible to discover in response to a proper search. If it does, the financing statement, even though filed, is ineffective.

Article 9 has, for the most part, fairly simple rules on what the debtor’s name is. For a registered organization – that is, a corporation, limited liability company, or limited partnership – the debtor’s name is its registered name. That is, the name indicated in the organic documents filed with the state under whose law the organization is organized. *See* § 9-503(a)(1). Note, this might be different than the name that appears in a publicly searchable electronic database maintained by the Secretary of State’s office.

When the collateral consists of property held in trust, the rules for where to file a financing statement and what name to use for the debtor are slightly different. Some trusts, such as Delaware statutory trusts, are legal entities separate and distinct from their settlors, trustees, and beneficiaries, and under applicable law such a trust holds title to the trust estate.²⁶ Accordingly, when such a trust uses personal property as collateral for an obligation, the trust itself is the debtor for the purposes of Article 9, and any filing should generally be based on the location of the trust.²⁷ Other trusts, such as most common-law trusts, are not treated as distinct legal entities. Under applicable law, the trustee of such a trust holds legal title to the trust estate. In such cases, the trustee is the “debtor,” and filings should be based on the location of the trustee.

Oddly, the rules on what name to use for the debtor (when the collateral consists of property held in trust) – which themselves are rather complicated – are independent of whether the debtor is the trust or the trustee. *See* § 9-503(a)(3). The charts that follow – along with the answer keys for them – depict thirteen variations on how to complete and where to file a financing statement, based on the type of trust, type of trustee, and type of settlor.

²⁶ *See* Del. Code tit. 12, §§ 3801(a), 3805(f).

²⁷ *See* U.C.C. §§ 9-301, 9-307.

Chart 9
The Debtor's Name – Trustee is the Debtor

UCC 1 Financing Statement Box	Trust with a Name		
	Individual Trustee	Registered Organization Trustee	Organization (Not Registered) Trustee
Box 1a	A	A	A
Box 1b	N/A	N/A	N/A
Box 1c	C	C	C
Box 5	E	E	E
Box 10	N/A	N/A	N/A
Where to File	G	H	I

UCC 1 Financing Statement Box	Trust Without a Name					
	Individual Trustee		Registered Organization Trustee		Organization (Not Registered) Trustee	
	Individual Settlor	Organization Settlor	Individual Settlor	Organization Settlor	Individual Settlor	Organization Settlor
Box 1a	N/A	B	N/A	B	N/A	B
Box 1b	B	N/A	B	N/A	B	N/A
Box 1c	C	C	C	C	C	C
Box 5	E	E	E	E	E	E
Box 10	F	F	F	F	F	F
Where to File	G	G	H	H	I	I

Chart 10
The Debtor's Name – Trust is the Debtor

UCC 1 Financing Statement Box	Trust with a Name		Trust without a Name	
	Trust is a Registered Organization	Trust is Not a Registered Organization	Trust is Not a Registered Organization	
			Individual Settlor	Organization Settlor
Box 1a	A	A	N/A	B
Box 1b	N/A	N/A	B	N/A
Box 1c	D	D	D	D
Box 5	N/A	E	E	E
Box 10	N/A	N/A	F	F
Where to File	J	K	K	K

KEY			
A	Name of trust	G	Trustee's location, § 9-307(b)(1) or (c)
B	Name of settlor or testator	H	Trustee's location, § 9-307(e) or (f)
C	Mailing address of trustee	I	Trustee's location, § 9-307(b)(2), (b)(3), or (c)
D	Mailing address of trust	J	Trust's location, § 9-307(e)
E	Check first item (collateral is held in trust)	K	Trust's location, § 9-307(b)(2), (b)(3), or (c)
F	Information to distinguish debtor (whether trust or trustee) from other trusts with same settlor or trustee, § 9-503(a)(3)(A)		

Unfortunately, while only the debtor's name, the secured party's name, and a description of the collateral are necessary for a filed financing statement to be effective, other additional information is needed to prevent the filing office from rejecting a financing statement. *See* § 9-516(b). Such information includes the address of the debtor and the address of the secured party. Moreover, while an error in such information does not undermine the efficacy of a filed financing statement (*i.e.*, the financing statement remains effective against a subsequent lien creditor, such as the bankruptcy trustee), they can impair the filer's priority over a subsequent secured party or other purchaser. *See* § 9-338.

The filing office is not supposed to inspect submitted financing statements for errors, merely for omissions. If any of required information is missing, the filing office is supposed to reject the financing statement. However, to deal with the possibility of filing office error, Article 9 contains rules on what happens if the filing office improperly accepts a financing statement it should have rejected, *see* § 9-520(c), or improperly rejects a financing statement that it should have accepted, *see* § 9-516(d). The following chart summarizes these rules.

