Publicity in secured transactions law: Towards a European public notice filing system for non-possessory security rights in movable assets?

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Chapter 5

U.S. secured transactions law with regard to movable assets
"(…) if you want to understand Revised Article 9, don't read it."

Scott J. Burnham

1. Introduction

1.1. General

American commercial law is set forth in the Uniform Commercial Code ('UCC'). The UCC is one of the many uniform acts established by the National Conference of Commissioners on Uniform State Laws ('NCCUSL') and the American Law Institute ('ALI'). First published in 1951, the UCC is divided into 11 articles that address the core subjects of commercial private law:

- Article 1: General Provisions
- Article 2: Sales
- Article 2a: Leases
- Article 3: Negotiable Instruments
- Article 4: Bank Deposits and Collections
- Article 4a: Funds Transfers
- Article 5: Letters of Credit
- Article 6: Bulk Sales
- Article 7: Warehouse Receipts, Bills of Lading and Other Documents of Title
- Article 8: Investment Securities
- Article 9: Secured Transactions; Sales of Accounts and Chattel Paper

1 The NCCUSL is a state-supported, non-profit organization that drafts and promotes the enactment of uniform state laws, called 'Uniform Acts', in areas of state law where uniformity is needed. NCCUSL members must be members of the bar. According to its website the NCCUSL "provides states with non-partisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law."

See <uniformlaws.org> (last visited February 5, 2014). Officially, the Uniform Law Commission ('ULC') does the drafting of the state laws, and its sponsor, the NCCUSL approves these drafts. Because of their close connection, however, the NCCUSL and the ULC are often lumped together, i.e. the names are used interchangeably. Hereafter, 'NCCUSL' will be used only to refer to (either of) both.

2 The ALI is similar to NCCUSL. According to its website it is 'the' leading independent organization in the U.S. that produces scholarly work to clarify, modernize, and otherwise improve the law. Moreover, its website provides: "The Institute (made up of 4,000 lawyers, judges, and legal scholars of the highest qualifications) drafts, discusses, revises, and publishes Restatements of the Law, model statutes, and principles of law that are enormously influential in the courts and legislatures, as well as in legal scholarship and education."

See <www.ali.org> (last visited February 5, 2014).

3 For information on the several modifications and enactments of the UCC since 1951, see e.g. Kelly & Puckett 1995, p. 287 et seq., the Uniform Commercial Code, Official Text and Comments 2004 (West), p. III and Harris & Mooney 2006, p. 4.
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The UCC’s principal aim is to provide uniformity in business laws in the United States. It functions as a ‘model law’ for all 50 states: each state can choose to incorporate the UCC in its local state law. Hence, the UCC does not have actual force of law: each state is permitted to make changes to this model law before it is incorporated. Because every state that has adopted the UCC with minor changes, it is commonly held that the UCC has indeed achieved uniformity.4

Article 9 UCC deals with the law on secured transactions.5 Contrary to what the UCC’s name might suggest, the scope of Art. 9 UCC is not limited to dealings between commercial parties; it covers all types of creditors and all types of debtors. Its main objective is to facilitate transactions between market parties who engage in secured financing, by making this type of financing more uniform, efficient, and flexible, thus more accessible. This is achieved by providing a uniform set of market-oriented rules to regulate core issues in secured transaction law. Most importantly, these rules address the creation of security rights, their effect against third parties and priority issues between the different types of creditors.6

1.2. Background

1.2.1. Background of Art. 9 UCC

Prior to the adoption of Art. 9 UCC, a bewildering number of security devices existed.7 The common devices included: right of pledge, chattel mortgage, conditional sale, trust receipt, factor’s lien8 and assignments of accounts receivable.9 Different bodies of law

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4 Two nuances should be made with regard to this ‘uniformity’. First of all, Art. 1 UCC provides some general guidelines and terms that apply throughout the whole UCC and therefore also to Art. 9 UCC, whereas only 37 states have enacted the Revised Art. 1 UCC. Furthermore, many contracts have been implemented under former versions of Art. 9. UCC, which has led to case law still under litigation. However, the basic concepts of both versions of Art. 9 UCC are considered to have remained unchanged. Moreover, in the 2010 amendments to Art. 9 UCC, transition provisions (§§ 9-801-809 UCC) were adopted to address transition problems of this kind. This thesis will take the model law as a basis for description; particular changes made by the states will be ignored.

5 An electronic version of Art. 9 UCC can be found on the website of the Legal Information Institute of the Cornell University Law School <www.law.cornell.edu/ucc/9> (last visited February 5, 2014).


7 Cf. Livingston 2007, p. 111: “Before Article 9, personal property secured transactions were governed by a myriad of state laws.”

8 In U.S. secured transaction law, the term ‘lien’ generally refers to a wide-ranging variety of encumbrances on the debtor’s property. Both ‘consensual liens’, such as a security right or a mortgage, and ‘non-consensual liens’, such as a tax lien, are covered by the term ‘lien’. For more information on the ‘factor’s lien’ specifically, see Adams et al 1995, p. 886.

9 Official Comment 1 to § 9-101 UCC. It is beyond the scope of this thesis to elaborate on the features of these different devices, but in a nutshell the following might be noteworthy. The right of pledge was the most basic form of a security right; like the German ‘Faustpfand’ the pledgee was required to take possession of the collateral. The chattel mortgage was a security device that was adopted for reasons comparable to those for the adoption of fiduciary transfer in the Netherlands, as both were a response to the need for a non-possessory security right after the Industrial Revolution. The conditional sale was a kind of ‘retention of title device’ as it comprised a sale and delivery to the buyer of the movable asset under the condition that the buyer would not obtain title in the assets until and unless the buyer paid the
covered these several devices with the result that the scope and the procedures for their validation and enforcement were very complex and unclear. An important reason to introduce Art. 9 UCC was to create uniformity:

“(…) differences between one device and another persisted, in formal requisites, in the secured party’s rights against the debtor and third parties, in the debtor’s rights against the secured party, and in filing requirements, although many of those differences no longer served any useful function.”

Not only the diversity of security devices in and of itself was considered to be a problem; the fact that many security rights did not have to be publicly filed also encountered much criticism. A majority of American legal scholars criticized the idea of ‘secret liens’, which was an important reason for supporting the adoption of a uniform public notice filing system. This thesis focuses on the current (2010) version of Art. 9 UCC.

Since its adoption, Art. 9 UCC has been revised several times. The most significant revision took place in 1972 (‘Art. 9 (1972) UCC’), 2001 (‘Art. 9 (2001) UCC’) and – less far reaching – in 2010 (‘Art. 9 (2010) UCC’ or ‘Art. 9 UCC’). All revisions had been prompted by commercial practice needs. The 1972 revision did not affect the basic structure of Art. 9 UCC, but the 2001 UCC revision – the result of a decade of work – did, since it encompassed an expansion of the types of property to be secured under purchase price. For more information on the several pre-Art. 9 UCC devices, see Adams et al 1995, p. 883-889, White & Summers 2002, § 30-1 and Harris & Mooney 2006, p. 87.


11 Official Comment 1 to § 9-101 (1999) UCC. Dana mentions a few examples of this ‘non-uniformity’:

“An unfiled chattel mortgage was by the law of many states “void” against creditors generally; a conditional sale, often available as a substitute for the chattel mortgage, was in some states valid against all creditors without filing, and in states where filing was required was, if unfiled, void only against lien creditors”, and: “The recognition of so many separate security devices had the result that half a dozen filing systems covering chattel security devices might be maintained within a state, some on a country basis, others on a state-wide basis, each of them had to be separately checked to determine a debtor’s status.”


12 See e.g. Lipson 2004, p. 425, footnote 10: “(…) are secret liens universally castigated”. See Lipson for further references. Karl Llewellyn, the Chief Reporter of the UCC described a secret lien as ‘that rat in Denmark’. Llewellyn 1939, p. 730.

13 Except where otherwise indicated, references to provisions of Art. 9 UCC are to the 2012 version (that is, after giving effect to the 2010 amendments), though it should be noted that – except the provisions on filing – most other provisions have not been altered since its introduction in 2001. References to prior versions of Art. 9 UCC will indicate the year of that particular version in parentheses.

Art. 9 UCC and at the same time, contained several new priority and perfection rules. The 2010 amendments most importantly addressed filing issues that had been experienced since the adoption of Art. 9 (2001) UCC; it did not affect Art. 9 UCC’s basic structure and also much of the terminology has remained unchanged. At present, Art. 9 (2010) UCC has been enacted in all states. The effective date of adoption by all states was July 1, 2013.

A few basic elements of U.S. property law will be provided in the subsection 1.2.2 before continuing further with an explanation of Art. 9 UCC.

1.2.2. Basic elements of U.S. property law

U.S. property law distinguishes between real rights (rights in rem) and personal rights (rights in personam). The first category carries the distinction further to include movable (tangible and intangible) property (commonly referred to as ‘personal property’) and immovable property (‘real property’). Art. 9 UCC covers security rights that take the form of rights in rem in personal property and fixtures; guarantees and other personal rights fall outside the scope of Art. 9 UCC.

The U.S. concept of ownership differs from the classic civil law definition. While both systems recognize ownership held in common, under U.S. law each of the co-owners is regarded as the owner of an individual fractional interest in the property. Furthermore, the right of ownership in property is regarded as a so-called ‘bundle of rights’, the underlying idea is that every such right can be individually conveyed to a third party.

An example of this would be the conveyance of powers that go with the exercise of a limited right or with the grant of a lease: in the latter case the lessee ‘owns’ the right to

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15 In a nutshell the 2001 revision entailed a modernization, fine-tuning and clarification of ambiguities in Art. 9 UCC. Due to its magnitude, the promulgation of Art. 9 (2001) UCC was postponed until July 1, 2001. All states had adopted this version by the end of 2006. For more information about the most significant changes made to Art. 9 (2001) UCC compared with Art. 9 (1972) UCC see Official Comment 4 to § 9-101 UCC, Harris & Mooney 1999, p. 857. White & Summers 2002, § 30-1, Harris & Mooney 2006, p. 87-88 and Picker 2009, p. 20. Sigman 2004 also provides some useful background information with regards to the 2001 revision of Art. 9 UCC on p. 63.

16 Official Comment 4h to § 9-101 UCC.


18 Louisiana was one of the states to adopt Art. 9 UCC (2001) in 2001 and the 2010 amendments in 2012. It has in fact adopted most UCC articles, except Art. 2 UCC, because it prefers to maintain its own civil law tradition for governing the sale of goods. Since the term ‘articles’ is used in Louisiana to refer to provisions of the Louisiana Civil Code, it is customary in Louisiana, e.g. in case law, to refer to the major subdivisions of the UCC as ‘chapters’ instead of articles.

19 Many Civil law jurisdictions only recognize the concept of ‘co-ownership’ of assets (for Dutch law, see title 3.7 BW), which must be distinguished from individual ownership of fractions, or parts, of the asset concerned.
use and to possess the collateral during the lease term\(^\text{20}\), whereas the lessor ‘owns’ the bare ownership, i.e. the other powers.\(^\text{21}\)

As a basic rule, a security right in collateral can be created only \textit{if and to the extent} the debtor has rights in the collateral, known as the principle of ‘nemo dat quod non habet’: one cannot give what one does not have.\(^\text{22, 23}\) The Official Comment to Art. 9 UCC makes clear that in accordance with personal property law principles the security interest \textit{only} attaches to whatever interest the debtor may have himself.\(^\text{24}\) Due to its adherence to the bundle of rights doctrine, however, in the U.S. the ‘nemo dat’ principle is interpreted differently than in civil law tradition: U.S. law allows the debtor to grant a security interest in separate rights that are part of the bundle that constitutes full ownership. Accordingly, a debtor can grant a security interest in an asset that he does not fully own but, for example, merely leases.

1.3. Art. 9 UCC: an overview

1.3.1. Structure

Art. 9 UCC comprises six Parts. Part 1 contains general provisions and the scope of the Article; Part 2 lays down rules for the effectiveness of the security agreement, ‘attachment’ of a security interest and rights of the parties to the security agreement; Part 3 contains rules about ‘perfection’ and priority; Part 4 is about rights of third parties; Part 5 gives detailed rules on filing; and Part 6 contains rules on default and enforcement. The concepts above will be explained in more detail in the next subsections.

1.3.2. Key features

Art. 9 UCC applies to all security interests with regard to personal property and fixtures. ‘Personal property’\(^\text{25}\) refers to all movable tangible and intangible property, except immovable property.\(^\text{26}\) ‘Fixtures’ are defined as ‘goods that have become so related to

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\(^{20}\) See § 2A-103(1)(m) UCC and Revised § 2A-103(1)(g) UCC for the definition of ‘leasehold interest’.

\(^{21}\) See § 2A-103(1)(q) UCC and Revised § R2A-103(1)(w) UCC. See also Harris & Mooney 2006, p. 89 and Rusch 1995, p. 567. It is beyond the scope of this thesis to delve into the bundle of rights doctrine in more detail. For more information on this subject, see e.g. Schroeder 1994a, p. 239-319 and Schroeder 1996b, p. 1281-1341.

\(^{22}\) This follows from the fact that debtor must have ‘rights in the collateral or the power to transfer rights in the collateral to a secured party’ (§ 9-203(b)(2) UCC); see infra subsection 2.1.2 for more details.

\(^{23}\) Or in old English law: ‘He who hath not, cannot give’, see LoPucki & Warren 2012, p. 144, Harris & Mooney 2006, p. 138 and White & Summers 2002, § 31-3(f). This is sometimes also referred to as ‘the concept of derivative title’, see Rusch 1995, p. 567. For more in-debt information on this concept, see e.g. Kozolchyk 1987 and Tabac 1991.

\(^{24}\) Official Comment 6 to § 9-203 UCC.

\(^{25}\) ‘Personal property’ is not defined in the UCC.

\(^{26}\) Hence, Art. 9 UCC covers the area of law that should be distinguished from real property law – the area of law that covers property rights in immovable property. Immovable property is fixed to the ground, such as land and buildings.
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particular real property that an interest arises under real property law’ (§ 9-102(a)(41) UCC). Art. 9 UCC adopts a so-called ‘unitary approach’. This means that in principle Art. 9 UCC governs all transactions in personal property and fixtures that serve the purpose of providing security for an obligation. It covers all forms of personal property, e.g. movable assets, claims, securities, intellectual property rights. Moreover, Art. 9 UCC applies regardless of the form of the transaction conducted by the parties or the name that parties have given to the transaction. This ‘functional approach’ is another key feature of Art. 9 UCC:

“(…) this article applies to: (1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract.”

Consequently, both security in the form of a limited right and ownership used as security fall under the rubric of Art. 9 UCC as ‘security interest’. Therefore, whereas past law would speak of pledgors, pledgees, vendors, vendees, entrusters and trustees, present law would require a ‘Debtor’ pursuant to a ‘Security Agreement’ to grant a ‘Security Interest’ covering ‘Collateral X’ to a ‘Secured Party’ to secure a(n) (future) obligation.

Art. 9 UCC distinguishes between the ‘attachment’ of a security interest and its ‘perfection’. ‘Attachment’ stands for the enforceability of the security interest against the debtor (and a limited group of third parties), whereas the concept of ‘perfection’ points to the moment the security interest becomes enforceable against (all other) third parties. As

27 § 9-102(a)(41) UCC is considered to be a cross-reference to real property law; that law determines ‘whether goods have become so related to particular real property that an interest in them arises under real property law’. This means that the details as to this determination vary from state to state. Moreover, whether something has to be qualified as a ‘fixture’ depends for a large part on the facts and circumstances of a particular case. As a result, it is an uncertain area of the law. Mostly, courts take several factors into account such as the (objectively manifested) intent of the parties (‘intention’), the degree of the equipment’s physical affixation to the real property (‘attachment’), but also the common function and use of certain goods. This last element is sometimes referred to as the ‘institutional doctrine’. Common examples of fixtures are a fireplace or an elevator in a house. See e.g. White & Summers 2002, § 33-5, Harris & Mooney 2006, p. 504-505 and Livingston 2011, p. 197-198. For more examples of fixtures, see Livingston 2011, p. 198-199.


29 The adoption of the ‘unitary approach’ is considered to be one of the UCC’s most important contributions to the American legal system. Harris & Mooney 2006, p. 87.

30 § 9-109(a) UCC. The rationale for this rule was formulated in Pough v. Davis, 96 U.S. 332 (1877), See LoPucki & Warren 2012, p. 28 for an analysis of this case. See also Official Comment 1 to § 9-109(a) UCC, White & Summers 2002, § 30-2 and Cf. Sigman 2004, p. 58: “(…) the apparent form of the transaction and the language of the documentation are disregarded; it is the economic substance that governs.” In Art. 9 (1972) UCC this notion was formulated somewhat differently in § 9-102(1)(a) UCC: “(…) this Article applies to any transaction (regardless of its form) which is intended to create a security interest in personal property.” Sigman correctly points out that form and language could have consequences for other purposes, such as tax consequences and balance sheet presentation. See Sigman 2004, p. 58.

31 Hence, in contrast to the ‘numerus clausus’ principle used in the civil law tradition, Art. 9 UCC stands for an ‘open’ system of security rights. See e.g. White & Summers 2002, § 30-1(a) and Dana 2002, p. 359-360.
section 2 will clarify, attachment requires the security agreement to be signed, value to be
given to the debtor and the debtor to ‘have rights’ in the collateral. For perfection to
occur, additional formalities must be satisfied, such as taking possession of the collateral
or filing a financing statement in the public register (Cf. section 3).

An important feature of Art. 9 UCC was the adoption of a uniform notice filing
system: secured creditors are required to file their security right in a filing system that is
publicly accessible, in order for that right to have effect against (all) third parties. This ‘notice filing’ received its name because the public is put on notice of the possible existence of security. This is achieved by means of (electronic) filing of one page—a ‘financing statement’, which contains the name of the debtor, the name of the secured party and an indication of the collateral. This notice serves the purpose to warn potential creditors of the possible existence of security interests in the debtor’s property (by searching under the latter’s name) and to do so in an efficient manner, cost- and otherwise. This warning does not mean that security is actually in place or that the assets concerned may not be available to be put up as security, in the first place because a financing statement can be filed in advance of any finance transaction. A financing statement may therefore be on file, even at a time when parties have not (yet) engaged in a secured transaction. Similarly, a valid security interest still on record as such may have ceased to exist because the secured claim has been discharged without the release of the properly recorded security:

“(…) the filed notice gives no information about the actual state of affairs. The only conclusion which can be drawn from the notice is that the parties (whose addresses are given) evidently intended, at the time of filing, to engage in some kind of financing transaction. No transaction may have ever taken place; or all the loans may have been repaid so that nothing is left outstanding; or all the debtor’s assets of the types covered by the notice may in fact be subject to lien to secure a continuing indebtedness.”

Hence, if creditors come across a financing statement during a search, further inquiry will always be necessary to establish the extent of another’s claim with regard to the debtor’s property. Because filing creates priority in connection with all future transactions, a

32 Before the adoption of a uniform filing system, several states already adopted some form of public filing. See quote from Dana in footnote 11 of this Chapter.

33 Section 3 will provide an explanation of how a filing or taking possession results in perfection. Section 4 will discuss the legal consequences of perfection in relation to third parties—essentially the priority rules.

34 A financing statement is completely separate from and is not to be confused with a so-called ‘financial statement’, which has an accounting connotation. More information on financing statements will be provided in section 3.


36 This possibility of filing a financing statement at an early stage, i.e. even before the loan has been granted, is expressly provided by § 9-502(d) UCC: “A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.” Cf. Livingston 2007, p. 117, footnote 26.

37 Gilmore 1 1965, pp. 469. See also: “The essence of notice filing is that the document placed on record, instead of describing a particular transaction or particular collateral, merely states that the parties ‘are or expect to be’ engaged in a course of financing transactions.” Gilmore 1 1965, pp. 468.
finance party is encouraged to file early to take advantage of the tools that ensure priority and to avoid the risk of intervention by prospective secured parties (see infra subsection 4.3.1). This type of filing can be contrasted to ‘transaction filing’, whereby the security interest is created at the moment the security documentation itself, containing all relevant transaction particulars, is filed. Transaction filing always takes place after the security interest has been created – it cannot be filed in advance – and its priority relates to a single transaction rather than to a chain of potential transactions.38

An important disadvantage of transaction filing is that it is not suitable for finance structures in which collateral must be provided on a recurring basis during the term of the financing, for example in the context of asset based finance of inventories. Not only does the lender have to monitor whether new purchase contracts for the supply of inventory are executed by the borrower, it must also assure that the consecutive purchase contracts are timely filed, each time new inventory comes in. This is cumbersome not only for the secured lenders concerned (i.e. filers), but also for those who search for security interests on file (i.e. to searchers).40

1.3.3. Main concepts and definitions

Although Art. 9 UCC has introduced a ‘functional’ security device, Art. 9 UCC still contains some distinctions typical of pre-UCC devices, notably distinctions based on different types and use of the property. If necessary, for instance, rules are specifically geared to e.g. ‘consumer goods’,41 ‘inventory’42 (business), ‘equipment’43 (industrial and commercial) and ‘farm products’.44, 45 This difference in treatment for different types of

38 See more specifically, McCormack: “Under transaction filing, registration does not confer priority over a pre-existing charge that is duly registered later in time, whereas the opposite is true under a notice filing system. Moreover, under a notice filing system, what is filed is not the security agreement itself but a financing statement that contains abridged details of whatever security interests have been created or may be created between the parties.” McCormack 2004a, p. 161. For more information on ‘transaction filing’ in English law, see McCormack 2004a, p. 83 and p. 129 et seq. A filing system that facilitates ‘transaction filing’ is sometimes referred to as a ‘document based’-registry (as opposed to a ‘notice based’-registry), see ‘The UNCITRAL Legislative Guide on Secured Transactions’ (Vienna: UNCITRAL, 2010), p. 110-111, or as ‘systems of (full) registration’; see Comment B to IX. – 3.301 (DCFR).
39 Cf. Gilmore I 1965, p. 469: “Thus under notice filing the questions of validity and of perfection, which are almost impossible to separate under “transaction filing”, become quite distinct. If the notice is properly filed, it serves to perfect subsequent transactions, which are themselves valid; the notice does nothing to validate subsequent transactions which do not meet the statutory requirements for validity.”
41 § 9-102(a)(23) UCC: ““Consumer goods” means goods that are used or bought for use primarily for personal, family, or household purposes.”
42 § 9-102(a)(48) UCC: ““Inventory” means goods, other than farm products, which: (A) are leased by a person as lessor; (B) are held by a person for sale or lease or to be furnished under a contract of service; (C) are furnished by a person under a contract of service; or (D) consist of raw materials, work in process, or materials used or consumed in a business.”
43 § 9-102(33) UCC: ““Equipment” means goods other than inventory, farm products, or consumer goods.”
44 § 9-102(a)(34) UCC: ““Farm products” means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are: (A) crops grown, growing, or to be grown, including: (i) crops produced on trees, vines, and bushes; and (ii) aquatic goods produced in aquacultural operations; (B) livestock, born or unborn, including aquatic goods produced in aquacultural operations; (C) supplies used or produced in a farming operation; or (D) products of crops or livestock in their unmanufactured states.”
collateral is prompted mainly by finance patterns. A solid understanding of the different types of collateral is important because not every mode of perfection is permitted for every type of collateral and the rights of third parties vary in accordance with the type of asset that is the subject of a transaction. Moreover, the use of the correct terminology is significant mostly for the secured creditor because the accurate description of the collateral in the financing statement is decisive to determine whether the security interest is actually enforceable vis-à-vis third parties.

In view of this, it is useful to shortly identify the various types of Art. 9 UCC collateral. In finance transactions, ‘collateral’ is a generally used term for any asset, tangible or intangible, movable or immovable, that belongs to the debtor and in which he grants a security interest to his creditor. Under Art. 9 UCC, however, ‘collateral’ has a broader and more specific meaning: ‘… the property subject to a security interest or agricultural lien. The term includes: (A) proceeds to which a security interest attaches; (B) accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and (C) goods that are the subject of a consignment.’ ‘Goods’ can be (part of) the collateral and refers to tangible movable assets. The category of ‘goods’ itself can be subdivided into four categories, namely: ‘inventory’, ‘farm products’, ‘consumer goods’ and ‘equipment’. I reiterate that if a movable asset becomes so related to particular real property that an interest in them arises under real property law, it becomes a ‘fixture’. Hence fixtures have characteristics of both personal property and real property. ‘General intangibles’, to conclude, is a

46 See e.g. Harris & Mooney 2006, p. 91.
47 An important example will be discussed in section 4 with regard to the right of a bona fide purchaser if there is a prior security interest: if the collateral is categorized as ‘inventory’ the purchaser buys free of the security interest, but does not buy free if the collateral is ‘equipment’. See also White & Summers 2002, § 30-1(b).
48 See infra subsections 3.3.1.3.
49 § 9-102(a)(12) UCC.
50 More specifically, § 9-102(a)(44) UCC provides: “‘Goods’ means all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes. The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods. The term does not include a computer program embedded in goods that consist solely of the medium in which the program is embedded. The term also does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction.”
51 Art. 9 (1972) UCC made this distinction explicitly in § 9-109 UCC: “[Classification of Goods: "Consumer Goods"; "Equipment"; "Farm Products"; "Inventory"] (…)"
52 According to the Official Comment 3 to § 9-334 UCC, there are in fact three categories of goods in this respect: “(1) those that retain their chattel character entirely and are not part of the real property; (2) ordinary building
Distinctions are not only based on different types and use of the property, but also on the functioning of a security interest: i.e. on whether the secured loan facilitates the acquisition of goods or whether it does not have such purpose. Furthermore, the UCC’s rules are tailored to deal with specific types of creditors. Some of these creditors are defined in Art. 9 UCC: e.g. the ‘Secured Party’ and the ‘Lien Creditor’. Other creditors are defined elsewhere in the UCC, and these definitions apply by way of cross-reference, such as ‘Buyer in the ordinary course of business’ and ‘Purchaser’.

1.3.4. Scope

As regards the scope of Art. 9 UCC, the following is noteworthy. First of all, the definition of ‘security interest’ extends beyond interests that ‘secure payment or performance of an obligation’. Not only does Art. 9 UCC encompass any interest of a ‘consignor’ when a transaction meets the requirements applicable; it also covers some interests arising under other articles such as the interest of a buyer and a seller under Art. 2 UCC. Moreover, Art. 9 UCC applies to some interests arising under Art. 2A UCC (in favor of a lessee), while Art. 9 UCC is primarily designed for contractual transactions, it nevertheless applies to ‘agricultural liens’ on farm products that fall under the category of statutory liens, not consensual security interests. Other statutory liens, such as mechanics liens, are in favor of a lessee, and are governed by the UCC. Materials that have become an integral part of the real property and cannot retain chattel character for purposes of finance; materials that have become an integral part of the real property and cannot retain chattel character for purposes of finance; and (3) an intermediate class that has become real property for certain purposes, but as to which chattel financing may be preserved.” See also White & Summers 2002, § 33-5 and Harris & Mooney 2006, p. 503-506. See supra footnote 25.

53 § 9-102(a)(2) UCC: “‘General intangible’ means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.”

54 See § 9-102(a)(29) UCC for a definition of ‘deposit account’.

55 See § 9-102(a)(51) UCC for a definition of ‘letter-of-credit-right’.

56 Cf. White & Summers 2002, § 30-1(b). For purposes of this thesis I will limit myself to discuss the rules on movable assets; more specifically to rules on inventory and equipment only. No attention will be paid to other tangible movable assets, such as ‘tangible negotiable documents’, ‘instruments’, ‘money’ and ‘tangible chattel paper’.


58 See § 9-102(a)(73) UCC.

59 § 9-102(a)(52) UCC.

60 § 1-201(b)(9) UCC.

61 § 1-201(b)(30) UCC. These definitions sometimes overlap: ‘Purchaser’, for example, includes both a buyer in the vernacular sense of the word and, surprisingly, a secured party.

62 See Rev. § 1-201(b)(35) UCC. ‘Security interest’ is defined in Art. 1 UCC rather than in Art. 9 UCC because it is applicable to the UCC as a whole, see § 9-102(c) UCC: “[Article 1 definitions and principles.] Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.”
other articles such as the interest of a buyer and a seller under Art. 2 UCC. Moreover, Art. 9 UCC applies to some interests arising under Art. 2A UCC (in favor of a lessee), Art. 4 UCC (in favor of a bank that takes an item for collection) and Art. 5 UCC (in favor of an issuer of, or nominated person with respect to, a letter of credit). Furthermore, while Art. 9 UCC is primarily designed for contractual transactions, it nevertheless applies to 'agricultural liens' on farm products that fall under the category of statutory liens, not consensual security interests. Other statutory liens, such as mechanics liens, are in general not governed by Art. 9 UCC, but by the law of the individual statute that creates them. Yet, some interests that do secure an obligation fall outside the scope of Art. 9 UCC: § 9-109(d) UCC contains a long list of exceptions. These include real estate transactions and certain security rights in copyrights and patents. In addition, there are transactions that require close examination to establish whether or not they fall inside the scope of Art. 9 UCC. The key example of this is a 'true' lease, which is covered by Art. 2 UCC and 2A UCC. Some forms of leases are characterized as a security interest. This thesis will not discuss what determines such characterization or the thin line between security interest and leases.

2. The creation of an enforceable security interest and legal consequences
2.1. Requirements for 'attachment' of a security interest
A 'security interest' is defined as an interest in personal property or fixtures, which secures payment or performance of an obligation (§ 1-201(35) UCC). An obligation is

63 For consignors, see § 1-201(b)(35) UCC: “Security interest” (…) includes any interest of a consignor (…).” Cf. § 9-109(a)(4) UCC and § 9-102(a)(20) UCC. For buyers, see § 1-201(b)(35) UCC: “Security interest” (…) includes any interest of (…) a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Article 9 (…).” Cf. § 9-109(a)(3) UCC and § 9-102(a)(12). To be more specific: a 'security interest' does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under § 2-401 UCC, but a buyer may acquire a security interest by complying with Art. 9 UCC (see § 1-201(b)(35) UCC). The same goes for sellers and lessors: despite the fact that their right under Art. 2 or 2A UCC to retain or acquire possession of the goods is not a 'security interest', they may acquire a 'security interest' by complying with Art. 9 UCC. Moreover, a retention or reservation of title by a seller of goods under Art. 2 UCC is limited in effect to a reservation of a 'security interest' (see § 1-201(b)(35) UCC, § 2-401 UCC and subsection 4.2.2.1).
64 See Harris & Mooney 2006, p. 305-306 and 351.
65 § 9-109(a)(2) UCC provides: “(a) [General scope of article.] (…) this article applies to: (…) (2) an agricultural lien.” See § 9-102(a)(5) UCC for a definition of an ‘agricultural lien’. See § 9-109(d)(2) UCC.
66 For more information on these subjects, see Picker 2009, p. 404-452.
67 See § 1-201(b)(35) UCC. Whether a transaction in the form of a lease creates a security interest is determined pursuant to § 1-203 UCC. It is of primary importance to parties that they are aware of the distinction between two legal figures, since negligence of the need to perfect their interest (in this case: to file) can result in serious loss and damages; if the 'lessor' fails to file a financing statement, its security interest will be unperfected and can be subordinated to an interest of a competing claimant. For more information on this rule, i.e. about the exact distinction between a security interest and a lease, see e.g. Harris & Mooney 2006, pp. 308 and 323.
68 See supra footnote 62.
usually a contractual promise to repay a loan or to pay the price of goods bought. The ‘debtor’ is the person having an interest (other than a security interest or other lien) in the collateral; the ‘secured party’ is the person in whose favor a security interest has been created. The asset in which the security interest exists is the ‘collateral’.

The requirements for the creation of a security interest are threefold (§ 9-203(a) and (b) UCC). Until these requirements have been met, a security interest is not enforceable against the debtor, i.e. it has not ‘attached’: (1) ‘value’ must have been given to the debtor; (2) the debtor must have ‘rights in the collateral or the power to transfer rights in the collateral to a secured party’, and (3) there must be a ‘security agreement’ that meets certain formal requirements or the collateral must be in the possession of the secured creditor. The following subsections will address each of these requirements successively.

2.1.1. ‘Value’

A security interest is only enforceable if value has been given to the debtor. The definition of value shows that it is quite easy to comply with this requirement (§ 1-204(44) UCC):

“(…) a person gives value for rights [i.e. for the security interest, DJYH] if the person acquires them:
(1) in return for a binding commitment to extend credit or for the extension of immediately available credit, whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection;
(2) as security for, or in total or partial satisfaction of, a preexisting claim;
(3) by accepting delivery under a preexisting contract for purchase; or
(4) in return for any consideration sufficient to support a simple contract.”

70 However, in theory a security interest can secure virtually any obligation. Other laws deal with the question of whether or not an obligation exists. See also Harris & Mooney 2006, p. 89.
71 Under Art. 9 UCC ‘debtor’ is defined as: “(A) a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor; (B) a seller of accounts, chattel paper, payment intangibles, or promissory notes; or (C) a consignee.” § 9-102(a)(28) UCC.
72 Under Art. 9 UCC ‘secured party’ is defined as: “(A) a person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding (B) a person that holds an agricultural lien; (C) a consignor; (D) a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold; (E) a trustee, indenture trustee, agent, collateral agent, or other representative in whose favor a security interest or agricultural lien is created or provided for; or (F) a person that holds a security interest arising under Section 2-401, 2-505, 2-711(3), 2A-508(5), 4-210, or 5-118.” § 9-102(a)(73) UCC. In common usage, however, ‘secured party’ often connotes the first category. In this thesis I will do the same, unless I indicate otherwise.
73 To reiterate, under Art. 9 UCC ‘collateral’ is defined as: “(…) the property subject to a security interest or agricultural lien. The term includes: (A) proceeds to which a security interest attaches; (B) accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and (C) goods that are the subject of a consignment.” § 9-102(a)(12) UCC. See supra subsection 1.3.3.
74 ‘Consideration’ is a central concept in the field of contract law in common law, reflecting the notion that a transaction requires deliberation or value to have been given, in order to constitute an enforceable contract. Consideration can take a number of forms, varying from the payment of a price to making a simple promise. Cf. White & Summers 2002, § 31-3, note 96 on this matter; they make clear that consideration in the form of a promise, forbearance, or forgiveness of debt is value. See White and Summers for further references to case law on this subject.
In the normal course of events, a lender will have lent money to its debtor or promises to do so, in return for a security interest in certain assets of the latter. As a result, sub (1) or (4) will practically always be fulfilled. For commercial practice, section (2) is of great importance as it makes clear that also pre-existing debt also qualifies as ‘value’ so that security may be given. Hence, a loan made without security in the first instance (‘past consideration’) counts as value sufficient to allow a security interest to attach in collateral at a later time. In addition, value is given if an entity ‘contingently’ lends money by only guaranteeing someone else’s debt.

If it turns out value has not been given, it is very unlikely that the creditor will take the matter to court; the debtor does not owe anything to the creditor, so the latter suffers no loss. If there would be any issue to arise as regards the condition of ‘value’, it is more likely to concern the question which debt is secured rather than whether any debt is secured. In addition, it sometimes poses difficulties determining when value has been given, i.e. the timing, since that can be relevant for priority purposes. This will be discussed in more detail in subsection 3. In sum it can be said that as to whether value has been given, there is often little room for dispute.

2.1.2. Rights in the collateral

The second requirement for attachment is that the debtor has ‘rights in the collateral or the power to transfer rights in the collateral to a secured party’ (§ 9-203(b)(2) UCC). This matter is dealt with by Articles 2 and 2A and by common law. It follows that U.S. law employs a different concept of ownership than civil law countries: although the ‘nemo dat’ rule is advocated in both legal traditions, in the United States ‘having rights’ is not restricted to full ownership. As a consequence, a debtor has rights in the collateral or the power to transfer rights in the collateral – and hence, can grant a security interest with respect to it – if it merely leases the property or has possession of the collateral pursuant to a contract of purchase, a consignment or bailment agreement. The same applies to the

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73 See White & Summers: "Nine times out of ten an enforceable security interest will arise from a loan or extension of credit by the creditor to the debtor (value), the debtor’s ownership of the collateral (rights in the collateral), and written agreement that describes the collateral and is signed by the debtor (9-203(b)(3)(A)). The remaining 10% of the cases, or perhaps 1%, involve no writing but only possession of the collateral by the creditor, an electronic record or control.” White & Summers 2002, § 31-2 and § 31-3(e). Cf. Dana 2002, p. 386, Picker 2009, p. 26 and p. 87, and LoPucki & Warren 2012, p. 143.

76 Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).

77 Picker 2009, p. 87.


80 Picker 2009, p. 87.

81 Hereafter, I will refer to this requirement by referring to ‘has rights in the collateral’. Given that § 9-203(1) (1972) UCC referred only to ‘rights in the collateral’, § 9-203(b)(2) (2001) UCC has broadened the circumstances under which an effective security interest can be created. See Official Comment 6 to this section.

82 Hence, local certificate of title law, such as § 2-401 UCC, § 2-403 UCC, § 2-501(1)(a) UCC, § 2-502 UCC or common law rules dealing with bailment and the like determine the debtor’s ‘title’. White & Summers 2002, § 31-3(f) and Picker 2009, p. 72.
Chapter 5

situation in which a debtor has possession despite a retention of title clause, or despite clauses restricting the debtor's right to encumber or dispose of the property. Still, the debtor can only grant a security interest to the extent it has ‘rights’ in the goods itself. Hence, in the case of a lease, the security interest gives the creditor only a right to foreclose under the debtor’s rights as a lessee. This means that the secured creditor would have a right to sell the lease contract.

Likewise, if the debtor only has a license in a trademark (for example in Levi's jeans), the secured party will have a security interest in the license only. Hence, in the event of foreclosure, the secured party will acquire the borrower's license to operate this Levi's jeans distributorship only.

The debtor can also have rights in the collateral when he has so-called ‘voidable title’ in collateral, for example if the debtor has not paid for the asset it has bought. In that case the secured party has a security interest in that voidable title only. From the moment the debtor pays its seller, the voidable title matures to full title, with the result that the bank’s security interest also attaches to full title.

In most situations the debtor creates a security interest in favor of a third party, it owns the property or has a limited interest in it. When the debtor does not have rights in the collateral, attachment does not take place until after the debtor acquires such rights.

2.1.3. Authenticated security agreement (or possession) and related formalities

A security interest cannot attach in the absence of an authenticated security agreement. This is the last of the three requirements for creation of an enforceable security interest (§ 9-203(b)(3) UCC). In a nutshell, this requirement can be fulfilled in two ways: the debtor can ‘authenticate’ a record or the secured creditor can take possession of the collateral. The latter option is considered an alternative evidentiary test for authentication, but it has to occur pursuant to an (oral) agreement in order to be valid. In addition, the secured
creditor must prove that its possession is ‘pursuant to the debtor’s security agreement’. Pawns are perhaps the most familiar example of this.

With regard to pawns, the U.S. law tradition is that the pawnbroker can sell the goods if the debtor does not ‘redeem’ his pawn. In contrast to many Civil law countries, however, the pawnbroker can keep the surplus if the sale attracts a price that is higher than the debt. Conversely, the pawnbroker has to accept the shortfall if the proceeds of sale of the goods is insufficient to cover the loan. If applicable, ‘reasonable expenses’, such as the cost of insurance and payment of taxes or other charges, incurred in the custody, preservation, use, or operation can be chargeable to the debtor and are secured by the collateral. Moreover, the debtor bears the risk of accidental loss or damage to the extent of a deficiency in any effective insurance coverage (§ 9-207(b) UCC). For more information on the duties and rights when the secured party is in possession, see § 9-207(c) UCC.