Chart 11
Effect of Errors in a Filed Financing Statement

Error	Efficacy if Filing Office Accepts the Financing Statement	Efficacy if Filing Office Rejects the Financing Statement
Missing Name of Debtor	Ineffective under § 9-502.	Ineffective. § 9-516(b)(3)(A).
Missing Name of Secured Party	Ineffective under § 9-502.	Ineffective. § 9-516(b)(4).
Missing Collateral Description	Ineffective under § 9-502.	Presumably ineffective. Efficacy under § 9-516(d) should be limited to the extent the filing would be effective under § 9-502 if accepted.
Missing Address for Debtor	Effective under §§ 9-502, 9-516(a), 9-520(c).	Ineffective. § 9-516(b)(5)(A).
Missing Address for Secured Party	Effective under §§ 9-502, 9-516(a), 9-520(c).	Ineffective. § 9-516(b)(4).
Incorrect Name of Debtor	Under §§ 9-502, 9-506(c), effective if disclosed in response to a proper search; otherwise ineffective.	Under § 9-516(d), effective against lien creditors but presumably only to the extent it would be effective under § 9-506 if accepted; ineffective against purchasers for value who relied on absence of record from files.
Incorrect Name of Secured Party	Should be accepted. Under §§ 9-502, 9-506(a), effective unless seriously misleading.	

Error	Efficacy if Filing Office Accepts the Financing Statement	Efficacy if Filing Office Rejects the Financing Statement
Incorrect Address for Debtor	Should be accepted. Generally effective, § 9-502, but under § 9-338 not against purchasers for value who reasonably rely on the incorrect information.	Under § 9-516(d), effective against lien creditors; ineffective against purchasers for value who reasonably relied on absence of record from files.
Incorrect Address for Secured Party	Should be accepted. Effective. § 9-502. § 9-338 does not apply because this is § 9-516(b)(4) information, not (b)(5) information.	

PERFECTION BY CONTROL

Control is a method of perfection for investment property, deposit accounts, letter-of-credit rights, electronic chattel paper, and electronic documents of title. *See* §§ 9-310(b)(8), 9-314. For deposit accounts and letter-of-credit rights as original collateral (*i.e.*, not as proceeds of other collateral), control is the exclusive method of perfection. *See* § 9-312(b). "Control" is defined differently for each of these types of collateral:

Perfection by Control	
Deposit Account	§ 9-104
Electronic Chattel Paper	§ 9-105
Investment Property	§§ 9-106 and 8-106
Letter-of-Credit Rights	§ 9-107

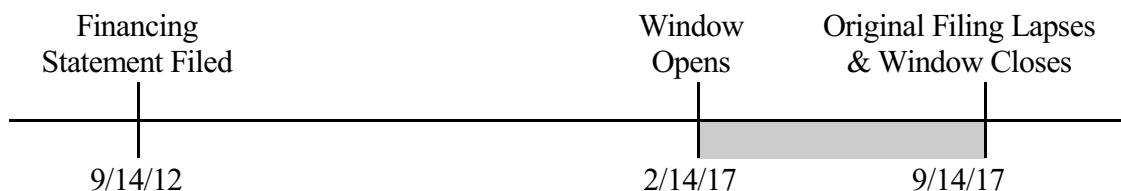
Control is a conceptual analog to possession for certain types of intangible collateral, property for which physical possession is impossible. Accordingly, many of the rules associated with it are the same as those for possession. Thus, just as possession can be through an agent, *see* § 9-313 cmt. 3, so too can control, *see* §§ 9-104 cmt. 3. Similarly, just as perfection by possession will be lost when the secured party relinquishes possession, control is sufficient to perfect a security interest only as long as the secured party retains control. *See* § 9-314(b), (c). More important, just as perfection by possession can occasionally provide a better priority than perfection by filing, a secured party can often obtain a better priority by perfecting through control than through some other permissible method. *See* §§ 9-327, 9-328, 9-329. Finally, a secured party in control of the collateral has many of the same rights and duties as a secured party in possession. *See* §§ 9-207, 9-208. One notable difference from the possession-based rules, however, is that a secured party can still have control over these types of assets even if the debtor has access to them. *See* §§ 9-104(b), 8-106(f).

With respect to deposit accounts, if the secured party is the depositary bank, it automatically has control. *See* § 9-104(a)(1). For a secured party that is not the depositary bank, there are only two methods for obtaining control: (i) enter into a control agreement with the depositary bank and the debtor; or (ii) become the depositary bank's customer on the deposit account. Nothing requires a depositary bank to enter into a control agreement, *see* § 9-342, and obtaining the assent of most banks has proven to be much more difficult than the drafters of revised Article 9 anticipated. Depositary banks want to ensure that their own rights are protected and that they will incur no liability to the secured party for their own errors or delays in complying with the secured party's instructions. Perhaps more important, they want to ensure that the control agreement does not interfere with their normal processes for posting credits and debits to a deposit account. To deal with this problem, an ABA Task Force produced a model deposit account control agreement, and commentary thereto, for use in commercial transactions involving a security interest in a deposit account.²⁸ This model is the product of much negotiation and is intended to be generally acceptable to both the lending community (specifically, their legal counsel) and the operational departments of depositary institutions. Nevertheless, most large banks have their own form control agreement and are reticent or unwilling to vary it or to use any other document.