In line with the core topic of this thesis – non-possessory security rights in movable assets – I will from now on leave the subject of possessory security aside and focus entirely on the requirement of the authenticated security agreement.

A ‘security agreement’ is an agreement that creates or provides for a security interest (§ 9-102(74) UCC). The security agreement contains the conveyance of a property interest to the lender. At the same time it contains various asset and security specific promises of the debtor, such as the debtor’s representation of unencumbered legal title to the collateral and the promise to insure the collateral. The ‘loan agreement’ tends to be documented separately, containing typical arrangements concerning the loan, such as term, maturity date, principle, repayment schedule, interest, financial covenant, etc.

In order for the security agreement to meet the requirements of § 9-203 UCC, it should show first that the debtor actually provides the security interest, which means that the document must show the debtor’s intention to grant the secured party a security interest. The inclusion of a provision: “Debtor hereby grants the Secured Party a security interest in (…)” would serve this purpose. If this requirement has not been properly fulfilled, there must be an inquiry as to whether the parties actually intended to create the security interest.

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90 Harris & Mooney 2006, p. 140. However, Official Comment 4 to § 9-203 UCC makes clear that possession as contemplated by § 9-313 UCC does also suffice for purposes of § 9–203(b)(3)(B) UCC, even though it may not constitute possession ‘pursuant to the debtor’s agreement’ and consequently might not serve as a substitute for an authenticated security agreement under subsection (b)(3)(A).
91 Several legal sources discussing the historical development of pawns can be found in Adams et al 1995, p. 883, footnote 25.
93 See e.g. White & Summers 2002, § 3-1(b). An example of a typical security agreement can be found on pp. 89-98 of Picker 2009.
94 This is also common practice in Europe. See Comment B to IX. – 1:101 (DCFR) and the Comments to IX. – 1:201 (DCFR).
95 According to White & Summers, the fact that the debtor transfers the interest ‘as security’ should be readily deductible by an objective server. See White & Summers 2002, § 31-3.
96 This is usually referred to as the ‘grant clause’. See Picker 2009, p. 26. Courts take, however, varying approaches to this matter, that is: some courts are more strict than others in actually requiring an actual grant clause. For illustrative case law on this matter (such as the ‘American card-rule, referring to the case imposing the requirement of a formal grant), see Picker 2009 p. 50-51.
interest (‘meeting of minds’). The UCC does not explicitly require certain words or precise form to evidence the existence of a security interest, but the courts differ in their approach to this matter.  

Second, the debtor has to ‘authenticate’ the security agreement in order for it to be valid. This means to ‘sign; or with present intent to adopt or accept a record, to attach to or logically associate with the record an electronic sound, symbol, or process (§ 9-102(a)(7) UCC). ‘Record’, in turn, is defined as: ‘(...) information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form (§ 9-102(a)(70) UCC).’ In short, this means that authentication is no more than an inscription on a record. Consequently, an inscription on a Word document that is electronically stored on a USB stick would amount to ‘authentication’. Moreover, email, magnetic media, optical disk, digital voice messaging systems, audiotapes, photographic media and paper are considered as ‘records’.  

In the Art. 9 (2001) UCC revision, the term ‘signed’ was replaced everywhere in the UCC by the medium-neutral term ‘authenticated’ and the term ‘writing’ was replaced by the medium-neutral term ‘record’. This can be seen as a reflection of Art. 9 UCC’s embrace of modern technology: besides the usual signing – which is in fact still by far the most common form of authenticating a security agreement – the debtor can arrange some other ‘authenticating’ event, such as an electronic communication. The 2010 amendments modified the definition of ‘authenticate’ to conform to definitions of other Articles in the UCC.  

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97 This follows from case law White and Summers mention in footnote 2, 3 and 5 and 22 of § 31-3. For example, a signed promissory note containing only a description of goods to be acquired with the proceeds does not cross the threshold, nor does a written document indicating an intent to create an interest sometime in the future. Parol evidence is considered to be admissible in this inquiry. See Official Comment 3 to § 9-203 UCC and also White & Summers 2009, § 31-3.  

98 This is a – the only – requirement ‘in the statute of frauds’, which means that certain kinds of contracts are required to be written (not oral or ‘verbal’) and be signed by all parties to an agreement in order to be binding. According to the Official Comment 3 and 5 to this section, an evidentiary function is served by requiring a signed security agreement, since it is to minimize the possibility of disputes as to the terms of a security agreement (e.g. as to the property that serves as collateral for the obligations secured). See also Sigman 2004, p. 65.  

99 In addition, Official Comment 9(a) to § 9-102(a)(70) UCC states: “A “record” need not be permanent or indestructible, but the term does not include any oral or other communication that is not stored or preserved by any means. The information must be stored on paper or in some other medium. Information that has not been retained other than through human memory does not qualify as a record.” White & Summers 2002, § 31-3, add to this: “Nor is it necessary that the “symbol” has the characteristics of a signature or secret code; the symbol adopted with the intention of identifying a person need not be unique like a signature or a fingerprint. Typing the name “John Jones” or “First Day Ditching Company by John Jones” (with Jones’ approval) into a document which is recorded on a floppy disk would in itself be adequate to authenticate, even though the typed name would give no assurance that the person whose name appears at the end of the document authorized the use of this name.”  

100 See Official Comment 9 to § 9-102 UCC.  

101 Before the 2010 amendments, authenticate was defined as ‘to sign; or to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record’ (§ 9-102(a)(7) (2001) UCC).
Courts appear to take quite a liberal approach as to what constitutes the signature of the debtor. A typed name may be sufficient, and so may a photocopy of a signed signature, as well as many other symbols.\(^{102}\) Usually, a representative individual such as an officer or a general partner of the company does the signing.\(^{103}\) If the debtor makes use of an agent to execute the security agreement, one must resort to non-UCC laws of partnership, corporations or agency in order to determine how business entities may sign a security agreement (§ 1-103(b) UCC). (To encumber the assets of the company, the agent must obviously be authorized to do so.) There must in any event be ‘present intent’, meaning that any subsequent modifications or additions to a description of the collateral also need the debtor’s approval.\(^{104}\) The lender does not have to sign any documents because the lender is not making a promise.

Finally, the security agreement must provide a description of the collateral in order to be valid.\(^{105}\) Consequently, there will be at least two descriptions of the collateral in most secured transactions: a description in the security agreement that exists between parties and a description in the financing statement, which will be filed in the public register.\(^{106,107}\)

Despite the fact that printed forms of security agreements that meet the skeletal requirements of § 9-203 UCC are readily available,\(^{108}\) many parties are being taken to court because the security agreement does not adequately describes the collateral. The most frequently litigated questions in this respect are the so-called ‘multiple documents’: cases in which parties present various loan documents collectively and hope that a judge will accept that this establishes the existence of a security agreement with respect to particular collateral.\(^{109}\) In such cases, courts are asked what minimum record will suffice in order for a security interest to be created. Soon after Art. 9 UCC’s enactment, for

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\(^{102}\) See also White & Summers 2002, § 31-2, especially footnote 81.

\(^{103}\) Harris & Mooney 2006, p. 140. The absence of a true business name does not make the security interest invalid, as long as the evidence indicates that the signet had the intent to bind the entity by the signature, see White & Summers § 31-3(c), especially footnote 85.

\(^{104}\) White & Summers 2002, § 31-3(c), especially note 82.

\(^{105}\) One should distinguish between the question of whether parties fulfilled the minimum requirements of § 9-203 UCC (statute of frauds) – at stake here – and the question which assets parties intended to bring within the scope of the security interest (discussed in the subsection 2.1.4.). If the secured party chooses to take possession as an alternative to authenticate a security agreement, there is, obviously, no need to describe the collateral.

\(^{106}\) Although, in the financing statement an indication of the collateral is sufficient; see infra subsection 3.3.1.3.

\(^{107}\) According to White & Summers, the reason for this differentiation is not clear. It seems that there is also no consensus on this issue between courts. Opinions vary from: “because the financing statement speaks to the world, it must do this in a standard manner” (In re Cilek, 115 B.R. 974 (Bankr. W.D.Wis. 1990)), to: “financing statement description cannot expand security agreement’s narrower description because of the different functions performed by the two instruments” (Allis-Chalmers Corp. v. Staggs, 37 UCC REP 262 (1983)). For more examples, see footnote 45 of White & Summers 2002, § 31-3(b). Rules on the description of the collateral in the security agreement are laid down in § 9-108 UCC and will be discussed in subsection 2.1.4; rules on the description of the collateral in the financing statement can be found in § 9-504 UCC and will be discussed in subsection 3.3.1.

\(^{108}\) Harris & Mooney 2006, p. 140.

\(^{109}\) Harris & Mooney 2006, p. 137.
example, it was often argued that a financing statement could perform the function of a security agreement if it was supported by other documents, such as a board of directors’ resolution. In re Numeric111 – still a leading case on this matter – the judges decided that the existence of an authenticated security agreement can be proven by more than one document:112 courts can make use of the so-called ‘composite document rule’, which holds that e.g. a promissory note, a financing statement and correspondence between parties can be read together in order to establish a security right.113 In spite of this, courts seem to maintain different approaches to this matter: some courts are very strict, allowing only a signed security agreement; others are rather indulgent.114 A financing statement alone is generally considered as insufficient.115

If the debtor changes its business structure, i.e. its identity, for example by merging with another company, a security interest is not enforceable against the ‘new debtor’116 unless the (original) debtor has authenticated a security agreement describing the collateral.117 Hence, the security agreement entered into by the original debtor automatically binds118 the successor i.e. the new debtor (§ 9-203(d) UCC).119, 120 If the minimum (‘statute of frauds’) requirements of § 9-203 UCC have been fulfilled, an important subsequent question is: which of the liabilities and assets parties intended to bring within the scope of the security interest fall within the scope? Subsection 2.1.4 will address this issue.

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111 In re Numeric Corp., 485 F. 2d 1328 (1st Cir. 1973).
113 For more details on this doctrine and other related case law, see Harris & Mooney 2006, p. 136-137 and p. 141-142.
114 See e.g. LoPucki & Warren 2012, p. 138-142.
116 § 9-102(56) UCC provides: “(New debtor) means a person that becomes bound as debtor under Section 9-203(d) by a security agreement previously entered into by another person.”
117 § 9-203(b) UCC.
118 § 9-203(d) UCC: “A person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than this article or by contract: (1) the security agreement becomes effective to create a security interest in the persons’ property; or (2) the person becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.” According to the Official Comment 7 to this article, persons who become bound under this paragraph are limited to those who both become primarily liable for the original debtor’s obligations and succeed to (or acquire) the assets. Hence, sureties and other secondary obligors as well as persons who become obligated through veil piercing and other non-successorship doctrines would not fall within the scope. Harris & Mooney point out that one may need to look to non-UCC law to determine whether a person becomes a new debtor. In this respect, they question whether this is consistent with the need for uniformity, since these rules vary from state to state. Harris & Mooney 2006, p. 496-497.
119 See also § 9-203(c) UCC, which provides: “If a new debtor becomes bound as debtor by a security agreement entered into by another person: (1) the agreement satisfies subsection (b)(3) with respect to existing or after-acquired property of the new debtor to the extent that the property is described in the security agreement; and (2) another security agreement is not necessary to make a security interest enforceable.”
120 This rule is prompted by the widely shared idea that a debtor should not “(…) be able to evade the obligations of a validly executed security agreement by the simple expedient of an alteration in its business structure”. See Harris & Mooney 2006, p. 496, where they refer to the case In re West Coast Food Sales, Inc. 637 F. 2d 707 (9th Cir. 1981).
2.1.4. Scope of the security interest I: future advances and after-acquired collateral

2.1.4.1. Description of the secured liabilities in the security agreement

With regard to the description of the secured liabilities general rules apply, and there is virtually no limit to the obligations that can be secured, as long as the parties have clearly expressed their intention (§ 9-204(c) UCC). In practice, most lenders make use of expansive definitions that purport to secure both existing and ‘future advances’ and other liabilities, such as:

“Secured liabilities’ shall mean and include all loans, advances, debts, liabilities, obligations, covenants and duties owing to the Bank by the Borrower, whether now existing, or hereafter created or arising, including, without limitation (…)”

These ‘future advance clauses’ or ‘dragnet clauses’ assure lenders that future advances are secured from their inception. In these clauses ‘non-advance provisions’ are generally also considered to be valid. In the absence of a clear description of the secured liabilities, the courts should determine which liabilities are secured, by construing the parties’ agreement under applicable law. By doing so, conventional, sensible rules of interpretation should apply.

Hence, the 2001 version of Art. 9 UCC rejected case law decided under Art. 9 (1972) UCC that applied other tests, such as whether a future advance or other subsequently incurred obligation was of the same or a similar type or class as earlier advances and obligations secured by the collateral, also referred to as the ‘relatedness rule’, and this remained unchanged with the 2010 amendments of Art. 9 UCC.

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121 § 9-204(c) UCC provides: "[Future advances and other value.] A security agreement may provide that collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are sold in connection with, future advances or other value, whether or not the advances or value are given pursuant to commitment." § 9-102(a)(69) UCC specifies what it means when something is given pursuant to commitment: “Pursuant to commitment”, with respect to an advance made or other value given by a secured party, means pursuant to the secured party’s obligation, whether or not a subsequent event of default or other event not within the secured party’s control has relieved or may relieve the secured party from its obligation.” See also LoPucki & Warren 2012, p. 158 and Harris & Mooney 2006, p. 145.

122 For the sake of clarity: an ‘advance’ refers to a payment of money to the debtor as a loan; ‘future advance’ means an advance made after the security agreement has been signed; ‘non-advance’ refers to an amount that was not advanced to the debtor as a loan, but which the latter is still obligated to pay, such as interest and attorney’s fees. Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).

123 Example definition taken ‘Commercial Law Practice Tips: A Compendium of Advice for Lawyers from Lawyers’ (newsletter by American Bar Association), p. 8, to be found at apps.americanbar.org. See also White & Summers 2002, note 78, § 31-3(c).

124 See supra footnote 121; these include, for example, the clause that the debtor should pay the creditor’s attorney’s fees, other expenses of collection, and interest. LoPucki & Warren 2012, p. 158.

125 See Official Comment 5 to § 9-204 UCC and White & Summers 2002, § 31-3(c) and illustrative case law mentioned in that section.
2.1.4.2. Description of the collateral in the security agreement

A description of the collateral is sufficient, whether or not it is specific, if it reasonably identifies what is described (§ 9-108 (a) UCC). This has a sole evidentiary purpose: it should identify the collateral described. Subsection (b) provides a few examples of what ‘reasonable identification’ constitutes, as this description is quite open-ended:

“(…) a description of collateral reasonably identifies the collateral if it identifies the collateral by: (1) specific listing; (2) category; (3) except as otherwise provided in subsection (e), a type of collateral defined in [the Uniform Commercial Code]; (4) quantity; (5) computational or allocational formula or procedure; or (6) except as otherwise provided in subsection (e), any other method, if the identity of the collateral is objectively determinable.”

Yet, according to subsection (c), ‘all the debtor’s personal property’ or words of similar purport does not reasonably identify the collateral. In view of section (b), however, this proves to be a limit in form, not in substance: parties that wish to include all of the debtor’s assets could list by all the different types of goods specified by Art. 9 UCC (‘inventory, farm products, equipment etc.’).

If two parties disagree on whether other, less or more collateral is included under the security interest, White & Summers argue that two independent inquiries should be made in resolving this issue. Firstly, a court should determine whether the terminology used by the parties objectively indicates that what parties intended to agree upon. (In this inquiry, parol evidence would not be admissible.) Subsequently, the court must establish whether parties did actually intend to create the security interest in that particular collateral. Hence, judges should not give in to the temptation to focus only on the question put forward by law, i.e. whether the description could plausibly be read to include the property claimed. See also LoPucki & Warren: “[With regard to descriptions in security agreements,] if the identity of the collateral is objectively determinable, the words should mean whatever the parties intended them to mean provided the intent was expressed objectively.”

127 Some illustrations to simplify: subsection 1 would allow a security agreement to show ‘collateral is computer No. 1234’; subsection 2 would allow a security agreement to show ‘all rice in depot X’; subsection 3 would allow the definitions in the UCC such as ‘equipment’ or ‘inventory’; subsection 4 would allow e.g. the statement ‘50% of the debtor’s rice stored in depot X’. At last, subsection 6 leaves slack to allow the debtor to show how the description ‘objectively determines’ the identity of the collateral. Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York) and White & Summers 2002, 31-3(b.)
128 Super generic descriptions are not sufficient for purposes of the security agreement, nevertheless they are permitted for financing statements. This will be discussed in subsection 3.3.1.
129 Cf. LoPucki, Abraham & Delahaye 2013, p. 1794: “American lawyers combine all possible categories of property to create descriptions that cover all property of the debtor that can serve as collateral.” White and Summers argue that the prohibition of the use of super generic descriptions in security agreements is surprising because it applies to all debtors from the largest corporation to the smallest consumer. See White & Summers 2002, § 31-3(b).
131 Although the UCC’s definitions are strong evidence of the parties’ actual intentions, these intentions must be established separately, White & Summers argue, because the last question is a factual one. See White & Summers 2002, § 31-3(b).
Art. 9 UCC allows a secured party to assert a security interest in 'after acquired property': property that the debtor has acquired after authenticating the security agreement. This so-called 'floating lien' concept is expressly sanctioned by § 9-204(a) UCC: "(…) a security agreement may create or provide for a security interest in after-acquired collateral." There are two exceptions to this rule: after-acquired property clauses are ineffective with respect to (1) 'consumer goods', other than an accession when given as additional security, unless the debtor acquires rights in them within 10 days after the secured party gives value; and (2) future commercial tort claims (§ 9-204(b) UCC). The first limitation is based on the conviction that security interests in consumer goods should not be permitted unless those interests secure the purchase price of the collateral. The reason that tort claims have to be in existence at the time of authentication in order for the security interest to attach is a result of a conscious decision to that effect by the drafters of Art. 9 UCC.

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127 Some illustrations to simplify: subsection 1 would allow a security agreement to show 'collateral is defined as “a rice warehouse No. 1234”'; subsection 2 would allow a security agreement to show 'all rice in depot X'; subsection 3 would allow the definitions in the UCC such as 'equipment' or 'inventory'; subsection 4 would allow a security agreement to show 'all rice except that on the floor of depot X'; subsection 5 would allow a security agreement to show 'a floating lien over all rice in depot X'; subsection 6 would allow a security agreement to show 'property not subject to a security agreement is defined as “merchandise other than rice.”' The judge continues: "A reasonable third party would understand those descriptions alone, with no need to inquire further. One could be reasonably certain, based on those descriptions, of what collateral is secured. This is not so with the description “all merchandise”. This description could conceivably cover any type of item." See LoPucki & Warren 2012, p. 151, 153 and 154.

128 This approach is, explicitly or not, regularly taken by judges: since the general rules to the interpretation of contracts are applicable, they try to determine the intention as objectively expressed in the security agreement and can use extrinsic evidence if the agreement is ambiguous. In practice, nine times out of ten this evidence establishes parties' intent to secure a particular loan by particular collateral. If third parties are involved, courts tend to interpret security agreements (including the sections on the description of the collateral) more literally, rather than focusing on the actual intent of the parties. If these third parties happen to be consumers, courts seem to be even less liberal in interpreting the security agreements.

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133 A security agreement is a contract, so these rules apply. See § 9-201(a) UCC, § 1-201(3) UCC (Rev. §9-201(b)(3)), and § 1-205 (UCC Rev. §1-303).