For control of investment property, the method of control depends upon the type of investment property and the identity of the secured party.

MAINTAINING PERFECTION

With a few exceptions, financing statements are effective only for five years. *See* § 9-515(a). To maintain the efficacy of a financing statement for a longer period, the secured party must file an amendment constituting a continuation statement. *See* § 9-513. To be effective, a continuation statement must be filed within the last six months of the five-year efficacy period of the initial financing statement. For example, if a financing statement were filed on September 14, 2012, an effective continuation statement would need to be filed sometime between February 14, 2017 and September 14, 2017: the shaded area in the illustration below.



A continuation statement filed either before that six-month window opens or after it closes is ineffective. If a continuation statement is timely filed, the financing statement's effectiveness is extended for another five-year period from the date that the financing statement would have otherwise lapsed if not continued. Continuing with the example above, the financing statement

²⁸ *See* Joint Task Force on Deposit Account Control Agreements, *Initial Report of the Joint Task Force on Deposit Account Control Agreements*, 61 BUS. LAW. 745 (2006); Joint Task Force on Deposit Account Control Agreements, *Additional Report*, 64 BUS. LAW. 801 (2009).

would remain effective until September 14, 2022. The secured party may extend the financing statement's effectiveness indefinitely by filing a new continuation statement every five years (in the six-month window).

Other events occurring after a financing statement is filed to perfect a security interest can impact the efficacy of the financing statement or otherwise make it desirable to update the public record. Article 9 therefore contemplates several different types of filings. The following charts describe those types of filings and indicate when a change to the public record is necessary to maintain perfection.

Chart 12
Types of Filings

Type of Filing		Code	When Needed
Financing Statement		§ 9-502	At conception of deal
Amendment	Continuation Statement	§ 9-515	To continue effectiveness of filing beyond five years
	Termination Statement	§ 9-513	When secured obligation has been fully satisfied; to remove cloud from title
	Other	§ 9-512	To change a name or address; to add or release collateral; to assign the filing

Chart 13
Changes in Collateral Affecting the Validity of a Financing Statement

	Change in How the Collateral is Used	First Generation Non-cash Proceeds (i.e., a trade)	Proceeds Acquired with Cash Proceeds
Change does not affect the description of the collateral or the perfection method	No new filing is needed.	No new filing is needed.	No new filing is needed.
Change affects the description of the collateral (i.e., its classification)	No new filing is needed, § 9-507(b).	No new filing is needed, § 9-315(d).	New filing is needed within 20 days, § 9-315(d).
Change affects the method of perfection	New action is needed immediately. See § 9-311.	New filing is needed within 20 days, § 9-315(d).	New filing is needed within 20 days, § 9-315(d).

Chart 14
Changes in the Debtor Affecting the Validity of a Financing Statement

	Debtor Name or Location Change	Sale or Trade (collateral with new owner)
Change does not render the filing seriously misleading	No new filing is needed	N/A
Change makes the filing seriously misleading	Filing is needed to remain perfected in collateral acquired more than four months after change, § 9-507(c).	No new filing is needed, § 9-507(a).
Change affects the governing law (makes a new jurisdiction the place to file against the collateral)	New filing is needed within four months, § 9-316(a)(2), (h).	New filing is needed within one year, § 9-316(a)(3).

Chart 15
Perfection in Collateral Following a Reorganization of the Debtor

	Transferred Assets	Assets Owned by New Debtor Before Reorganization	Assets Acquired by New Debtor After Reorganization
Attachment	Yes, generally. § 9-315(a)(1).	Determined by non-Code law. § 9-203(d), (e).	
Perfection if new entity is located in same jurisdiction as original debtor	Yes. § 9-507(a)	Yes. § 9-508	Yes, if filing is not seriously misleading. If filing is seriously misleading, effective only as to collateral acquired within four months after reorganization. § 9-508.
Perfection if new entity is located in different jurisdiction than original debtor	Yes, for one year. § 9-316(a)(3)	New filing is needed within four months. § 9-316(i).	

SEARCHING FOR EXISTING LIENS

Any search for perfected security interests must begin by ascertaining all the methods in which a such a security interest could be perfected. It must also take into account all the events that might have occurred after such a security interest was perfected, and whether the security interest could remain perfected despite those events.

In addition to searching for perfected security interests, prospective buyers and lenders also need to search for other liens that might encumber the collateral. For most types of property, the list of possible liens is extensive. The one that is probably of greatest concern is a federal tax lien, which attaches upon "assessment" to all real and personal property of the taxpayer.

The federal tax lien is very powerful; it takes priority over many other encumbrances, including security interests. Pursuant to 26 U.S.C. § 6323(a), however, that priority does not kick in unless and until the IRS files a notice of federal tax lien in accordance with 26 U.S.C. § 6323(f). This notice, which is analogous to a financing statement, "must identify the taxpayer." Treas. Reg. § 301.6323(f)-1(d)(2).

Most courts construing this requirement have adopted a "constructive notice" approach as the general rule. Under this approach, a notice is effective if the name of the taxpayer on it is sufficient for a third party searcher to find the notice and understand that it might relate to the taxpayer.²⁹ This approach is somewhat similar to Article 9's "seriously misleading" standard. *See* § 9-506(a). However, it lacks the clear rules in § 9-506(b)–(d) that require a filed financing statement to either have the debtor's correct name or be retrieved pursuant to a search under the correct name.

There are some significant implications that flow from this. In most states, a notice of a federal tax lien is to be filed in the same office as the UCC records and indexed with them. However, a searcher who, in reliance on revised § 9-506(b)–(d), searches only under the debtor's correct name might not discover a filed notice of tax lien that has a slight error in the debtor/taxpayer's name. Nevertheless, such a notice might still be effective. For example, the United States Court of Appeals for the Sixth Circuit has ruled that a notice of tax lien that used common abbreviations for parts of the taxpayer's name was effective.³⁰

Beyond this, searchers must be careful about where they search for notices of tax liens. Tax lien notices are to be filed in the state in which the taxpayer's property is located. Personal property is then deemed located at the residence of the taxpayer.³¹ While the combination of these rules makes the place to file and search for notices of tax liens appear similar to that for most Article 9 financing statements, in fact the office might be different for any or all of the following three reasons: (i) a taxpayer's residence is not necessarily in the same jurisdiction as a debtor's location under § 9-307; (ii) the relevant office within the state of the taxpayer's residence might be different from the office in which UCC records are filed; and (iii) notices of tax liens might be kept in a database or indexing system separate from UCC records even if filed within the same office.

For example, for purposes of filing a notice of tax lien, a corporate or partnership taxpayer is deemed to reside where its principal executive office is located.³² This is not necessarily the state where that entity is deemed located for Article 9 purposes. *Cf.* § 9-307. Within a particular state, the state might have designated an office other than the secretary of state's office to file notices of

²⁹ *See In re Hudgins*, 967 F.2d 973 (4th Cir. 1992).

³⁰ *In re Spearing Tool and Mfg., Co.*, 412 F.3d 653, 656-57 (6th Cir. 2005), *cert. denied*, 549 U.S. 810 (2006). The court did distinguish earlier decisions that involved searches using a paper index, on which entries with misspellings could nevertheless readily be discovered. The court seemed to recognize that such decisions are inapposite to electronic searches of a computer database. This suggests that while the Sixth Circuit was willing to impose on creditors the burden of searching under the finite number of possible *abbreviations* of the debtor's name, it would not compel them to search against the infinite number of possible *misspellings*. *Id.* at 656. *Cf.* *In re Crystal Cascades Civil, LLC*, 398 B.R. 23 (Bankr. D. Nev. 2008), *aff'd*, 415 B.R. 403 (9th Cir. BAP 2009) (making similar observations and ruling that a notice of tax lien against Crystal Cascades Civil, LLC that omitted the word "Civil" was ineffective).

³¹ 26 U.S.C. § 6323(f).

³² *See* 26 U.S.C. § 6323(f)(2).

tax liens or the state might have failed to designate the office, in which case the designated office is the United States District Court clerk's office for the judicial district where the property is located.³³ Even if the same office is designated by the state, such as the secretary of state's office, the secretary of state might maintain two different databases, with separate types of search logic, for tax liens and financing statements.

It is also worth noting that the federal statutes that preempt the UCC filing system in favor of a federal filing, such as those for copyrights and aircraft, do not apply to notices of tax liens.³⁴ Thus, a notice of federal tax lien filed in the appropriate state office will be effective as to the types of property otherwise covered by a central, federal filing system for all types of assignments, including security interests. Moreover, 26 U.S.C. § 6323(f) does not require the IRS to take any action to file a new notice if the debtor moves or changes its name and the cases are not consistent in deciding whether the IRS has to do anything to maintain the effectiveness of its filing. Accordingly, to be safe, it is wise to assume the IRS has no such duty and that notice of tax lien will continue to be effective once it is filed in the correct place.

³³ See 26 U.S.C. § 6323(f)(1)(B). Massachusetts is apparently the only state that has not designated a state office in which to file notices of federal tax liens. *Cf.* Mass. Gen. Laws ch. 36, § 24 (apparently dealing only with real property). As a result, such notices are to be filed with the Clerk of U.S. District Court. See *SSG, Inc. v. Omni Medical Health & Welfare Trust*, 71 A.F.T.R.2d ¶ 93-2022, 93-1 U.S.T.C. ¶ 50,353 (D. Mass. 1993); *In re Tourville*, 216 B.R. 457 (Bankr. D. Mass. 1997); Rev. Rul. 85-89, 1985-2 I.R.B. 18, 1985-2 C.B. 326.