135 White & Summers 2002, § 31-3(b).

136 See for example In re Skirn, 251 B.R. 157 (Bankr. W.D. Okla 2000): "It is understandable for a creditor to desire one catch all phrase which creates a security agreement in every possible situation. However, in doing so, it may not ignore one of the primary reasons for creating a security agreement, which is to give notice to a secured party. This can only be achieved by describing what property is subject to the security interest." The judge continues: "A reasonable third party would understand those descriptions alone, with no need to inquire further. One could be reasonably certain, based on those descriptions, of what collateral is secured. This is not so with the description “all merchandise”. This description could conceivably cover any type of item." See LoPucki & Warren 2012, p. 151, 153 and 154.

137 According to LoPucki & Warren, these judges take into account the fact that the question of whether a description enables third parties to identify collateral depends on who the third parties are, what information they start with and what obligations can be placed on them to gather additional information. LoPucki & Warren 2012, p. 154.

138 Cf. Official Comment 2 to § 9-204 UCC: "(Section (a)) validates a security interest in the debtor's existing and (upon acquisition) future assets, even though the debtor has liberty to use or dispose of collateral without being required to account for proceeds or substitute new collateral."

139 See supra footnote 41.

140 See Official Comment 2 to § 9-204 UCC, which refers to § 9-335 UCC and see LoPucki & Warren 2012, p. 156.

141 Official Comment 3 to § 9-203 UCC and LoPucki & Warren 2012, p. 156.

142 Cf. Official Comment 4 to § 9-204 UCC and LoPucki & Warren 2012, p. 197. According to LoPucki & Warren, the concern is that even sophisticated business debtors would be surprised by the consequences
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Whether a description in a security agreement is sufficient to include after-acquired collateral if the security agreement does not state this expressly is a frequent topic of litigation in the American courts.\textsuperscript{143} Judges take different approaches to this matter.\textsuperscript{144} Official Comment 3 to § 9-108 UCC provides explicitly that the rules on the interpretation of contracts are applicable, which means that the intention of the parties – as objectively expressed in the security agreement – is supposed to govern.\textsuperscript{145}

Despite the fact that every case depends on the details, the majority view seems to be that, although some courts require express language in the security agreement stating that claims automatically attach to after-acquired collateral, no express language is required.\textsuperscript{146} However, the nature of the property concerned always plays an important role in this assessment. In the case of property that turns over rapidly, such as inventory or accounts, most courts find that after-acquired property is automatically included.\textsuperscript{147}

When another type of property is at stake, judges are often much less liberal. ‘Equipment’, for example, would mostly be read as ‘all equipment presently owned’. In difficult cases, judges typically take other factors into account, such as the practice of the industry in which parties work or testimonies by the parties.\textsuperscript{148}

2.1.5. Scope of the security interest II: accessions and commingling

‘Accession’ occurs when goods are physically united with other goods in such a manner that the identity of the original goods is not lost (§ 9-102(a)(1) UCC). The question whether a security interest covers also accessions of the collateral depends on the description of the collateral in the security agreement.\textsuperscript{149} ‘Commingling’ occurs when goods are physically united with other goods in such a manner that their identity is lost in a product or mass (§ 9-336(a) UCC). As a result of commingling the identity of the original collateral does get lost. As a rule, the secured party’s security interest is transferred from the original collateral to the product or mass (§ 9-336(c) UCC).\textsuperscript{150}

\textsuperscript{143} Official Comment 3 to § 9-108 UCC.
\textsuperscript{144} Harris & Mooney 2006, p. 144.
\textsuperscript{145} Besides Official Comment 3 to 9-108 UCC, also Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).
\textsuperscript{146} For illustrative case law of this view, see Harris & Mooney 2006, p. 145 and LoPucki & Warren 2012, p 157.
\textsuperscript{148} White & Summers 2002, § 31-3.
\textsuperscript{149} Official Comment 5 to § 9-335 UCC.
\textsuperscript{150} See also Official Comment 2 and 3 to § 9-336 UCC. It is beyond the scope of this thesis to elaborate on the details on when accession or commingling occurs.
2.2. Legal consequences of ‘attachment’ of a security interest

2.2.1. General enforceability of the security interest

A security interest that has attached has effect between two parties: the debtor and the – from now on: secured – creditor.\footnote{151} In addition to this enforceability against the debtor, a security interest becomes enforceable (often referred to as ‘generally effective’) against third parties, unless the UCC provides otherwise, according to § 9-201(a) UCC:

“\[General Effectiveness of Security Agreement.] Except as otherwise provided in [the Uniform Commercial Code], a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.”\footnote{152}

Notwithstanding the suggestion of general effectiveness, this rule should not be paraphrased to the effect that a security interest is effective against all third parties, i.e. ‘good as against the world’. In fact this ‘general effectiveness’ applies only to unsecured creditors that have not (yet) seized the debtor’s assets and subsequent unperfected secured creditors of the debtor.\footnote{153} Hence, for the sake of clarity, an unperfected security interest is not effective against perfected secured creditors, lien creditors\footnote{154} and the trustee in bankruptcy; see infra section 4 for more details.

2.2.2. The secured party’s right to proceeds: value tracing

A second consequence of attachment of a security interest is that the secured party is given an automatic right to proceeds of the collateral. This finds its roots in the ‘value tracing’-concepts employed in U.S. law. These concepts ensure that the security interest of the secured party follows the value of the collateral as it changes – i.e. transforms into another object – or if the debtor disposes of it to a third party. The most important value-tracing concept used in Art. 9 UCC is ‘proceeds’.\footnote{155} Under Art. 9 UCC, proceeds include:

(A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;
(B) whatever is collected on, or distributed on account of, collateral;
(C) rights arising out of collateral;
(D) to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral;

\footnote{151} Or put differently: a security interest ‘attaches’ to collateral when it becomes enforceable against the debtor. An agreement may expressly postpone the time of attachment; see § 9-203(a) UCC. Cf. Harris & Mooney 2006, p. 90 and Picker 2009, p. 26.
\footnote{152} See also Official Comment 2 to § 9-201(a) UCC. For a definition of ‘purchaser’, see infra footnote 61.
\footnote{153} White & Summers 2002, § 31-1 UCC.
\footnote{154} After an unsecured creditor has acquired a lien on the property by attachment, levy or the like (§ 9-102(a)(52) UCC), it becomes a ‘lien creditor’. See infra subsection 4.1.
Hence, as a result of § 9-102(a)(64) UCC, a lender can ‘trace’ the value of the collateral as it changes or is disposed by the debtor. If the debtor sells or leases machines, for example, and receives cash in return, the cash is considered to be ‘proceeds’ under sub (a). Likewise, if the debtor acquires an account receivable or a promissory note in return for an asset sold, they are also qualified as ‘proceeds’ under subsection (a). An example of ‘rights arising out of collateral’ under subsection (c) would be rights to convert a debt security; an example of subsection (d) is a warranty claim. Subsection (e) entails that money received by the debtor from its insurance company, for example in the case of an accident involving his car, is to be qualified as ‘proceeds’, and so is the right to sue if the debtor is not paid. Moreover, because ‘proceeds’ fall within the definition of ‘collateral’ in § 9-102(a)(12) UCC, whatever is received when they are disposed of is considered to be ‘proceeds’ as well. Hence, in Mann’s words: “[T]he proceeds of proceeds are proceeds”. If the debtor sells bikes and deposits the purchase price received in his account, that money is ‘proceeds’; if the debtor buys new bikes with that money, the new bikes are also ‘proceeds’ (of the old bikes).

Proceeds are mainly important in the context of financed inventory or accounts. In this type of business, proceeds are the most important means for the debtor to repay the outstanding credit loan. Proceeds can, however, also be important in the context of dispositions that have taken place in violation of the security agreement, such as the sale of equipment. In that case, secured parties cannot always assert their interest against the acquirer, for example because the collateral cannot be located or the acquirer deserves ‘good faith purchaser’ protection. In such case, the purchase price will accrue to the secured creditors as ‘proceeds’. Hence, the concept of proceeds allows the secured party to ‘double-dip’: it can chase the assets in the hands of the debtor and take the...
proceeds the debtor has received upon sale of the goods.\textsuperscript{163} Despite the fact that the secured party can claim both, it can obviously only be satisfied once.\textsuperscript{164}

The secured party has an automatic right to proceeds even when the security agreement is silent:\textsuperscript{165} the only condition is that the proceeds are ‘identifiable’ (§ 9-315(a)(2) UCC). Proceeds cease to be identifiable when they are commingled or dissipated. In that case, the security interest ceases to attach.\textsuperscript{166}

‘Proceeds’ and ‘after acquired property’ frequently overlap: if a secured party has forgotten to describe certain collateral in the security agreement (see supra subsection 2.1.4), there is a good chance that the collateral is still covered as ‘proceeds’ of the collateral that has been described in the security agreement.\textsuperscript{167} Hence, the right to after-acquired property finds both its source and the scope of the right in the security agreement (i.e. it has to be written down specifically), whereas the right to proceeds finds its source\textsuperscript{168} and the scope of the right\textsuperscript{166} solely in the statutes of Art. 9 UCC. Aside from bankruptcy, it makes no difference whether a creditor obtained a security interest in property by means of an after-acquired property clause or through attachment of the proceeds; what matters is that at least one of the concepts covers the collateral at stake.\textsuperscript{170} Once the debtor has filed for bankruptcy, however, after-acquired property clauses are ineffective with regard to collateral the debtor acquires after the petition in bankruptcy (§

\textsuperscript{163} Picker 2009, p. 283-284.
\textsuperscript{164} See Official Comment 2 to § 9-315 UCC.
\textsuperscript{165} This follows from § 9-203(f) UCC, in conjunction with § 9-102(a)(12) UCC and § 9-315(a)(2) UCC. § 9-203(f) UCC: “The attachment of a security interest in collateral gives the secured party the right to proceeds provided by Section 9-315 (…);” § 9-102(a)(12) UCC: “Collateral” (…) includes (...) proceeds to which a security interest attaches (…),” and § 9-315(a)(2) UCC: “(…) a security interest attaches to any identifiable proceeds of collateral.” Furthermore, the security interest will attach in any ‘supporting obligation’, such as a guarantee (§ 9-203(f) UCC). See also § 9-102(a)(78) UCC.
\textsuperscript{166} With regard to commingling, the following might be noteworthy. If proceeds are ‘goods’, ‘commingled goods’ are ‘goods that are physically united with other goods in such a manner that their identity is lost in a product or mass’, see § 9-315(b) and § 9-336 UCC. Several clear-cut examples: wine in a barrel or grain in a silo. If the proceeds are not goods, but for example cash, they are identifiable ‘to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved’, see § 9-315(b) UCC. An example of such an equitable principle is the ‘lowest intermediate balance rule’ (LIBR). This rule was developed in case law in order to identify what otherwise would not have been identifiable (anymore), for example when ‘cash proceeds’ are commingled in a bank account containing non-proceeds. See Harris & Mooney 2006, p. 225. The narrow context of this thesis does not allow for further elaboration.
\textsuperscript{167} Thus, if a first lender has not described certain collateral in the security agreement whereas a subsequent lender did, it is still covered as proceeds of the collateral the first lender did describe in the security agreement. To overcome this problem, inter-creditor agreements are often agreed upon. In these agreements the various lien positions and the rights and liabilities of each (secured) party and its impact on the other secured parties are specified. Since this matter touches upon the subject of perfection (see § 9-315(c) UCC), it will be discussed in more detail in section 3.
\textsuperscript{168} § 9-203(f) UCC.
\textsuperscript{169} § 9-102(a)(64) UCC.
\textsuperscript{170} LoPucki & Warren 2012, p. 183.
11 U.S.C. 552(a). 171 Hence, after bankruptcy newly acquired property – such as inventory and accounts – will not be covered by the security interest. The secured party will, however, continue to have its right to proceeds of existing collateral (§ 11 U.S.C. 552(b)(1)). 173

For this reason, the key question lawyers often tease their brains with is: what conversion took place after bankruptcy? 174 There have been innumerable judgments rendered on the exact difference between ‘proceeds’ and ‘after-acquired property’. What it boils down to is the perception that, under U.S. bankruptcy law, a secured party is allowed to ‘trace’ its collateral value when this is converted into something else, but is not allowed to improve its position at the expense of the bankruptcy estate (i.e. unsecured creditors) by acquiring additional value after commencement of the case. 175

This distinction is dictated by the difference in policy that is presumed to underlie the different procedures. The (perceived) purpose of Art. 9 UCC is to safeguard the position of secured creditors, whereas the purpose of the Bankruptcy Code is to preserve some value for other secured and unsecured creditors, and to keeping the business alive, which will also be beneficial to those who are (technically speaking) non-creditors. 176

Attachment of the proceeds is only half the battle, thus section 3 will address what steps the secured party should take to (continue to) perfect a security interest in proceeds. Whether the secured party can chase the collateral in the possession of an acquirer will be discussed in section 4.

2.2.3. The secured party’s remedies in case of the debtor’s default

A third important consequence of attachment of a security interest relates to the remedies that can be exercised by the secured lender in case of the debtor’s default. 177 First, secured

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171 Citations to the Bankruptcy Code in this thesis are to Title 11 of the United States Code as in effect on December 31, 1998 July 1, 2010. Bankruptcy Code is a synonym for Title 11 of the United States Code ("11 U.S.C.") not to be confused with Chapter 11, which is one of the chapters of that Code.

172 § 11 U.S.C. 552(a): “Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.” Cf. LoPucki & Warren 2012, p. 183 and White and Summers 2002, §§ 31-17, 32-6.

173 § 11 U.S.C. 552(b)(1): “(…) if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such agreement extends to property (…) acquired before the commencement of the case and to proceeds (…) of such property, then such security interest extends to such proceeds (…) acquired by the estate after the commencement of the case to the extent provided by such security agreement (…)”. Besides ‘proceeds’, § 11 U.S.C. 552(b) mentions 4 other categories with regard to which value tracing is allowed: ‘products’, ‘offspring’, ‘rents’ and ‘profits’. For more information about these concepts, see eg LoPucki & Warren 2012, p. 182-183. See also, White and Summers 2002, § 32-6 and § 32-7.

174 Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).


176 Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).

177 ‘Default’ is the debtor’s failure to pay the debt when due or failure to otherwise perform under the loan agreement. LoPucki & Warren 2012, p. 217. Default typically includes the debtor's insolvency, bankruptcy, breach of a loan covenant, but also the existence of a conflicting lien on the collateral. Harris & Mooney 2006, p. 93. What contributes to default and what the circumstances are under which a bank is
lenders can make use of self-help remedies, such as repossession of the collateral without going to court, refusal to make further advances to the debtor under a line of credit or acceleration of the loan.

'Acceleration' means that the agreed date to payment is brought forward and that whatever is outstanding needs to be paid immediately. In principle, acceleration occurs whenever the contract says so. Usually, i.e. in individual loan transactions (whether to businesses or persons) with a payment schedule (as opposed to a line of credit payable on demand) that have not been securitized, the lender proceeds to acceleration if the default on the payments becomes serious enough. Still, many courts tend to rule that a creditor must take ‘affirmative action’ to put the debtor on notice that it intends to exercise its right to accelerate, even when the terms of the security agreement do not require notice or demand as a prerequisite to accelerating the loan. There is some tension here, since many lenders are reluctant to give notice to the debtor because it could incite the debtor to file for bankruptcy (unwanted and/or unexpectedly). The debtor can ‘cure’ the default by tendering performance of the missed term before the creditor accelerates. This means that the debtor can prevent acceleration by tendering the arrears due. Sometimes the debtor needs to pay a ‘late-fee’, and normally the lenders take that and do not accelerate the whole amount.

\[178\] Notwithstanding the suggestion, taking something back exemplified by ‘repossession’ is generally used to refer to a lender taking physical control of the collateral when the debtor is in default. Unless otherwise agreed upon, a secured party may take possession of the collateral immediately upon default as long as the repossession takes place without breach of the peace, § 9-609 sub (b) UCC. This is referred to by the term ‘self help repossession’. See Picker 2009, p. 26, LoPucki & Warren 2012, p. 43 and White & Summers 2002, § 34-1, 34-7 and 34-8. Many judgments have been rendered concerning the phrase “breach of the peace”; see White & Summers 2002, § 34-8 and the case law mentioned in footnote 4. According to White & Summers, the two main factors judges take into account are: whether the debtor has given his consent to the entry and whether there was an entry by the creditor upon the debtor’s premises. The disabling of equipment is one example explicitly mentioned in subsection (a)(2) that would amount to a breach of the peace. If the secured party violates the rule on breach of the peace, the party risks tort liability, including punitive damages, criminal penalties and more. This rule cannot be waived, see §9-602(6) UCC. For more information and illustrative case law, see White & Summers 2002, § 34-8, footnotes 1, 2 and 3 and Picker p. 366-384. See also, LoPucki & Warren 2012, p. 46-48 and Official Comment 3 to § 9-609 UCC. The latter source provides that in considering whether a secured party has engaged in a breach of the peace courts should hold the secured party responsible for the actions of others taken on the secured party’s behalf, including independent contractors engaged by the secured party to take possession of the collateral. I will not elaborate further on this matter.

\[179\] This is different under most European jurisdictions; under English law, for example, a payment default is tantamount to committing sacrilege. The lender can and most typically will accelerate at an earlier stage, e.g. when there are other types of default such as a breach of a financial covenant.

\[180\] Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).
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Alternatively, secured parties can make use of judicial remedies, such as foreclosure and replevin, which are administered by the courts. If a secured creditor exercises these remedies under state law before the debtor goes into default, the creditor acts wrongfully and is liable for any damage sustained by the debtor. Moreover, if a secured party fails to comply with the rules on default procedures of Part 6 of Article 9 it can lose its rights against the debtor. In this subsection, only the two most commonly used judicial remedies, foreclosure and deed in lieu will be discussed.

The purpose of foreclosure is to terminate the debtor’s ‘equitable right of redemption’ – i.e. to terminate the debtor’s right to repay the lender the outstanding principal loan and interest due. As a result of foreclosure, the lender acquires clear, definitive and reliable title to the assets. However, the lender must remit the surplus proceeds to the debtor.

Every borrower has a so-called ‘equitable right of redemption’, i.e. the right to pay off the debt. This is often referred to as the debtor’s ‘right to redeem’. This right cannot be taken away by any type of contract. It was developed by the English courts of equity with respect to real estate.

If the secured party decides to foreclose, i.e. to sell the property, the secured party can choose between ‘judicial foreclosure’ and ‘Art. 9 UCC foreclosure’. In a judicial foreclosure, the collateral is sold in a public sale whereby strict procedural requirements must be observed. The court that orders a foreclosure sale has some discretion as to certain aspects of the judicial sale, such as the period of advertising and the manner in which bidders identify themselves. In practice, the procedures for foreclosure and other

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181 When the debtor is not willing to give his consent, a secured party can repossess the collateral through judicial action. The easiest way to obtain such an order is by filing an ‘action for replevin’. Secured creditors entitled to the possession of collateral pursuant to § 9-609 UCC commonly resort to replevin. In that case, the writ directs the sheriff to take possession of the property from the debtor and give it to the secured party.


183 For more detailed information on related issues, see LoPucki & Warren 2012, p. 58-77 and 78-92.

184 See § 9-608(a)(4) UCC for the rules on surplus in an Art. 9 foreclosure.

185 Harris & Mooney 2006, p. 93.

186 Strictly speaking there are three options, because there is also the concept of ‘strict foreclosure’. In a strict foreclosure the secured creditor accepts the collateral in (full or partial) satisfaction of the debt, without repossessing and reselling the collateral (see §§ 9-620 UCC, 9-621, 9-622 UCC). It is a procedure by which the secured party acquires the debtor’s interest in the collateral without the need for a sale or other disposition under § 9-610 UCC. Cf. Official Comment 2 to § 9-620 UCC. This consent is considered to be given by the debtor even if the debtor does not respond to a proposal by the secured creditor. LoPucki & Warren 2012, p. 78. Strict foreclosure is fairly unusual; in many legal systems it is not tolerated but Comment 2 to § 9-620 UCC states that strict foreclosures should be encouraged and often will produce better results than a disposition for all concerned. The conditions are to be found in § 9-620 UCC.