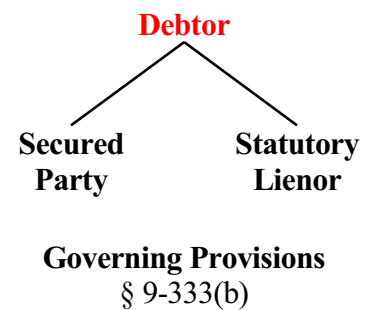
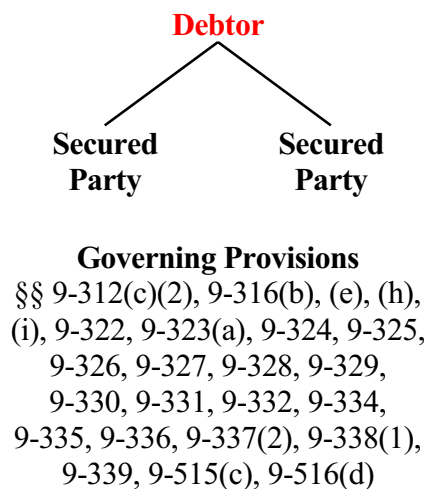
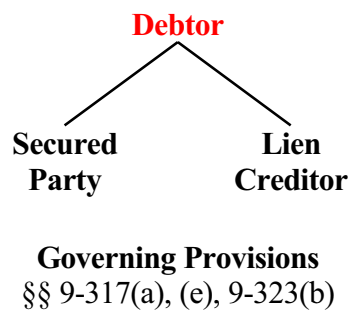
³⁴ See 26 U.S.C. § 6323(f)(5).

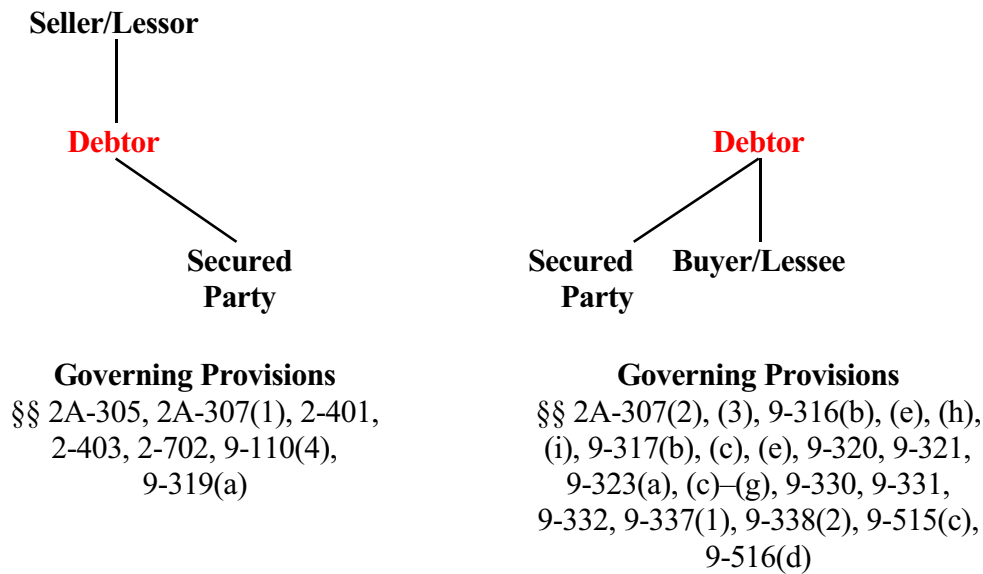
PRIORITY

Article 9 has dozens of different priority rules, most of which are located in Subpart 3 of Part 3. §§ 9-317–9-339. *See also* §§ 9-110(4), 9-312(c)(2), 9-316(b), (e), 9-340, 9-515(c), 9-516(d). Most of these rules are easy to understand and apply. The main “trick” to resolving a priority conflict is to ascertain which rule or rules apply (yes, more than one rule can govern a single dispute). For the most part, this depends on six factors:

- Whether, when and how the secured party perfected.
- What type of entity the competing claimant is (*see* charts that follow).
- Whether one or both interests is a purchase-money security interest.
- Whether the secured obligation includes future advances.
- The type of property involved (*e.g.*, goods, chattel paper, deposit accounts).
- Whether property has been commingled or become an accession or fixture.

The two most important factors are the type of property involved and the type of competing claimant. The competing claimant might be another entity with a lien – either a judicial lien, consensual lien (*i.e.*, a security interest), or statutory lien – or it could be someone either further up or down the chain of title. These variations are depicted in the diagrams below and on the next page. In these diagrams, a diagonal line represents a contingent claim to the collateral (*i.e.*, a lien, for which many of the rights are conditioned on default) and a vertical line represents a noncontingent transfer of ownership rights (*e.g.*, a sale, lease, or gift).





Note, some of the rules are expressed in terms of the rights of a “purchaser.” Be aware that a purchaser can be a buyer, a donee, or a secured party. *See* § 1-201(b)(29), (30). Also be aware that sometimes other law – such as federal law – applies and can affect or determine priority.

The most important rules with respect to disputes between secured parties – the default rules when nothing more specific applies – are all contained in § 9-322(a). That section has three priority rules, which are best explored in reverse order of their presentation in the statute. Subsection (3) provides that if the conflicting security interests are unperfected, priority goes to the first to attach. This rule is simply a codification of the “first in time, first in right” principle. The priority rule of subsection (2) is a major deviation from that principle, but not one which should be surprising. It grants priority to a perfected security interest over an unperfected one.

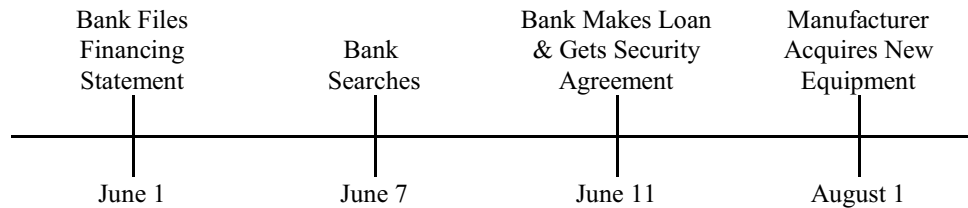
The final and most important rule in § 9-322(a) is in subsection (1), which governs the priority of two or more perfected security interests. It provides that the security interest first perfected or as to which a financing statement is first filed will have priority. This is known as the “first-to-file-or-perfect” rule. The security interest that is first in priority under that rule will win the priority contest as long as there is no time thereafter when there is neither a filing covering the collateral nor perfection of the security interest.

The reason why subsection (1) does not simply give priority to the first to perfect lies in the mechanics of the filing system. If the rule were first to perfect, there would be no way for a secured lender to be assured of its priority. No matter how early on it filed, its priority would not be established until it made the loan and its security interest attached. Given that there will always be some time lag between searching for prior liens and actually making the loan (and typically the security interest will not attach and thus cannot be perfected until the loan is made), there would always be the risk that another creditor could sneak in and perfect during that interval. Under the first-to-file-or-perfect rule, filing preserves a creditor’s place in line (sort of like having a friend save you a seat at the movie theater or a place in the supermarket checkout line). A lender may file when

the debtor first inquires about a loan,³⁵ leisurely conduct a search of the filing office to ensure its filing is first in time, and then, whenever it later chooses, make the loan and acquire its security interest.

Because the first-to-file-or-perfect rule sets the priority for security interests that attach after the financing statement is filed, it implicitly also sets the priority for security interests in after-acquired property. Consider the following example.

In late May, Manufacturer approaches Bank for a loan to modernize its main manufacturing facility. On June 1, Bank files a sufficient financing statement against Manufacturer in the correct location, listing equipment as the collateral, which Manufacturer has authorized Bank to do in an authenticated record (perhaps in the loan application). On June 7, Bank conducts its search of the UCC records. That search reveals Bank's own filing and no others against Manufacturer. On June 9, Bank approves the loan and so notifies Manufacturer. On June 11, Manufacturer authenticates a security agreement granting Bank a security interest in all of Manufacturer's existing and after-acquired equipment in return for a \$1 million loan, which Bank advances that day. On August 1, Manufacturer acquires some new equipment.



Bank's priority in the equipment Manufacturer acquired before Bank made the loan and Bank's priority in the equipment Manufacturer acquired on August 1 is the same. For all of the equipment, Bank's priority dates from when it first filed its sufficient financing statement: June 1. This is so even though Bank's security interest in the equipment Manufacturer acquired on August 1 did not attach (and was not perfected) until August 1.

³⁵ See § 9-502(d) (permitting filing before attachment).

ENFORCEMENT

DEFAULT

Article 9 conditions many of the secured party's enforcement rights upon the existence of a "default." However, Article 9 does not define "default." *Compare* §§ 9-601(a), 9-607(a), 9-609(a). Instead, what constitutes a default is governed by the parties' security agreement or loan agreement. Accordingly, drafting a default clause is very important. Part of the transactional attorney's job in defining default is to imagine all the things that could go wrong as the transaction continues into the future. Most obviously, the debtor could fail to make payments as required on the obligation. Thus, failure to pay in accord with the agreement is almost invariably included in the definition of default. But many other things could go wrong or circumstances could arise to increase the risk that the secured party will not be repaid. Perhaps the collateral value will depreciate or the debtor will dispose of the collateral so that, if the debtor later fails to pay, the value of the collateral will not be sufficient to satisfy the loan amount. Perhaps the collateral will become encumbered with a lien that has priority over secured party's security interest. If the debtor is operating a business, a change in management or ownership might affect the debtor's ability or willingness to pay. Accordingly, most security agreements, particularly those that secure commercial loans, have a very robust definition of default.