187 Since statutes in most states specify the manner in which a foreclosure sale must be held, not many mistakes are made in these kinds of judicial foreclosures. See LoPucki & Warren 2012, p. 59 and Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).
Judicial sales appear to be inefficient: bids tendered rarely represent the actual market value and often generate insufficient proceeds to cover the outstanding loan. Consequently, secured parties seldom choose to foreclose judicially.

In practice, a judicial sale is often carried out in a two-sale process ("double sale"), since the creditor who brings the foreclosure case typically is the highest bidder at the sale. After the secured creditor has bought the collateral at the foreclosure sale himself, it sells it to a third party for market value. Judicial foreclosures are considered to be slow and tedious, as they normally take between 12-37 months.

"Art. 9 UCC foreclosures" serve essentially the same purposes as judicial sales, but are used much more frequently. The most important difference is that there is no need for court involvement. Hence, it is the secured creditor, not a public official, who conducts the sale. The secured creditor determines the value of the collateral, converts that value into cash and recovers from the proceeds whatever is owed to it. The sale procedure is governed by § 9-610(a) and (b) UCC, which give the creditor broad latitude to determine the method and timing of the sale.

Despite this leeway, the secured party has to dispose of the collateral in a "commercially reasonable" way. In fact, every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. There is frequent litigation about this legal standard, but it would be going too far to elaborate on this. In a nutshell, the UCC sale procedure is, to a much greater extent than most judicial procedures, aimed at realizing a fair price for the collateral. The manner of sale, its timing and location largely depend on the nature of the collateral concerned.

As an alternative to foreclosure, a secured party may propose to accept the collateral in satisfaction of the secured obligation. In 80% of the commercial transactions in which the debtor is not able to pay, there is such a so-called "deed in lieu". This is a voluntary transfer of the debtor's ownership to the lender and the debtor's right to redeem. The main reason for the debtor to do this is that the lender releases the debtor from further...

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188 LoPucki & Warren summarize the use of judicial sales as follows: "Threatening to blow the property to bits would accomplish as much, and the explosives might be less expensive." LoPucki & Warren 2012, p. 59 and 75.
191 LoPucki & Warren 2012, p. 78 and 79.
192 ‘Dispose of’ includes to sell, lease, license or otherwise dispose of the collateral.
193 See § 9-607 (c)(1) and (2) and § 9-610 UCC.
194 Whether this is commercially reasonable or not has to be determined with the help of the comments to § 9-610 UCC, but more specifically with § 9-627 UCC. According to subsection (b), a secured party may dispose of collateral by either public or private proceedings. It is noted in Official Comment 2 that "(...) this section encourages private dispositions on the assumption that they frequently will result in higher realization on collateral for the benefit of all concerned." Also White and Summers reduce the content of § 9-627 to a single "price is everything". See White & Summers 2002, § 34-11 and Picker 2009, p. 398.
195 LoPucki & Warren 2012, p. 79-84.
pursuit. However, lien creditors and certain junior secured parties are entitled to object. In that case, the secured party that made the proposal is forced to dispose of the collateral (§ 9-620 UCC).

2.3. Requirements for creating a purchase money security interest (‘PMSI’)

2.3.1. Introduction to ‘purchase money’ financing

If a creditor – whether lender or seller – facilitates the acquisition of goods or software by the debtor, the security interest in this collateral is called a ‘purchase money security interest’, often abbreviated as ‘PMSI’. A PMSI is somewhat of a stranger in our midst, since it is established purely for priority reasons. Section 4 will discuss the most important consequence of a PMSI: it has ‘super priority’ over prior conflicting security interests, even though these latter interests had already been perfected at an earlier moment in time.

Since a PMSI is a type of security interest, it shares a few basic characteristics with a regular security interest. First of all, it will ‘attach’ if the three requirements discussed in subsection 2.1 – i.e. rights in the collateral, value to be given and a security agreement – are met. The requirement that the debtor must have ‘rights in the collateral’ is easily fulfilled when the PMSI holder is a lender: the debtor is the owner of the property acquired from the seller by making use of the funds received from the lender. If the PMSI holder is a seller, this becomes complicated: how can a PMSI be created in favor of a seller, if at the moment of creation the debtor does not yet hold legal title to the asset? U.S. law is not very dogmatic with regard to this issue: the debtor has ‘rights in the collateral’ as soon as the debtor bought the property after which a PMSI is considered to be granted to the seller. This occurs regardless of what the contract between the seller and the buyer provides (§ 9-109(a)(1) UCC).

Moreover, a lender or seller can enforce its PMSI just like they can enforce an ordinary security interest. Unlike a regular security interest, however, a PMSI can arise only in goods and software. Moreover, unlike a regular security interest, it is not possible to stipulate a PMSI by means of a contract if the nature of the relationship does not qualify

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196 In the context of this paragraph, the term ‘junior interest’ refers to parties who have a security interest in the collateral that ranks behind the security interests of another secured creditor, for example because it was perfected later in time. This term should be sharply distinguished from the common terminology ‘junior debt’ (or ‘junior creditor’) vs. ‘senior debt’ (or ‘senior creditor’), which are normally used to refer to the phenomenon of contractual subordination by which one creditor subordinates its debt (i.e. accepts a lower rank than afforded by statute) for the benefit of one or more other creditors.

197 Harris & Mooney 2006, p. 93.

198 I reiterate from subsection 1.3.3 that ‘goods’ refers to movable tangible assets; see § 9-102(a)(44) UCC. It includes ‘inventory’, ‘farm products’, ‘consumer goods’ and ‘equipment’.

199 § 9-102(a)(76) UCC: “‘Software’ means a computer program and any supporting information provided in connection with a transaction relating to the program. The term does not include a computer program that is included in the definition of goods.”

200 See Part 6 Art. 9 UCC.
as such. A PMSI is conditioned upon the nature of the finance relationship: the value received must enable the debtor to acquire rights in (or the use of) the collateral and, second, the value should be in fact so used.\textsuperscript{201,202}

Since both lenders and suppliers of goods can facilitate the acquisition of goods or software, there are two types of ‘purchase-money secured parties’: ‘purchase-money sellers’ and ‘purchase-money lenders’.

In a nutshell, in case of a ‘purchase money seller’, the goods sold are the ‘purchase-money collateral’; the obligation to pay for the goods is the ‘purchase-money obligation’; and, accordingly, the security interest in the goods qualifies as a ‘PMSI’. A ‘purchase-money lender’ has a security interest in goods the debtor has bought with ‘value given [by that lender, DJYH] to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used’ (§ 9-103(a)(2) UCC). In this case, the goods bought by the debtor qualify as the ‘purchase-money collateral’; the obligation to repay the loan used by the debtor to acquire the goods qualifies as the ‘purchase-money obligation’.

When seeking to make a purchase money financing, it is important that the creditor concerned (i.e. seller or lender) fulfills the conditions provided for in § 9-103 UCC. The most important requirement is that the value has to ‘enable’\textsuperscript{203} the debtor to acquire rights in the collateral and that the loan proceeds have to be ‘in fact so used’. This means that § 9-103 UCC incorporates a strict tracing requirement: if a loan was intended to enable the debtor to acquire certain collateral, but was not in fact used to buy that property, the security interest in that collateral is not categorized as a PMSI. Moreover, a security interest does not qualify as a PMSI if a debtor acquires property on unsecured credit terms and subsequently creates the security interest to secure the purchase price.\textsuperscript{204}

The question whether loan proceeds have been ‘in fact so used’ to acquire certain collateral, hence the question whether or not a PMSI has been established, does usually not result in a tracing problem when the creditor claiming a PMSI is a seller. Mostly, such problems occur only when the creditor claiming a PMSI is a lender. When the loan is paid directly to the debtor, usually the proceeds are transferred directly to the debtor’s bank account with the result that the proceeds commingle with the money the debtor has deposited in its bank account himself. As a result, it is not immediately clear whether the debtor used the loan proceeds to buy the collateral. American courts generally allow

\textsuperscript{201} White & Summers 2002, § 33-4(b).

\textsuperscript{202} This first step, that of determining the PMSI status, is set forth in the sections (a)(1), (2) and (b) of § 9-103 UCC, containing three essential definitions of what constitutes a PMSI in goods. Under § 9-103(b)(1) UCC, a security interest in goods is a PMSI ‘to the extent that the goods are purchase money collateral with respect to that security interest’. § 9-103(a)(1) UCC defines ‘purchase-money collateral’ as goods (or software) that secures a ‘purchase-money obligation’ incurred with respect to that collateral. A ‘purchase-money obligation’, subsequently, is defined as an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used (§9-103(a)(2) UCC).

\textsuperscript{203} This value is often called ‘the enabling loan’, see Harris & Mooney 2006, p. 253.

\textsuperscript{204} Official Comment 3 to § 9-103 UCC. Cf. Harris & Mooney 2006, p. 253-256.
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banks to use so-called ‘tracing rules’ which help them to meet their burden of proof205 in satisfying the ‘tracing’-requirement imposed by § 9-103(a)(2) UCC. These tracing rules allow to ‘earmarking’ (part of) the loan proceeds as ‘being paid for the collateral’, as a result of which the obligation to repay the loan qualifies as a ‘purchase-money obligation’. The most important tracing rule is the so-called lowest intermediate balance rule (‘LIBR’), as already briefly discussed in footnote 166. It is beyond the scope of this thesis to discuss this rule in more detail.206 The safest way for the purchase money lender to meet its burden of proof is to write out a check that is handed to the debtor to the seller’s order or to pay the seller directly.207

Where § 9-103 UCC tells us when a certain relationship qualifies as a ‘purchase money’-relationship, § 9-324 tells us what procedural requirements must be met for a purchase money lender to actually trump prior secured parties.208 Since these rules relate more directly to priority, § 9-324 will be discussed in section 4.209

2.3.2. Scope of PMSI: future advances and after-acquired property (cross-collateralization)

The concepts of future advances and after acquired property (‘cross collateralization’) do not sit well with the legal concept of PMSI, since a security interest in goods can be qualified as a PMSI only to the extent that the goods secure the enabling loan – hence, not other loans – and only to the extent only that that loan secures PMSI financed collateral (§ 9-103(b)(1) UCC).

Under Art. 9 (1972) UCC, courts had developed several rules to solve this problem, such as the ‘dual status rule’ and the ‘transformation rule’. When courts construed the secured obligation in cross collateralization clauses as having a ‘dual status’, the secured obligation was understood to consist of two parts: the debt incurred to purchase the collateral as the ‘PMSI part’ and the extent to which that they secured other loans as the ‘non-PMSI part’. Other courts were even stricter by ‘transforming’ what otherwise would be a PMSI into a non-PMSI – hence denying PMSI status – whenever the PMSI financed other collateral or when the PMSI secured obligation other than the enabling loan.210

The current Art. 9 UCC addresses this issue in § 9-103(b)(2) UCC, which makes clear that the use of cross-collateralization clauses that involve inventory, will not harm the purchase money status of the PMSI. A ‘transformation’ rule is applied that defines all of the security interests involved to be as purchase money:

205 See § 9-103(g) UCC: “[B]urden of proof in non-consumer-goods transaction. In a transaction other than a consumer-goods transaction, a secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security interest is a purchase-money security interest.”

206 For more information on the lowest intermediate balance rule, see e.g. Smith 2000.


209 In that same section, we will see that in some cases a PMSI is perfected without any further act on the part of the holder. This applies for example to consumer goods; in such case, the PMSI is so-called ‘automatically perfected upon attachment’, see §§ 9-309(1) UCC, 9-310(b)(2) UCC.

“A security interest in goods is a purchase money security interest: (…) (2) If the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase money security interest.”

This rule addresses complications that would otherwise arise in the context of allocation of payments. When (non inventory) non-consumer goods are the subject of a PMSI, the drafters have chosen a so-called ‘dual status’- rule: the security interest is deemed to be partly ‘PMSI’ and partly ‘non-PMSI’. As a result, there is a need for a method of allocation to determine what part of each debt (purchase money or non purchase money) has been discharged by the debtor’s otherwise undifferentiated payments. The burden of establishing the extent to which the security interest is a PMSI is on the secured party claiming the PMSI. This thesis will not elaborate further on this subject.

3. Perfection of a security interest in movable assets

3.1. Introduction

If a lender is willing to enter into a finance relationship with the debtor and to grant the latter a secured loan, it will want to make sure that its security right ranks ahead of all others. This means that the lender has to be satisfied that no security rights have been established prior to their own (or if they do, that they will rank after its own) and (2) that prospective financiers who take a security interest in the asset(s) will rank second or third in line. In order for that result to be achieved, the secured creditor has to give public notice of its security interest in a specifically prescribed manner. At this point, we come to the issue of perfection, which will be discussed in this section.

In legal literature ‘perfection’ is often described as the step that makes a security interest enforceable against third parties, as opposed to ‘attachment’ that makes a security interest solely enforceable against the debtor. However true in general terms, one must be warned that this is an over-simplification. In a nutshell, an unperfected security interest is not effective against perfected secured creditors, lien creditors and the trustee in bankruptcy, but does have effect against general unsecured creditors and later-in-time

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211 See also White & Summers 2002, § 33-4.
212 For example, this rule would apply to equipment that is not covered by § 9-103(b)(2) UCC.
213 § 9-103(f) UCC.
214 Parties can make this allocation by agreement. If they do not, parties have to allocate they payments according to § 9-103(c): “(…) (c)(3) in the absence of an agreement to a reasonable method and a timely manifestation of the obligee’s intention, [payments are allocated, DJYH] in the following order: (A) to obligations that are not secured; (B) if more than one obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred.” See also White & Summers 2002, § 33-4 on this matter.
215 § 9-103(g) UCC.
unperfected secured creditors. Before explaining these priority rules in more detail in section 4, this section will discuss the requirements for perfection.

3.1.1. The basics of perfection

The basic rule for perfection is set out in § 9-308(a) UCC: a security interest is perfected if it has attached and all of the applicable requirements for perfection (to be found § 9-310 UCC through § 9-316 UCC) have been satisfied. Security interests can be perfected in any of four ways: (i) by filing a financing statement, (ii) by taking possession, (iii) by taking control and by (iv) compliance with so-called state certificate-of-title legislation covering motor vehicles.

Strictly speaking, there are two more ways to perfect a security interest. First, a security interest can become perfected ‘automatically’. ‘Automatic perfection’ essentially means that it will be sufficient for the security interest to have attached; no additional formalities have to be fulfilled. The subject of automatic perfection will be discussed in section 4. Second, some security interests are perfected by compliance with a pre-empting statute, regulation, or treaty of the United States. This way of perfection will not be further discussed in this thesis.

The key factor to determine which method of perfection should be chosen is the nature of the collateral. For some types of collateral, only one of the above-mentioned methods can be used; for other types of collateral, different perfection methods are permissible. Since this thesis is concerned with the fate of movable assets, the discussion will be restricted to the methods of perfection that count for these types of assets, that is to say: (1) taking possession (subsection 3.2.1), (2) ‘certificates of title’ notation (subsection 3.2.2) and (3) filing a financing statement (subsection 3.3.). Before proceeding, it is important to note that the general rule is that perfection takes place by filing and that a security interest is perfected if it has attached and if all of the applicable requirements have been satisfied; i.e. both are constitutive. This means that, as a rule, if the applicable requirements for

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216 Thus, in general, unlike Dutch law (and the law of many other European jurisdictions), U.S. law makes a distinction between the effect of a security interest against the debtor (for this to occur, the security interest has to be attached) and its effect against (all) third parties (for this to occur, the security interest has to be perfected).

217 This way of perfection will be discussed in subsection 3.2.2 and 3.4.1.9.

218 In brief, perfection by means of filing is nearly always permissible. Taking possession is possible only with regard to several types of movable assets; see infra subsection 3.2.1. Perfection by means of taking control is possible only with respect to investment property, deposit accounts, letter-of-credit rights and electronic chattel paper. With regard to highly negotiable collateral, such as cash or bearer instruments, filing is entirely ineffective or subject to the interests of those who do have possession. This is because those who acquire such property in good faith are entitled to infer ownership from possession, see Adler, Baird & Jackson 2007, p. 16. Security interests in intangible goods (e.g. general intangibles, deposit accounts, electronic chattel paper) may not be perfected by possession. For more in-depth information on the various methods of perfection in various types of property, see e.g. LoPucki & Warren 2012, p. 332 et seq., Sigman 2004, p. 70 and Picker 2009, p. 157.
perfection are satisfied before the security interest attaches, perfection of the security interest occurs upon attachment.219

Furthermore, a security interest can be ‘continuously’ perfected if two different perfection methods are used, for example if the secured creditor first takes possession of an asset and then substitutes that with filing a financing statement. As long as the successive stages succeed one another without an intervening gap the security interest is continuously perfected. In that case, the date of perfection is when it first became perfected (i.e. when the secured party first received possession of the goods).220

3.2. Taking possession and certificate-of-title perfection

Taking possession and certificate-of-title notation are two important exceptions to the general rule that perfection should be effectuated by filing a financing statement (§ 9-310(a) UCC). These two methods of perfection will be discussed in the next two subsections.

3.2.1. Taking possession

Taking possession is a permissible method for perfection of a security interest in ‘tangible negotiable documents’, ‘goods’, ‘instruments’, ‘money’221 and ‘tangible chattel paper’ (§ 9-313(a) UCC).222 I reiterate that this thesis will focus mainly on inventory and equipment (both of which are ‘goods’).223

Possession is not defined in Art. 9 UCC, but the principles of agency apply to determine whether a particular person has possession.224 Perfection occurs no earlier than the time the secured party takes possession and continues only when the secured party retains possession (§ 9-313(d) UCC). The secured party can also take possession by means of an agent. For this to occur, the agent may not also be an agent of the debtor: only actual, not constructive or other fictitious possession will suffice.225 Alternatively, a
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secured party can perfect by taking possession, when the goods are in the possession of a third party who is not the secured party’s agent (§ 9-313(c) UCC). In that case perfection takes place when the person authenticates a record acknowledging that it holds possession of the collateral for the secured party’s benefit (§ 9-313(c)(1) UCC). Hence, a sole notification does not suffice. If, for whatever legitimate reason, the collateral consisting of goods must be released temporarily to the debtor, there is no immediate need to file: § 9-312(f) UCC affords the possibility of 20-day perfection in goods that are in the possession of a bailee but not covered by a negotiable document.

An interesting question is why the drafters of the notice filing system in Art. 9 UCC decided to keep the option of taking possession of the collateral instead of adopting the requirement of filing for all forms of perfecting security. Surely the purpose of all this was to make things as easy and straightforward as possible? According to Professor Mann, the premise is the fact that perfection in any system implies that people within the industry are charged with an obligation to discover, and as regards tangible goods, possession is traditionally considered to be something that people (should) notice. In addition, in most cases there is no real doubt about whether people are, or are not, in possession. The exceptions are quite rare.

As taking possession with regard to most of the debtor’s assets is impractical, both for lenders and debtors, it is not used often in practice.

226 When this person takes possession of the collateral after having authenticated this record, ‘taking of possession’ takes place at the latter of the two moments, i.e. when the debtor takes possession (§ 9-313(c)(2) UCC). A person who holds possession of the collateral is not required to acknowledge that it holds possession for the secured party’s benefit. If it does so nevertheless, it owes no duty whatsoever to the secured party and is not required to confirm the acknowledgement to another person. In addition, the acknowledgement is effective even if it violates the rights of the debtor. See §§ 9-313(f) and (g)(1) and (2) UCC.

227 This was different before; see Picker 2009, p. 158.

228 The same holds true for negotiable documents. See Official Comment 9 to § 9-312 UCC and also LoPucki & Warren 2012, p. 390.

229 Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).