Some enforcement rights are available not only upon default but also whenever the debtor and the secured party so agree. Chief among these is the right to collect on collateral. *See* § 9-607(a). Thus, for example, a debtor who grants a security interest in accounts might authorize the secured party to collect accounts even prior to default. A secured party might want this authority for any of the following reasons:

- It keeps the secured party informed about who the account debtors are, how to contact them, and what they owe – information that would be essential but perhaps difficult to acquire after default.
- It allows the secured party to monitor the collectability and genuineness of the accounts – facts that might be particularly important if the secured party is relying on the new receivables when making additional advances.
- It helps protect against a loss of priority by protecting against dissolution of the proceeds – if, for example, the debtor uses the proceeds of collection to pay employee, taxes, or other creditors.

Moreover, if the secured transaction is a sale of receivables, default is not a particularly relevant concept, and the secured party should be authorized to collect the receivables.

METHODS OF ENFORCEMENT

Article 9 provides three different methods for a secured party to foreclose a security interest.³⁶ The principal method is through a disposition: that is, a sale, lease, or license of the collateral. *See* § 9-610. A disposition may be by public sale – that is, an auction – or by private sale (anything other than an auction). The one critical requirement is that all aspects of the disposition must be commercially reasonable. *See* § 9-610(b).

A second method, used somewhat rarely, is “acceptance” of the collateral in full or partial satisfaction of the secured obligation. This method, colloquially referred to as “strict foreclosure,” requires the debtor’s consent after default. *See* §§ 9-620, 9-621.

The final method, which applies when the collateral consists of an obligation owed to the debtor (*e.g.*, accounts, chattel paper, instruments, or payment intangibles), is collection. *See* § 9-607. In essence, the secured party simply instructs the account debtor or other person obligated on the collateral to make payment directly to the secured party.

DEFENSES TO COLLECTION

Under general principles of contract law, the rights of a contract assignee are no better than the rights of the assignor. Thus, an assignee takes subject to all defenses that the counter-party would have against the assignor.³⁷ The rules in Article 9 are the same. *See* § 9-404(a)(1). Thus, the account debtor may assert against the secured party any defense to payment the account debtor could assert against the debtor.

In addition, the account debtor may also set off against its obligation to the secured party any other claim it has against the debtor which arose prior to the account debtor’s receipt of notification of the assignment. § 9-404(a)(2). For example, if the debtor sold a tractor on credit to the account debtor, and the debtor’s secured party seeks to enforce that obligation, the account debtor could assert any defense to payment arising from the tractor sale (such as if the tractor were defective, giving rise to a right to reject or revoke acceptance of it), regardless of whether that arose before or after the account debtor learned of the assignment. The account debtor could also use as a defense to payment any claim it has against the debtor arising out of a completely separate transaction that arose before the account debtor learned of the secured party’s interest in its obligation. Note, the distinction between defenses to payment and claims arising out of separate transactions is much like the difference between compulsory and permissive counterclaims.

³⁶ In addition, the secured party has the right to repossess or replevy tangible collateral. *See* § 9-609. That right, while occasionally important, is usually merely a precursor to one of the other enforcement methods. Acquiring possession and control does not, by itself, enable the secured party to extract value from the collateral.

³⁷ *See* Restatement (Second) of Contracts § 336.

ANALYTICAL APPROACH TO ARTICLE 9 ISSUES

Because issues about priority almost always require first an analysis of perfection, and issues of perfection require that attachment first be determined, most priority issues and many other issues under Article 9 should follow the same systematic analysis, outlined below.

1

IDENTIFY THE COLLATERAL

All analysis is collateral-specific: a secured interest might attach to some items of property but not to others. Similarly, a security interest might be perfected in some items but unperfected in others. Isolate each item of collateral in order to consider the issues for that type of collateral.

2

CLASSIFY THE COLLATERAL

See § 9-102

For each item of collateral identified in Step 1, determine why type of collateral it is by connecting it to the applicable Article 9 definition. With respect to goods, first determine how the debtor is using them (or, if the debtor is about to purchase them, how the debtor plans to use them). With respect to rights to receive money, consider the definitions of accounts, instruments, chattel paper, and general intangibles. Remember also that what appears to be one obligation might in fact be several (*e.g.*, the purchase price, sales taxes, and freight charges).

3

DETERMINE WHETHER ARTICLE 9 APPLIES TO THE COLLATERAL

See § 9-109

For each item of collateral, determine whether a security interest in that item is within the scope of Article 9. For example, most but not all security interests in accounts are subject to Article 9. Compare § 9-109(a) with (d)(4), (5), (6), (7). If Article 9 does not apply, the creditor might still be able to acquire a consensual lien on the property, but Article 9 will not indicate how to get it, how to perfect it (if the term perfection has any meaning outside of Article 9), or how to enforce it. The creditor will have to consult other statutes or the common law, which might provide little guidance.

4

DETERMINE IF AND WHEN ATTACHMENT OCCURRED

See §§ 9-109(a), 9-203, 9-204, 1-204, 9-102(a)(74)

Attachment requires: (i) that the debtor have rights or the power to convey rights in the property; (ii) value (typically an extension of credit constituting the secured obligation); and (iii) a security agreement. The security agreement typically must be authenticated by the debtor but form does not matter; conditional sales contracts as well as some leases and other transactions create security interests. Identify and resolve ambiguities in the security agreement's description of the collateral. Remember, a security interest cannot attach to property before the debtor acquires rights in it.

5

DETERMINE WHICH STATE'S LAW GOVERNS

See §§ 9-301 through 9-307; § 9-316

Revised § 1-301 generally permits parties to select their own governing law, but not with respect to perfection issues. With regard to perfection by any method, the Article 9 rules control which state's law govern. If perfection is by filing, Article 9 controls which state's law governs the filing, for both filing and searching.

6

DETERMINE HOW TO PERFECT

See §§ 9-309 through 9-314

Depending on several factors, principally the type of collateral involved, perfection may be by: filing, *see* § 9-310; possession, *see* § 9-313; compliance with a certificate of title statute or national registration system, *see* § 9-311; control, *see* § 9-314; or automatic, *see* §§ 9-309 & 9-312(e)-(h). Note, even if a creditor has alternative ways to perfect, one method might produce a better priority than the other methods

7

IF PERFECTING BY FILING, DETERMINE WHERE TO FILE

See § 9-501

Go to § 9-501, as enacted in the state whose law governs perfection. It will identify the office in which to file. For the most part, that will be the secretary of state's office. For fixtures, a central filing is adequate but filing a fixture filing in the office in which local real estate records are filed is necessary for a high priority as against someone who has an interest in fixtures that is governed by real estate law. *See* § 9-334.

8

EVALUATE CONTENTS OF ANY FILING

See §§ 9-502 through 9-510, & 9-516

A filing must contain the names of the debtor and the secured party as well as a description of the collateral. § 9-502(a). Other information, if missing, will prompt the filing office to reject the filing. § 9-516(b). The debtor's name is the most important, *see* § 9-503, but minor errors that are not seriously misleading will not invalidate a filing, *see* § 9-506.

9

EVALUATE THE CONTINUITY OF PERFECTION

See §§ 9-315, 9-316, 9-507 & 9-515

If perfection is by filing a financing statement, most filings are effective for only five years. A continuation statement must be filed in the six months prior to expiration of the five-year period to maintain continuous perfection for another five-year period. *See* § 9-515. Other post-filing events might render a security interest unperfected. *See, e.g.,* § 9-507. The most important events are when the collateral is transferred to a new owner, causing the governing law to change, *see* § 9-316(a), and when the security interest attaches to proceeds. When proceeds are involved, revisit the first five steps of this chart (in other words, because new property is involved, start the analysis over). Then, with respect to the efficacy of any existing filing, apply the rules in § 9-315(c), (d). If perfection is by a non-filing method, subsequent events may also cause the loss of perfection. *See* §§ 9-313, 9-314.

10

**CLASSIFY THE COMPETING CLAIMANT AND
IDENTIFY THE MAIN PRIORITY RULES FOR THAT CLAIMANT**

See §§ 1-201(b)(9), (29), (30), 9-102(a)(52)

The competing claimant might be a lien creditor, a buyer, a purchaser, a holder in due course, or a secured party. A buyer might or might not qualify as a buyer in ordinary course of business. Both buyers and secured parties also qualify as purchasers. The classification of the competing claimant is the most important factor in isolating the correct priority rule. The rights of a lien creditor are governed mostly by § 9-317. The rights of a holder in due course are protected by § 9-330. The rights of buyers are governed mostly by §§ 9-317, 9-320 & 9-331. The rights of a secured party are governed by § 9-322(a) subject to numerous exceptions, as set forth in Steps 11 through 13.

11

DETERMINE THE EXTENT TO WHICH ANY INTEREST IS A PMSI

See §§ 9-103, 9-317(3) & 9-324

For each secured party, determine the extent, if any, that its interest qualifies as a PMSI. In this respect, note that it might be that only some – but not all – of the collateral constitutes purchase-money collateral. Similarly, it might be that only some – but not all – of the secured obligation qualifies as a purchase-money obligation.

12

DETERMINE THE EXTENT TO WHICH THE SECURED OBLIGATION INCLUDES FUTURE ADVANCES

When dealing with two (or more) secured parties, it rarely matters the extent to which either secured obligation includes future advances. *See* § 9-323 cmt. 3. When dealing with a buyer or lien creditor, however, it is very common for the secured party to have priority with respect to some portion of the secured obligation but to lose that priority with respect to some or all advances made after the competing claimant acquired its interest. *See* § 9-323(b), (d).

13

CHECK FOR "SPECIAL" PRIORITY RULES

See §§ 9-325 through 9-339

Some types of collateral are subject to special priority rules. These include: deposit accounts, *see* § 9-327; investment property, *see* § 9-328; instruments and chattel paper, *see* §§ 9-330 & 9-331; certain proceeds, *see* § 9-322(c)-(e); fixtures and crops, *see* § 9-334; accessions, *see* § 9-335; and commingled goods, *see* § 9-336. Other important special rules cover claimants whose interests were created at different levels in the chain of title, *see* § 9-325, and the rights to money coming out of a collateralized deposit account, *see* § 9-332.