3.2.2. Certificate-of-title systems

With respect to vehicles (e.g. cars, motor vehicles, trucks, buses), airplanes and waterborne vessels (e.g. boats) security interests are perfected through a system of notation on ‘certificates of title’. Certificates of title – sometimes referred to as ‘certificates of ownership’ – are pursuant to ‘certificate-of-title legislation’, which is enacted in each state (§ 9-311 UCC). Compliance with certificate-of-title legislation is treated as the equivalent of filing a financing statement. An exception is made for vehicles in the dealer’s inventory; in that case the usual filing rules apply and perfection takes place by filing a financing statement (§ 9-311(d) UCC).

The reason for prescribing a different means of perfection for vehicles and the like lies in their very nature and function: security over these types of goods will almost invariably take the form of non-possessory security (the assets remain in possession of the debtor because surrendering possession to the lender is considered impractical). Moreover, these goods tend to move about, both within and between states. This makes it impractical to make them subject to a system of constructive notice through filing in a single state. Notice of this type of security interest is therefore considered to be achieved best by identifying the security interest on a certificate of title that travels with the collateral.

Certificates of title are issued by a designated central state office, frequently called the Department of Motor Vehicles (‘DMV’). States use different standards for perfection of security interests covered by a certificate of title. Some provide that perfection is conditioned upon indication of the security interest on the certificate, while other statutes

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226 See also Comment 3 to § 9-313 UCC. See also Picker 2009, p. 169.
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contemplate that perfection is accomplished when the secured party applies for a notation by the Department of Motor Vehicles by offering the proper documents and the filing fee – *i.e. not* the moment of the notation itself. 238, 239 Along with an identification of the owner, a certificate of title will provide other valuable information about the vehicle, such as the ‘VIN’240, make and model, and other existing liens on the vehicle. 241 Despite them being perfected by certificate of title legislation, security interests in these vehicles are subject to the provisions of Art. 9 UCC e.g. rules on default and priority rules (§ 9-311(c) UCC). 242

3.3. Filing a financing statement

An overwhelming majority of security interests are perfected by filing. According to § 9-310(a) UCC, filing a financing statement is the general rule for the perfection of security interests.243 For the purpose of this study it is sufficient to understand that filing is required with regard to movable assets – in Art. 9 UCC terminology ‘goods’ – including fixtures244, 245 As briefly explained in subsection 1.3.2, Art. 9 UCC adopted a system of ‘notice filing’. Essentially, notice filing boils down to delivering the message ‘to whom it may concern, I have filed before you’, its purpose is to give prospective creditors a warning on potential existing security rights (see infra subsection 1.3.2). 246 Thus, it is not required to file the security agreement; a simple record – a ‘financing statement’ –

238 This is analogous to the moment a security interest is perfected by a financing statement, see § 9-516(a) UCC, which will be discussed in subsection 3.3.4.1. For more information on the standards used by different states for perfection of security interests covered by a certificate of title, see Official Comment 11 to § 9-102 UCC.
239 Both ways of perfection qualify as ‘certificate of title’ under Art. 9 UCC, even if the statute of a particular state does not explicitly state the connection between the notation and perfection. Official Comment 11 to § 9-102 UCC.
240 The Vehicle Identification Number (‘VIN’) is a unique number that identifies the vehicle.
241 See e.g. LoPucki & Warren 2012, p. 423-438.
242 It is beyond the scope of this thesis to elaborate on the details concerning certificate of title legislation. For more details, see Picker 2009, p. 187 et seq., Harris & Mooney 2006, p. 119 et seq. and LoPucki & Warren 2012, p. 423 et seq.
243 The Official Comment to § 9-310 UCC even describes it as a ‘central Article 9 principle’.
244 As we will see in subsection 3.3.3.2, a security interest in fixtures can be perfected by filing a financing statement in the Secretary of State’s office, by filing a ‘record of mortgage’ in the real estate records, or both.
245 More specifically, filing a financing statement is necessary for perfection of security interests in chattel paper, negotiable documents, investment property and goods. Filing a financing statement is also necessary for perfection of agricultural liens, but these fall outside the scope of this thesis. In addition, filing is required with regard to other (non-tangible) assets, e.g. accounts, general intangibles and instruments. §§ 9-310(a), 9-312(a) and (d) UCC. The exceptions to the requirement to file a financing statement are listed in § 9-310(b) UCC.
246 As Official Comment 2 to § 9-502 UCC puts it: “the notice itself indicates merely that a person may have a security interest in the collateral indicated. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs”. Cf. Sigman 1999a, p. 74: “A financing statement is intended merely as a notice that a potential competing claimant may exist. Specific information is obtained not from the public record, but from the debtor and other third party sources as credit information services.”
providing a limited amount of information will do. Subsection 3.3.1 will provide more information on what a financing statement should contain.

3.3.1. Documents to be filed: content of the financing statement

A financing statement\(^{247}\) is sufficient if it identifies the debtor, (a representative of) the secured creditor, and the collateral against which the creditor has a claim (§ 9-502(a) UCC). It does not have to provide addresses of the debtor nor that of the secured party.\(^{248}\) No information concerning the nature or amount of the secured indebtedness needs to be provided.\(^{249}\)

This is different in case of real estate, where the mortgage is typically recorded in extenso.\(^{250}\)

In the following subsections the items of information required on the financing statement will be analyzed one by one, starting with the requirement of the name of the debtor.

3.3.1.1. The debtor’s name

The first formal requirement for a sufficient financing statement is that it must state the name of the debtor (§ 9-502(a)(1) UCC). The minimum requirements of Art. 9 UCC concerning the debtor’s identity are quite strict because the debtor’s name is key to discovering prior security interests in the collateral. If a debtor is to be characterized as a ‘registered organization’\(^{251}\) – ordinarily to include corporations, limited partnerships, limited liability companies and statutory trusts – the debtor’s name entered on the financing statement must be the name indicated on the ‘public organic record’ of the debtor’s ‘jurisdiction of organization’. In a nutshell, the ‘public organic record’ is the record that was initially filed with or issued by a State or the United States to form or organize an organization (§ 9-102(a)(68) UCC).\(^{252}\) The ‘jurisdiction of organization’ refers

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\(^{247}\) It reiterate from footnote 34 that a ‘financing statement’ should not be confused with a ‘financial statement’, which refers to a document describing e.g. the financial health of a company.

\(^{248}\) Hence, as we will see in subsection 3.6 et seq., a financing statement without each of both addresses is effective if it is accepted by a filing officer (assuming that the financing statement does satisfy the formal requirements of § 9-502(a) UCC and that it is authorized by the debtor), see § 9-509(a) UCC.

\(^{249}\) Cf. Sigman 2004, p. 76-78 on this subject.

\(^{250}\) Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).

\(^{251}\) See § 9-102(71) UCC: “Registered organization” means an organization formed or organized solely under the law of a single State or the United States by the filing of a public organic record with, the issuance of a public organic record by, or the enactment of legislation by the State or the United States. The term includes a business trust that is formed or organized under the law of a single State if a statute of the State governing business trusts requires that the business trust’s public organic record be filed with the State.” Former Art. 9 (2001) UCC (§ 9-102(70) UCC) defined a ‘registered organization’ as: “(…) an organization organized solely under the law of a single State or the United States and as to which the State or the United States must maintain a public record showing the organization to have been organized.”

\(^{252}\) Livingston refers to this concept as the organization’s “birth certificate”. Livingston 2011, p. 181
to the state under whose law the organization is organized (§ 9-503(a) UCC). The definition of ‘public organic record’ was adopted with the 2010 amendments to clarify which records should be used to verify the debtor’s correct name: articles of incorporation would qualify as such.

In the United States, most corporations are incorporated in the individual states by filing the proper documents with the appropriate state agency, which is in most states the Secretary of State. The documents to be filed – so-called ‘articles of incorporation’, ‘certificate of incorporation’ or the ‘charter’ – include the name of the corporation. All statutes require that the name may not resemble too closely the name of any other corporation formed or qualified to conduct business in that state, the purpose being that each corporation should have a unique name. In addition, the name must show that the entity is a corporation, by including e.g. ‘Corp.’, ‘Co.’, ‘Inc.’, or ‘L.L.C.’. Since two corporations can have the same name only if incorporated in different states, the requirement of an added state functions as a unique identifier as well. The corporation can change its name only by filing an amendment with the Secretary of State.

When the charter is submitted to the state official of the Secretary of State’s office, it will check the records to see whether the name is still available, usually by means of a(n) (online) list that proposed new names are checked against. Consequently, a corporation only has a single correct ‘official name’, at any given time, which appears both in its certificate of incorporation and in the records of the secretary of state. This makes it possible for every searcher to discover the precise spelling of a corporate name, including punctuation, hyphenation, capitalization and the correct designator (‘Inc.’ etc.).

It is in line with this, that the instructions that go with the standard UCC financing statement advise the filer to examine the debtor’s current filed charter documents to determine the debtor’s correct name, organization type, and jurisdiction of organization. The filed charter documents are often readily available to the public on websites of the local Secretary of State offices. These websites usually allow free searches in ‘Business Registry Databases’ or databases of a similar kind. See for example <sos.Oregon.gov/Pages/default.aspx> (last visited February 5, 2014) (Secretary of State of Oregon) and <www.sos.state.ia.us/Search/corp/corp_search.aspx> (last visited February 5, 2014) (Secretary of State of Iowa). A few states, such as Maine, have online

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253 § 9-503(a)(1) UCC: “A financing statement sufficiently provides the name of the debtor (…) if the debtor is a registered organization (…), only if the financing statement provides the name that is stated to be the registered organization’s name on the public organic record most recently filed with or issued or enacted by the registered organization’s jurisdiction of organization which purports to state, amend, or restate the registered organization’s name (…)”.

254 A corporation ‘incorporated in’ a certain state is created under the laws of that particular state.

255 Only very few special types of corporations, such as national banks, are incorporated by the federal government.


259 This is ‘Form UCC 1’, an example of which can be found in subsection 3.3.1.4.

In the case of a ‘non-registered organization’\textsuperscript{261} it is sufficient to provide the actual individual or organizational name of the debtor on the financing statement (§ 9-503(a)(5)/(6) UCC). It is not necessary to state the debtor’s trade name – the name by which the debtor is commonly known, but which is different from its legal name – on the financing statement nor to mention the names of partners, associates, or other persons comprising the debtor.\textsuperscript{262} Failure to indicate the representative capacity of a secured party or representative of a secured party does not affect the sufficiency of a financing statement either.\textsuperscript{263} When the organization does not have a name, the financing statement should provide the names of the individuals or other entities which comprise the organization (§ 9-503(a)(5)/(6)(b) UCC). The financing statement may provide the names of more than one debtor (§ 9-503(e) UCC).\textsuperscript{264}

3.3.1.2. The secured party’s name

The second formal requirement for a sufficient financing statement is that it must state the name of the secured party (§ 9-502(a)(2) UCC).\textsuperscript{265} It is possible to provide the name of more than one secured party (§ 9-503(e) UCC). The person whose name is listed as the name of the secured party or a representative of the secured party in the initial financing statement is the ‘secured party of record’ (§ 9-511(a) UCC).\textsuperscript{266} Where complex finance structures involve multiple lenders, Art. 9 UCC offers substantial flexibility in satisfying § 9-502(a)(2) UCC. For example, providing the name of all secured lenders will suffice to create multiple secured parties of record, each of which will have the power to exercise their rights as a secured party individually.\textsuperscript{267} Alternatively, a financing statement will be valid if it states the name of a(n) (collateral) agent for the secured party(ies) only, even if the agent is not a secured party himself, and even if the

\textsuperscript{261} A ‘non-registered organization’ is to include entities that are not formed or organized by the filing of a record with, or the issuance of a record by, a State or the United States. See Official Comment 11 to § 9-102(a) UCC. Examples are general partnerships, joint ventures and sole proprietorships. Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).

\textsuperscript{262} § 9-503(b)(1) and (2) UCC. The trade name may be provided, but it is never sufficient to state the debtor by the trade name alone (§ 9-503(c) UCC). See Harris & Mooney 2006, p. 165-166 for applicable case law on this matter held under Art. 9 (1972) UCC.

\textsuperscript{263} § 9-503(d) UCC.

\textsuperscript{264} \textit{Cf.} § 1-106(1) UCC: “In the Uniform Commercial Code, unless the statutory context otherwise requires: (1) words in the singular number include the plural, and those in the plural include the singular (…)”. See also Official Comment 4 to § 9-503(c) UCC.

\textsuperscript{265} The requirement that a financing statement should contain the signature of the secured party was eliminated by the amendment of Art. 9 UCC in 1972. Official Comment 2 to § 9-509 UCC.

\textsuperscript{266} Only the secured party of record has the power to terminate the financing statement’s effectiveness, see § 9-509(d)(1) UCC. See also Harris & Mooney 2006, p. 170.

\textsuperscript{267} Harris & Mooney 2006, p. 170.
financing statement omits the agent's representative capacity, see § 9-503(d). This possibility of omission of the agent's representative capacity is considered convenient in case the secured party(ies) and/or the debtor wish(es) to keep the relationship confidential.

Subsection 3.7 discusses what happens if a debtor's or secured party's name is stated incorrectly.

3.3.1.3. Indication of the collateral in the financing statement

Since the security agreement and the financing statement serve different functions, the requirements for description of the collateral differ accordingly. Whereas the description of the collateral in the security agreement serves the purpose of identifying the collateral by the secured party in order for him to foreclose if necessary, the purpose of the financing statement is to put third parties on notice that the debtor's property is encumbered. It is not expected that the financing statement will disclose what collateral is covered by that prior interest; for that, further inquiry will be necessary. Thus, if the description of the collateral makes it possible for a prospective creditor to make further inquiries, it is sufficient. As a consequence, a mere indication of the collateral is sufficient for the financing statement (§ 9-502(a)(3) UCC).

Hence, whereas generic language is not sufficient for description of the collateral in the security agreement (§ 9-108(c) UCC), it is sufficient for description of the collateral in the financing statement. The following description, for example, will suffice: 'Debtor grants a security interest to Secured Party in all of Debtor's present and future assets, in favor of Secured Party'.

The attentive reader probably wonders: if ‘notice’ to make further inquiries is the only purpose of the financing statement, why is there any requirement at all to provide a description of the collateral? 273 Surely, the debtor’s and the secured party’s needs are different. The secured party needs to have the details of the collateral to file a lawsuit to get the collateral back if the debtor defaults on the loan. The debtor needs to have the collateral description to remember what properties are encumbered. If the collateral description is not provided, the debtor might not remember which assets are encumbered and might not be able to pay for the property when due. Therefore, it is important to provide a description of the collateral in the financing statement.

268 See also Official Comment 3 and Harris & Mooney 2006, p. 170-171.
269 See Sigman 2004, p. 78.
270 Nonetheless, according to LoPucki & Warren, the description of collateral in a financing statement is often identical to that in the security agreement. LoPucki & Warren 2012, p. 318.
271 This differs from previous UCC articles, under which the financing statement had to contain a ‘description’ rather than an ‘indication’ of the collateral, see § 9-402 (1972) UCC. Cf. Sigman 1999a, p. 76 on this topic.
272 More specifically, § 9-504(1) UCC prescribes two ‘safe harbors’ for a sufficient financing statement: firstly, it may provide a ‘description’ of the collateral pursuant to § 9-108 UCC. This refers to the description requirement of the collateral of the security agreement, i.e. that it has to ‘reasonably identify’ the collateral. As already touched upon in section 2, this is the case when the collateral is identified by type or by category (§ 9-108(b) UCC). The second safe harbor is when the financing statement states that the financing statement covers ‘all assets or all personal property’ (§ 9-504(2) UCC). According to Official Comment 2 to § 9-504 UCC, both safe harbors are in accordance with the purpose of conditioning perfection on the filing of a financing statement, since both provide notice that a person may have a security interest in the collateral claimed. This (traditional) view was expressed in the Grabowski case, see In re Grabowski, 227 B.R. 388 (Bankr. S.D. Ill 2002): “In the case of a financing statement, a creditor may either describe its collateral by ‘type’ or ‘category’ as set forth in § 9-108 or may simply indicate its lien on ‘all assets’ of the debtor. (...) A financing statement need not specify the property encumbered by a secured party’s lien, but need merely notify subsequent creditors that a lien may exist and that further inquiry is necessary ‘to disclose the complete state of affairs.’” See also LoPucki & Warren 2012, p. 318 on this subject.
description of the collateral in the financing statement.\footnote{273} Surely, the debtor’s and the creditor’s name gives you sufficient information to know where to look for more? However much that is true, the financing statement also serves a purpose other than giving notice: it limits the prior secured party’s rights with regard to particular property vis-à-vis prospective creditors. It is precisely the description of the collateral in the financing statement that defines the extent of that priority. If a description refers to a piece of equipment with a specific serial number, for example, the secured party is not considered to be perfected in a piece of equipment with another serial number.\footnote{274} Overbroad descriptions could make second lenders worry about subsequent collateral grants to the first (filed) lender, so they complicate the debtor’s financing life ‘going forward’, in Picker’s words. Therefore, there seems to be a natural limit to this.\footnote{275}

To allow generic language in the financing statement implies that a financing statement is effective to cover after-acquired property of the type indicated, regardless of whether an after-acquired property clause is adopted in the security agreement. The secured party’s priority relates back to the moment a filing with respect of the original collateral was made. This is helpful in ongoing financing arrangements in which collateral must be provided on a recurring basis during the term of the financing, for example in the context of asset based finance of inventories: there is no need to refile for every new transaction.\footnote{276} But even when a single item of equipment is financed, there is no pressure to refile; the key to cover the collateral concerned is whether the indication of collateral in the financing statement is sufficient, not whether the transaction under the security agreement existed or whether the parties had contemplated the transaction at the time the financing statement was authorized to being filed.\footnote{277}

3.3.1.4. Example form

Art. 9 UCC contains an example form in § 9-521 UCC (‘Form UCC 1’), which is shown below. This form consists of one page with a few prescribed headings and fields. Since it is designed to be electronic\footnote{278}, it is also possible to download and type the required information. Non-uniform forms are permissible as long as additional charges are paid.\footnote{279}

\footnote{273} Compare Picker 2009, p. 154.
\footnote{274} This follows from In re Pickle Logging, Inc., 286 Bankr. 181, 49 U.C.C.2d 971 (M.D. Ga 2002). It stands for the proposition that if a financing statement collateral description clearly does not include the collateral of interest to the searcher, the searcher need inquire no further. LoPucki & Warren 2012, p. 320.
\footnote{275} Picker 2009, p. 154-156.
\footnote{276} Cf. supra subsection 1.3.2. Cf. LoPucki & Warren 2012, p. 517.
\footnote{277} See Official Comment 2 to Art. 9 (1972) UCC.
\footnote{278} Subsection 3.3.4.1 will discuss that almost every filing office accepts electronic forms.
\footnote{279} The filing office can refuse to accept a filing on the official form only for the limited reasons set forth in § 9-516(b) UCC. See infra subsection 3.6.
Chapter 5

Example: UCC Financing Statement 1

UCC FINANCING STATEMENT
FOLLOW INSTRUCTIONS

A. NAME & PHONE OF CONTACT AT FILER (optional)

B. E-MAIL CONTACT AT FILER (optional)

C. SEND ACKNOWLEDGMENT TO: (Name and Address)

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1. DEBTOR'S NAME: Provide only one Debtor name (1a or 1b) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name); if any part of the Individual Debtor's name will not fit in line 1b, leave all of item 1 blank, check here  and provide the Individual Debtor information in item 10 of the Financing Statement Addendum (Form UCC1Ad)

2. DEBTOR'S NAME: Provide only one Debtor name (2a or 2b) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name); if any part of the Individual Debtor's name will not fit in line 2b, leave all of item 2 blank, check here  and provide the Individual Debtor information in item 10 of the Financing Statement Addendum (Form UCC1Ad)

3. SECURED PARTY'S NAME: or NAME OF ASSIGNEE OR ASSIGNOR SECURED PARTY: Provide only one Secured Party name (3a or 3b)

4. COLLATERAL: This financing statement covers the following collateral:

5. Check only if applicable and check only one box: Collateral is held in a Trust (see UCC1Ad, item 17 and Instructions) Being administered by a Decedent's Personal Representative

6a. Check only if applicable and check only one box: Public Finance Transaction

6b. Check only if applicable and check only one box: Non-UCC Filing

7. ORGANIZATION'S NAME

8. ADDITIONAL NAME(S)/INITIAL(S)

9. ADDITIONAL NAME(S)/INITIAL(S)

10. SUFFIX

11. ADDITIONAL NAME(S)/INITIAL(S)

12. ADDITIONAL NAME(S)/INITIAL(S)

13. SUFFIX

14. THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

FILING OFFICE COPY — UCC FINANCING STATEMENT (Form UCC1) (Rev. 04/20/11)

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3.3.2. Authority to file

A financing statement is not effective unless its filing is authorized by the debtor. This requirement of authorization is quite easy to fulfill, since the debtor does not have to sign the financing statement. In fact, by signing the security agreement the debtor authorizes *ipso facto* the filing of a financing statement (or an amendment thereof) covering the collateral described in the security agreement and proceeds thereof, whether or not the security agreement expressly covers proceeds. Hence, evidence of debtor’s authorization does not need to be placed in the public files nor is this authorization checked by the filing officer.

The identity of the person who performs a filing is immaterial; it does not have to be placed in the public files either. In practice lenders often do it themselves. It is common practice that lenders ask their prospective debtors to sign an authorization to file a financing statement, even before both parties have agreed upon the (terms of the) loan. I reiterate from subsection 1.3.2, that the possibility of filing a financing statement at an early stage (§ 9-502(d) UCC), i.e. even before the loan has been granted, is a means for lenders to ascertain their priority vis-à-vis other lenders. Section 4 will discuss this subject in more detail.

It is noteworthy that part of the conducted ‘unauthorized filings’, are executed by displeased citizens, whether or not organized in groups, to thwart public officials. Hence, these filings are made maliciously, i.e. with the only purpose of preventing purported debtors to obtain credit. How Art. 9 UCC responds to these so-called ‘bogus filings’ or ‘bogus financing statements’ will be discussed in subsection 3.4.3.2.

A financing statement can also be only partially effective. If, for example, the debtor authorizes the filing of a financing statement covering *inventory* and the lender files a financing statement covering other, or more collateral than that, the financing statement

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280 §§ 9-509(a)(1) UCC, 9-510(a) UCC.
281 Art. 9 (1972) UCC (§ 9-402 UCC) required the debtor to sign the financing statement. See e.g. Harris & Mooney 2006, p. 172 and Sigman 1999a, p. 68-69.
282 If an amendment adds a debtor, this debtor must also authorize the amendment. Official Comment 3 to § 9-509(a)(1) UCC. However, if a new debtor will be bound by the security agreement, this automatically constitutes the new debtor’s authorization of the filing of a financing statement covering the collateral described in the security agreement. Official Comment 4 to § 9-509 UCC. See also Sigman 1999a, p. 70-71.
283 See §§ 9-509(b)(1) and (2) UCC and § 9-315(a)(2) UCC. Not only do the filing offices simply lack the resources to make such an inquiry, it would not have been possible either without having a severely adverse impact on efficiency of the filing and search process. Cf. Official Comment 3 to 9-502 UCC. As there is an increase in fraudulent filings, however, some states are adopting statutes that are allowing them to reject filing that are clearly fraudulent. These statutes are all state-based and vary greatly amongst the jurisdictions. See infra 2.4.2.2 of Chapter 6.
284 According to Official Comment 2 to § 9-509 UCC, this is consistent with, and a necessary aspect of, eliminating signatures or other evidence of authorization from the system. See also Sigman 2004, p. 77 and Harris & Mooney 2006, p. 172.
286 Harris & Mooney 2006, p. 173. Harris & Mooney mention the example of an unauthorized financing statement filed against the Governor of Hawaii.
is effective (and thus perfected) only with regard to inventory.\textsuperscript{287} When a financing statement is ineffective when filed, it becomes effective upon the debtor’s post-filing authorization or ratification.\textsuperscript{288}

3.3.3. Where to file

Throughout the United States there are more than four thousand filing offices, divided into central filing offices (‘UCC filing office’ or ‘the Secretary of State’) and local filing offices. Each state contains many local filing offices, dedicated to specific types of collateral or to specific types of liens, but only one UCC filing office. UCC filing offices cover a broad range of collateral security rights on personal property and fixtures.\textsuperscript{289}

Often when scholars refer to the United States’ filing system, they use the term ‘one big filing system’, as if there were one single filing system for the entire United States that is operated by the federal government. However, Art. 9 UCC adopts a state-based system, which requires that filing takes place in a particular state. Initially, Grant Gilmore – the main drafter of Art. 9 UCC – lobbied for such a ‘country-level’ filing system, but with no success.\textsuperscript{290} When Gilmore actually proposed the introduction of a filing system in the 1940’s, he meant that one should be introduced in each state, which is what was done.\textsuperscript{291}

Art. 9 UCC and other statutes guide lenders and other creditors to the single correct filing office in which to file.\textsuperscript{292} Since a notice cannot serve its purpose unless it is found, these rules are designed to ensure that both the filer and the searcher make the same determinations as to where to file and where to search. This subsection deals with Art. 9 UCC filing only.

3.3.3.1. Applicable law

The first step in determining where to file, is to assess which state law governs perfection. In case of a non-possessory security interest, the local law\textsuperscript{293} of the state where the debtor

\textsuperscript{287} See Official Comment 2 to § 9-510 UCC and Sigman 1999a, p. 71, footnote 75.

\textsuperscript{288} According to Official Comment 3 to § 9-509 (2010) UCC, this is because the notice value of the financing statement is independent of the timing of authorization or ratification.

\textsuperscript{289} Chapter 6, subsection 2.3.1.1 will deal with these different types of filing offices in more detail.

\textsuperscript{290} According to LoPucki & Warren, the main obstacle was that filing officers were already in place at the state level, and both jobs and political power would be shifted. LoPucki & Warren 2012, p. 417. For more information on the ‘one big filing system’ philosophy as set forth in the original proposals, see Gilmore 1965, p. 465.

\textsuperscript{291} Real estate excepted. LoPucki & Warren 2012, p. 417.

\textsuperscript{292} LoPucki & Warren 2012, p. 363. Under Art. 9 (1972) UCC, filers had to figure out whether to file: in the Secretary of State Office, in the county where the property was located or in both places, because each State allowed to file in three alternative ways. See e.g. LoPucki 1995, p. 620-622. The revision of 2001 was partly prompted by the need to reduce the number of potential ‘wrong filing office’ situations at both intrastate and interstate level and thus to reduce litigation on this matter. See Official Comment 2 to § 9-501 UCC.

\textsuperscript{293} ‘Local law’ should be understood to mean the substantive law of the relevant state. See e.g. Picker 2009, p. 295.
is located governs the question whether a security interest is perfected (§ 9-301 UCC). Consequently, the actual first step in determining where to file is therefore where the debtor is located. The ‘debtor’s location’ is determined by the type of the entity concerned (§ 9-307 UCC). A debtor that is a (non-registered) ‘organization’ and has only one ‘place of business’295 is considered to be located at that place of business (§ 9-307(b)(2) UCC). If the debtor has more than one place of business, it is considered to be located at its ‘chief executive office’296 (§ 9-307(b)(3) UCC). If the debtor is a ‘registered organization’297—e.g., a corporation, a limited partnership a limited liability company, or a statutory trust—the debtor is located in its state of organization (§ 9-307(c) UCC).298 These methods are referred to as ‘debtor-based filing’ (where the headquarters are) vs. ‘incorporation-based filing’.

This means that a corporation is incorporated under Illinois law is located in Illinois, even if its principal office and all of its business is in California and its chief executive office is located in, for example, Chicago.299

With respect to debtors located outside the United States, the law of the foreign country governs perfection, only if that law calls for public notice of security interests (§ 9-307(e) UCC).300 If not, the debtor files in the District of Columbia.301 Companies organized

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284 This is different from Art. 9 (1972) UCC, under which one had to file where the property was located. The 2001 revision of Art. 9 UCC had the effect of reducing significantly the number of filings since financing statements with regard to movable collateral, such as inventory, which has to be filed in one single filing office of the debtor’s location—rather than in each of the states in which the collateral was located. Official Comment 4 to § 9-301 UCC, Sigman 2004, p. 64 and White & Summers 2002, § 31-16a.

289 Chapter 6, subsectio n 2.3.1.1 will deal with these different types of filing offices in more detail.

289 This is different from Art. 9 (1972) UCC, under which one had to file where the property was located. The 2001 revision of Art. 9 UCC had the effect of reducing significantly the number of filings since financing statements with regard to movable collateral, such as inventory, which has to be filed in one single filing office of the debtor’s location—rather than in each of the states in which the collateral was located. Official Comment 4 to § 9-301 UCC, Sigman 2004, p. 64 and White & Summers 2002, § 31-16a.

291 According to Official Comment 3 to § 9-307 UCC and Sigman 2004, p. 68.

292 Since a notice cannot serve its purpose unless it is found, these rules are designed to ensure that both the filer and the searcher make the same determinations as to where to search.

293 'Local law' should be understood to mean the substantive law of the relevant state. See

294 Official Comment 2 to § 9-307(c) UCC. A debtor that is a (non-registered) ‘organization’ and has only one ‘place of business’

294 This is different from Art. 9 (1972) UCC, under which one had to file where the property was located. The 2001 revision of Art. 9 UCC had the effect of reducing significantly the number of filings since financing statements with regard to movable collateral, such as inventory, which has to be filed in one single filing office of the debtor’s location—rather than in each of the states in which the collateral was located. Official Comment 4 to § 9-301 UCC, Sigman 2004, p. 64 and White & Summers 2002, § 31-16a.

295 Although the UCC does not define ‘chief executive office’, this is the place from which the debtor manages the main part of the business operations or other affairs—under case law developed as the ‘nerve center’. It is presumed to be the place where persons dealing with the debtor would normally look for credit information, thus it is the appropriate place for filing; see Official Comment 2 to § 9-307 UCC, LoPucki & Warren 2012, p. 413 and White & Summers 2002, § 31-16b. Official Comment 2 also states that it will be relatively easy to determine which of the debtor’s offices is the chief executive office with regard to most multistate debtors and that, in the rare case that doubt arises, the secured party should file under the law of each possible jurisdiction.

297 See supra footnote 251 for a definition of ‘registered organization’.

296 If the debtor is an individual, the debtor is located in the state in which its principal residence is located.

297 White & Summers 2002, § 31-16. In their words: “The messy, practical question about where the CEO goes to work and whether that is the chief office will not be relevant.” This was different under the Art. 9 (1972) UCC, see e.g. LoPucki 1995.

298 If the debtor is an individual, the debtor is located in the state in which its principal residence is located.

299 White & Summers 2002, § 31-16. In their words: “The messy, practical question about where the CEO goes to work and whether that is the chief office will not be relevant.” This was different under the Art. 9 (1972) UCC, see e.g. LoPucki 1995.

298 Hence, § 9-307(e) UCC establishes an ‘equivalence test’: if the laws of the debtor’s jurisdiction are not substantially equivalent to the filing system of Art. 9 UCC, as measured by the criteria set forth in § 9-307(c) UCC, the debtor is deemed to be located in – and thus, may perfect according to the laws of – the District of Columbia. In 1995, 6.6% of all filings were against foreign corporations, see LoPucki 1995, p. 581, footnote 14.

300 Hence, § 9-307(e) UCC establishes an ‘equivalence test’: if the laws of the debtor’s jurisdiction are not substantially equivalent to the filing system of Art. 9 UCC, as measured by the criteria set forth in § 9-307(c) UCC, the debtor is deemed to be located in – and thus, may perfect according to the laws of – the District of Columbia. In 1995, 6.6% of all filings were against foreign corporations, see LoPucki 1995, p. 581, footnote 14.

under the law of the United States, i.e. under federal law, are located in the state designated by that law.302

In case of a possessory security interest, the local law of the jurisdiction where the collateral is located governs perfection, the effect of perfection or non-perfection, and the priority (§ 9-301(2) UCC). The same applies to perfection of a security interest in goods by filing a fixture filing303 and agricultural liens on farm products: the local law of the jurisdiction in which farm products are located governs the perfection, effect of perfection, and priority (§§ 9-301(3)(A) and § 9-302 UCC). Under § 9-303(c) UCC, perfection of goods covered by a certificate of title is governed by the state under whose certificate of title law the goods are covered.

Once the debtor’s location is established by reference to § 9-301 and 9-307 UCC and which state’s law governs perfection, the particular state’s version of § 9-501 UCC has been examined in order to determine where to file the financing statement.304

3.3.3.2. Filing rules

Art. 9 UCC leaves it open to each state to designate the filing office where the financing statement should be filed, see the square brackets in § 9-501(a) UCC:

“(…) if the law of a particular state governs perfection of a security interest, the office in which to file a financing statement to perfect the security interest or agricultural lien is:
(2) the office of [].”

By allowing only for the indication of a governmental agency (e.g., the Secretary of State) or a private party that maintains the State’s filing system, Art. 9 UCC dictates central—not local—filings.305 Each state version of § 9-501 UCC makes this indication, but each state will refer to the (i.e. its own) Secretary of State office.

Hence, ‘central filing’ does not refer to a ‘country level’ filing office (see supra the first paragraph of subsection 3.3.3). ‘Central filing’ means that the financing statement should be filed at the centralized—hence, the one and only—Secretary of State office of a particular state, which is located in the capital city of that state. Hence, in Illinois the Secretary of State office is located in Springfield, in Ohio the office is located in Columbus, in North Carolina the office is in Raleigh etc. ‘Local filing’, on the other hand, refers to a type of office that is not centralized. Such local offices are located in several districts/counties and are called the (local) ‘Register of Deeds Office’. Each state, and to some degree, the cities, counties and other subdivisions of a state, determine how local filing is

302 § 9-307(f) UCC. Here too, if such a designation is absent, filing should take place in the District of Columbia.
303 More details on ‘fixture filings’ will follow down below in this subsection.
305 Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York). See also Sigman 1999a, p. 62.
organized. As a result, local filing offices differ as to what can be filed and how it is to be filed.306

Local filing is prescribed for financing statements with regard to (i) 'as-extracted collateral'307; (ii) 'timber to be cut'308; and (iii) financing statements filed as fixture filings with respect to goods that are or are to become fixtures. The subject of fixture filings will be discussed further down below in this subsection. In addition, Art. 9 UCC provides special filing provisions for transmitting utilities (e.g., railroad, electric company).309

Hence, by means of example: it is established that the debtor’s location is the state of Wyoming, thus the local law of Wyoming is applicable to the question of where to perfect. Since local law (Wyoming’s version of § 9-501 UCC) will refer to its own Secretary of State’s office for filing, for perfection to take place, one has to file the financing statement in that particular office.310 Since most debtors are ‘registered companies’, in most cases, incorporation-based filing is dictated and many filings will take place in Delaware.311 Accordingly, the proper place for filing and searching can be determined solely from the public record, with no need to be concerned with the location of the debtor’s collateral or operations.312

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306 Personal Interview with Professor LoPucki. Local filing is considered to be costly and inefficient. In addition, it is considered to create uncertainty. See Official Comment 2 to § 9-501 UCC: “As Comment 1 to former Section 9-401 observed: “The principal advantage of state-wide filing is ease of access to the credit information which the files exist to provide. Consider for example the national distributor who wishes to have current information about the credit standing of the thousands of persons he sells to on credit. The more completely the files are centralized on a state-wide basis, the easier and cheaper it becomes to procure credit information; the more the files are scattered in local filing units, the more burdensome and costly. Local filing increases the net costs of secured transactions also by increasing uncertainty and the number of required filings. Any benefit that local filing may have had in the 1950’s is now insubstantial. Accordingly, this Article dictates central filing for most situations, while retaining local filing for real-estate-related collateral and special filing provisions for transmitting utilities.”

307 § 9-501(a)(1)(A) UCC. According to § 9-102(a)(6) UCC, ‘as-extracted collateral’ means: “(a) oil, gas, or other minerals that are subject to a security interest that: (i) is created by a debtor having an interest in the minerals before extraction; and (ii) attaches to the minerals as extracted; or (b) accounts arising out of the sale at the wellhead or minehead of oil, gas, or other minerals in which the debtor had an interest before extraction.” According to Sigman, minerals and related accounts, see Sigman 1999a.

308 § 9-501(a)(1)(A) UCC. Once the timber is cut, it falls into the category of ‘goods’ and has to be filed in the central filing office of the place where the debtor is located, see § 9-102(a)(44) UCC and § 9-501(a)(2) UCC. Cf. Sigman 1999a, p. 62, footnote 13.

309 §§ 9-501(b) UCC, 9-102(a)(81) UCC and Official Comment 2 to § 9-501 UCC.

310 Hence, the Secretary of State office of New York will be the office where the filing should take place when New York law applies, the Secretary of State office of Nevada will be designated when Nevada law applies, etc. The operation of these rules seems to imply that American law makes no distinction between the choice of law rules and the question of substantive law as to where to actually file. Most authors seem to reason along these lines: because the local law of state X is applicable one has to read § 9-301-307 UCC as if it directly tells filers the correct state in which to file a financing statement and searchers where to search for such a financing statement. LoPucki & Warren 2009, p. 404 and Sigman 2004, p. 64-65. This might be explained by the fact that the phrase ‘governs perfection’ in § 9-301(1) UCC is considered to include the question where one should file (‘in order to be perfected’). To European scholars this may seem awkward, as it is circular. It would be beyond the scope of this thesis to further elaborate on this matter.

311 This was different in the original proposals; see LoPucki & Warren 2012, p. 412.


Chapter 5

Filing rules with regard to ‘fixtures’

Subsection 1.1 explained that if a movable asset ‘becomes so related to particular real property that an interest in them arises under real property law’, it becomes a ‘fixture’. After having selected the appropriate state on the basis of § 9-301(3)(A) UCC – the state where the fixture is located – that state’s version of 9-501(a) UCC gives the secured lender two ways to perfect security interests in goods that are, or are to become, fixtures.313 First, the secured lender may perfect a security interest in the fixture by filing a regular financing statement in the Secretary’s of State office as designated by § 9-501(a)(2) UCC. This is called a ‘non-fixture filing’.314 Second, the secured lender may perfect a security interest in the fixture by filing in the office that is designated for the filing or recording of mortgages on the real property to which such collateral relates, i.e. in the local real-property mortgage office (§ 9-501(a)(1)(B) UCC), known as ‘fixture filing’.315 Hence, ‘fixture filings’ – which, by definition, are recorded in the real property records – should be distinguished from ‘UCC filings covering fixtures’ filed in the Art. 9 UCC index.316

3.3.4. Filing the financing statement at the filing office

3.3.4.1. Acceptance by the filing officer

When a financing statement is offered physically317 for filing, the filing officer stamps the financing statement – or a copy thereof – with the date, one (or two) unique number(s), and notes the date and time of filing. Generally, the offered filing will be provided with a ‘file number’,318 a unique number that differentiates the filing offered from all other filings. In some states, filing officers also assign a ‘Financing Statement Number’ to a financing statement. This number refers to the entire record – so the initial financing statement and any amendments made thereto.319

313 See also Official Comment 4 to § 9-501 UCC.
315 Under § 9-102(a)(40) UCC, a ‘fixture filing’ is the filing of a financing statement covering goods that are or are to become fixtures and satisfying the requirements of § 9-502(a) and (b) UCC.
316 § 9-501(a) and Comments 3 and 4; § 9-102(a)(6), (40), (41), Sigman 1999a, p. 62 and White & Summers 2002, § 31-13 and § 33-5. When reference is made to the UCC ‘index’ as a noun, this refers to the searchable database in which data is stored.
317 In addition, in many states, filings may be presented by fax. Sigman 2004, p. 59.
318 According to § 9-519(b) UCC, a file number [assigned after January 1, 2002] must include a digit that: (1) is mathematically derived from or related to the other digits of the file number; and (2) aids the filing office in determining whether a number communicated as the file number includes a single-digit or transpositional error. According to LoPucki & Warren 2012, p. 297-298, in some local systems the file number is called the book and page number. ‘200725000018’ is an example of a file number in Ohio. Katie Zvolanek, see infra footnote 358.
319 Thus, when two subsequent filings have been made (an amendment and a continuation), each receives the same Financing Statement Number and a separate file number. An example of a Financing Statement Number in Ohio: ‘OH00059722615’. Katie Zvolanek, see infra footnote 358. An example of a Financing Statement Number in Texas: ‘120012345678’. Randy Moes, see infra footnote 358.
The filing officer returns the original financing statement to the filer, with a receipt. At a later time, a copy of the financing statement will be indexed as prescribed in § 9-519(a) UCC. In practice this means that a filing officer enters the data manually into the database (i.e. the computer system), scans the paper copies and saves the images into the database. The initial financing statement will be indexed according to the name of the debtor as well as all filed records relating to the initial financing statement, with the result that the relevant files are related to one another (§ 9-519(c)(1) UCC). The indexing has to be completed within two days of receipt by the officer (§ 9-519(h) UCC). The time at which the financing statement is offered to the filing office counts as the moment of filing (§ 9-516(a) UCC).

Filing can also take place electronically. Most Secretary of State filing offices list a public site that can be accessed through the internet. Whereas in 2004 only half of the states accepted electronic filings, in 2012, 46 out of 51 states accept these filings.

In the U.S. two different methods of electronic filing are available: ‘Web-based’ and ‘XML-based’. Web-based filing systems target all filers and are implemented differently in each jurisdiction. XML-based filings are prepared by the filer and transmitted electronically: they target large-volume filers like large lenders and service companies. Generally, XML-based filing solutions provided by jurisdictions implement the ‘IACA XML standard’ with minor to moderate deviations: this is a document containing recommendations to the states as to technical specifications for the processing of financing statements.

320 When using the verb ‘index’ I allude to the act of entering the data into the searchable database.
321 § 9-519(a) UCC prescribes ‘filing office duties’: “For each record filed in a filing office, the filing office shall: (1) assign a unique number to the filed record; (2) create a record that bears the number assigned to the filed record and the date and time of filing; (3) maintain the filed record for public inspection; and (4) index the filed record in accordance with subsections (c), (d), and (e).”
322 § 9-519(d) prescribes how indexing is done with respect to UCC filings covering fixtures. For more information on how financing statements are indexed, see LoPucki & Warren 2012, p. 297.
323 According to LoPucki & Warren filing offices are traditionally a few weeks behind in indexing new filings. In extreme cases, filing offices can be more than four months behind. LoPucki & Warren 2012, p. 384: “When such delays occur, the filing officers invariably blame their legislatures for not appropriating sufficient funds for the filing offices to carry the workload. No one can prove the filing officer wrong and no penalty is imposed for violating this article (…)”
324 An example is Ohio: <www.sos.state.oh.us> (last visited February 5, 2014).
325 LoPucki & Warren 2012, p. 297 for further references.
326 The 46 out of 51 mentioned states that accept electronic filing, accept this ‘standard’ way of ‘web-based filing’. In fact, these are all states except for Arizona, Florida, Louisiana, Maryland and Tennessee. Katie Zvolanek, see infra footnote 358.
328 The ‘IACA XML Technical Specifications For Uniform Commercial Code Revised [1999, DJYH] Article 9 (Version 2.4, July 14, 2011)’ can be found on <www.iaca.org/secured-transactions/xml-technicalSpecifications/> (last visited February 5, 2014; hereafter ‘IACA XML Standard’. It provides the main difference with Web based filing systems (HTML) on p. 7: “The web today is based on HTML, and it is an effective tool for creating a “look” and “feel” for a portal. Unfortunately HTML falls short because it is unable to “tag” or label an object on one site so another site or system can recognize that same object. Enter Extensible Mark-up Language,
Each jurisdiction uses a different method to handle acknowledgement of electronic filings. In most states, an electronic filing simply goes straight into the database without human intervention and completes the appropriate data fields. If human intervention is in place, filing officers ‘assign’ – not stamp – a sequential filing number to the filing, electronically return that information to the filer, and generate a PDF containing the information in the electronic filing plus the assigned filing number which is put ‘on record’ in place of a paper filing.

In general, those who file electronically fill out a financing statement on the website of the filing office – see the example form shown in subsection 3.3.1.4 – and charge the filing fee to their credit card. Frequent filers, such as financing institutions, often establish an account in advance through which electronic financing statements are transmitted. The filing fees are charged to the filer’s account upon receipt.

In the state Ohio, for example, the Secretary of State allows customers to have a prepay account that they have money deposited into; with each filing this office deducts the cost of the filing. Online users all have accounts and they can either pay by credit card or directly through a checking account (ACH payments). The bulk of frequent filers have one of the accounts described above.

Subsection 3.6 addresses the question when and to what extent the filing officers are bound to accept financing statements.

3.3.4.2. Filing fees

§ 9-525 UCC provides rules for all fees for filing and indexing and for responding to requests for information. States have the freedom to set the filing fees at their discretion, but the Official Comment provides certain incentives with regard to the fee structures employed. For example, electronic processing should be cheaper than written records, additional fees for multiple debtors should be imposed only with respect to written (XML). XML provides a mechanism to label sets of data so they can be shared between systems. It is the underlying standard for systems communication and enables the transfer of data across various media. XML is already being used in many systems including cellular phones, web and Windows applications.”

329 Randy Moes, see infra footnote 358.
330 Katie Zvolanek; see infra footnote 358. Technical details on the (complicated) process of processing financing statements can be found in the IACA XML Standard, p. 14-16.
332 Randy Moes, see infra footnote 358 and LoPucki & Warren 2012, p. 296-297
333 Katie Zvolanek; see infra footnote 358.
Each jurisdiction uses a different method to handle acknowledgement of electronic filings. In most states, an electronic filing simply goes straight into the database without human intervention and completes the appropriate data fields. If human intervention is in place, filing officers 'assign' – not stamp – a sequential filing number to the filing, electronically return that information to the filer, and generate a PDF containing the information in the electronic filing plus the assigned filing number which is put 'on record' in place of a paper filing. Those who file electronically fill out a financing statement on the website of the filing office – see the example form shown in subsection 3.3.1.4 – and charge the filing fee to their credit card. Frequent filers, such as financing institutions, often establish an account in advance through which electronic financing statements are transmitted. The filing fees are charged to the filer's account upon receipt.

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Compared to the filing systems that existed before Art. 9 UCC was adopted (which existed for each security device), the current system is considered to be an improvement from the viewpoint of both prospective creditors and existing secured creditors. Not only the costs of procuring information are reduced – which I will discuss in subsection 3.5.4. – but also the costs of filing. Some authors claim that the adoption of electronic filing has reduced the transaction costs by 75% and the costs of the actual perfecting by 90%. How financing statements are indexed will be discussed in subsection 3.5.1.

3.4. Filing updates

3.4.1. Maintaining perfection

Information concerning financing statements may become incorrect after the filing process has been completed: changes may occur in e.g. the name of the debtor, the amount and nature of the collateral. How post-filing changes affect the legal sufficiency of a financing statement and what can be done to mitigate the consequences will be discussed in subsection 2.4 of Chapter 6.

3.4.2. Amendments to a financing statement

Generally, it is permissible to add or delete collateral covered by, or otherwise amend the information provided in, a financing statement by filing an ‘amendment’. An amendment that adds collateral or a debtor does not need the debtor’s signature when filed, but it must be authorized by the debtor to be effective. The amendment does not extend the period of effectiveness of the financing statement. See the following page for the example of an amendment form adopted by the statute of Art. 9 UCC (‘Form UCC 3’).

334 Official Comment 2 to § 9-525 UCC.
336 Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).
337 §§ 9-512(a) and 9-509(a) UCC.
338 §§ 9-509(a), 9-510(a) UCC. § 9-402(4) (1972) UCC did require the debtor’s signature. See Official Comment 3 to § 9-512 UCC.
339 Unless otherwise provided in § 9-515 UCC. See §§ 9-512(b) UCC and 9-515 UCC.
### Example – UCC Amendment

**UCC FINANCING STATEMENT AMENDMENT**

**FOLLOW INSTRUCTIONS**

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A. NAME &amp; PHONE OF CONTACT AT FILER (optional):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B. E-MAIL CONTACT AT FILER (optional):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C. SEND ACKNOWLEDGMENT TO: (Name and Address):</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY**

1. **NAME & INITIALS:**
   - **FIRST PERSONAL NAME**
   - **ADDITIONAL NAME(S)/INITIAL(S)**
   - **SUFFIX**

2. **AND**
   - **FIRST PERSONAL NAME**
   - **ADDITIONAL NAME(S)/INITIAL(S)**
   - **SUFFIX**

3. **Also check one of these four boxes:**
   - **Check one of these four boxes:**
     - **ADD**
     - **DELETE**
     - **RESTATE COVERED collateral**
     - **ASSIGN collateral**

4. **PARTY INFORMATION CHANGE:**
   - **Complete for Assignment or Party Information Change:**
     - **ADD name:** Complete item 4.
     - **DELETE name:** Give record name in item 5a (or recorded) in the REAL ESTATE RECORDS.
     - **RESTATE covered collateral:**
       - **ADD name:** Complete item 6a.
       - **DELETE name:** Give record name in item 6b.
     - **ASSIGN collateral:**
       - **ADD name:** Complete item 6a.
       - **DELETE name:** Give record name in item 6b.

5. **CURRENT RECORD INFORMATION:**
   - **Complete for Party Information Change:**
     - **ADD name:** Complete item 7a or 7b.
     - **DELETE name:** Give record name in item 7b.

6. **NEW RECORD INFORMATION:**
   - **NEW RECORD INFORMATION:**
     - **ADD name:** Complete item 8.
     - **DELETE name:** Give record name in item 8.
     - **ASSIGN collateral:**
       - **ADD name:** Complete item 8.
       - **DELETE name:** Give record name in item 8.

7. **OTHER INFORMATION:**
   - **OTHER INFORMATION:**
     - **ADD name:** Complete item 9.
     - **DELETE name:** Give record name in item 9.

8. **COLLATERAL CHANGE:**
   - **ADD collateral:**
     - **DELETE collateral:**
     - **RESTATE covered collateral:**
     - **ASSIGN collateral:**

9. **NAME OF SECURED PARTY OF RECORD AUTHORIZING THIS AMENDMENT:**
   - **Provide only one name:**
     - **FULL NAME:**
   - **Provide only one name:**
     - **FULL NAME:**

10. **OPTIONAL FILER REFERENCE DATA:**
    - **Provide only one name:**
      - **FULL NAME:**

**FILING OFFICE COPY — UCC FINANCING STATEMENT AMENDMENT (Form UCC3) (Rev. 04/20/11)**
Although ‘continuation statements’ and ‘termination statements’ – see the next subsection for more details – are different types of amendments, Art. 9 UCC contains separate sections containing specific rules applicable to these types of amendments. Hence, a single amendment can serve multiple purposes: it can accomplish continuation and add a debtor or collateral at the same time.\(^\text{340}\) In making an amendment, two alternative techniques may be used: an amendment may identify the information contained in the financing statement that is to be changed only, or; alternatively, it may take the form of an amended and restated financing statement.\(^\text{341}\)

An amendment becomes part of the financing statement to which it relates (\(\$ 9-102(a)(39)\) UCC) so it must identify, by its file number, the initial financing statement to which it relates (\(\$ 9-512(a)(1)\) UCC). If an amendment adds a debtor, it is effective with regard to the added debtor only if the added debtor authorizes the filing (\(\$ 9-509(a)\) UCC) starting from the date of the filing of the amendment, not from the date of the filing of the initial financing statement (\(\$ 9-512(d)\) UCC).\(^\text{342}\) The same is true if the amendment adds collateral; it is effective as to the added collateral only from the date of the filing of the amendment (\(\$ 9-512(e)\) UCC).\(^\text{343}\) The next subsection will address how a debtor or (part of) the collateral is removed from filings in the filing system.

3.4.3. Termination of a financing statement and release

3.4.3.1. Usual termination

If a debtor has paid off the secured obligation and there is no commitment left to make an advance, the debtor has to be able to ‘clear title’ to the property in order to obtain financing from another lender.\(^\text{344}\) Therefore, the financing statement in the filing system should be removed. In most states, it is not possible to literally remove financing statements from the files: instead, a ‘termination statement’ should be filed, which is the addition of another document stating that the earlier document is no longer effective (\(\$ 9-102(a)(80)(B)\) UCC). As the example on the previous page shows, a termination statement is no more than an amendment with the ‘Termination’ box indicated.

Since termination statements – as all amendments – become part of the financing statement to which they relate they must identify the initial financing statement by stating

\(^{340}\) Official Comment 2 to \(\$ 9-512\) UCC.

\(^{341}\) In this case, the amendment would state for example: “the financing statement is amended and restated to read as follows: (...)”. See Official Comment 3 to \(\$ 9-512\) UCC.

\(^{342}\) The same applies to the determination of priority.

\(^{343}\) An amendment is ineffective to the extent it purports to delete all debtors and fails to provide the name of a debtor to be covered by the financing statement, or purports to delete all secured parties of record and fails to provide the name of a new secured party of record (\(\$ 9-512(e)\) UCC). Cf. Official Comment 5 to \(\$ 9-512\) UCC.

\(^{344}\) In addition, the lender can benefit from having a financing statement removed from the filing system, as it will receive fewer bothering inquiries about property in which it no longer has a security interest. See LoPucki & Warren 2012, p. 379.
the same ‘file number’. \textsuperscript{345} The lender must send this termination statement to the debtor or the filing office within 20 days after \textit{the debtor} has requested this by means of an authenticated demand (§ 9-513(c)(1) UCC). \textsuperscript{346} Hence, a lender cannot make such a request. Upon the filing of a termination statement, the financing statement ceases to be effective (§ 9-513(d) UCC).

In a prototypical secured transaction between a debtor and a lender, after signing the security agreement, the lender sends a properly filled out financing statement to the Secretary of State for filing. At the same time, a lender typically orders a search of both the UCC filing system and the local county real estate records in order to determine whether a prior security right in the debtor’s property has been established. If the lender comes across another financing statement, it will request the first-in-time secured creditor on file to inform him about the amount due and, if necessary, to prepare a ‘termination statement’. In the usual course of events, the debtor will receive the signed authorization to file the termination statement when it can show the first lender a check for the exact balance outstanding (including the interest computed up to the day of the closing). \textsuperscript{347}

If the secured party fails to send a termination statement to the filing office or the debtor after the former received an authenticated demand, it becomes liable for ‘actual damages’, referring to e.g. loss resulting from the debtor’s inability to obtain, or increased costs of, alternative financing. \textsuperscript{348} In addition, it will be fined a (fixed) civil penalty of $500. \textsuperscript{349}

3.4.3.2. Bogus filings

A financing statement can also be filed without being authorized by the debtor \textit{from the very outset}. \textsuperscript{350} Such a ‘bogus filing’ – sometimes referred to as a ‘harassment’ or a ‘straw man’ filing – is mostly undertaken to harass public figures or to affect their credit status. \textsuperscript{351} A bogus filing has no effect and does not result in perfection (§ 9-510(a) UCC). \textsuperscript{352} Nevertheless, it can be crucial for the (person named as) debtor to have a financing statement terminated since it may prevent the debtor from obtaining secured

\textsuperscript{345} § 9-102(a)(80)(A) UCC.

\textsuperscript{346} This is different in the case of ‘consumer goods’: in this case § 9-513(a)(1) UCC provides that the secured party himself, \textit{i.e.} without being requested by the debtor, has the duty to file a termination statement within one month after the debt has been paid in full. This rule is prompted by the belief that many consumers will not realize the importance of clearing the public record. See Official Comment 2 to § 9-513 UCC.


\textsuperscript{348} § 9-625(b) UCC. In addition, competing creditors (including senior creditors) holding a security interest or other type of lien may recover damages. See § 9-625(c) UCC and Official Comment 3 to § 9-625 UCC.

\textsuperscript{349} § 9-625(b) UCC and (e)(4) UCC. See also on this subject: Harris & Mooney 2006, p. 95 \textit{et seq.} and LoPucki & Warren 2012, p. 379.

\textsuperscript{350} This person is in violation of § 9-509(a)(1) UCC. In addition, it is liable under § 9-265(a) and (c) UCC for actual and statutory damages. See also Official Comment 3 to § 9-509 UCC.


\textsuperscript{352} In addition, the filing of a bogus filing results in a $ 500 penalty, see §§ 9-625(e)(3), 9-509(a)(1) UCC. See also Sigman 1999a, p. 69 on this topic.
finance from another lender. For this to be achieved, the debtor can ask the (person named as) secured party to provide a termination statement for a financing statement whose filing the putative debtor did not authorize. If no termination statement is forthcoming, the debtor itself may authorize the filing of a termination statement. Alternatively, the (alleged) debtor is entitled to file a so-called ‘information statement’, which sets forth the basis for the debtor’s belief that the financing statement was inaccurate or wrongfully filed, i.e. the public record should be corrected (§ 9-518 UCC). Since 2010, also a secured party of record with respect to the financing statement that believes that such a record has been filed may file an information statement indicating that the person that filed the record was not entitled to do so (§ 9-518(e) UCC.

In 2003 the Bogus Filing Task Force was established by the Secured Transactions Section (‘STS’) of the International Association of Commercial Administrators (‘IACA’) to combat (the persons who file) bogus filings. Since the subject of bogus filings and the solutions to this problem relate more closely to the question which problems the U.S. notice filing system brings about – i.e. the subject of Chapter 6 – I refer to that chapter for further details.

The IACA is a professional organization composed of administrators that work for and with government filing offices throughout the United States and other countries that have or anticipate the development of similar filing systems. The (in the context of this study) most important section of the IACA is the ‘STS’; the Secured Transactions Section, which is comprised by IACA members who have responsibility for the personal property secured transaction registry functions in their jurisdiction. STS’ main concern is the standardization of information requirements and the search results in secured transaction registries. Therefore, it played an important role in the design of the filing provisions in the revision of Art. 9 UCC.

3.4.3.3. Release

It is also possible to release part of the collateral from coverage of a financing statement. The secured party can achieve this by amending the financing statement (§ 9-512(a) UCC); see heading 8, box ‘describe collateral deleted’ on Form UCC 3. The secured party is not obliged to partially release security unless it has undertaken by contract to do so. Here, too, the amendment should identify the initial financing statement to which it relates by using the same file number. After the amendment is filed, it becomes part of the financing statement (§ 9-102(a)(39) UCC).

353 If the debtor does not know the address of the named secured party, because there is no relationship with this party whatsoever, according to § 1-202(e) UCC the putative secured party is deemed to have received a notification if it is delivered to the address shown in the financing statement. Official Comment 3 to § 9-513 UCC.
354 See also § 9-509(d)(2) UCC and Official Comment 3 to § 9-513 UCC.
355 However, the filing of an information statement does not affect the effectiveness of an initial financing statement or other filed record; see § 9-518(e) UCC. Moreover, the secured party does not have a duty to file a termination statement. Under Art. 9 (1999) UCC this statement was called a ‘correction statement’.
356 See <www.iaca.org/secured-transactions/> (last visited February 5, 2014).

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3.5. Searching the register

3.5.1. The filing system

The search methods used in the different filing offices differ considerably. Filing offices use different types of technology, thus they process and store the financing statements (and addenda) according to their own methods. For the sake of clarity, I will explain only the main structure of how these filing offices operate in allowing people to search files.

To reiterate, the Secretary of State filing offices (‘UCC filing offices’) generally provide for the possibility to offer financing statements in paper form, i.e. to offer a financing statement physically. When this is completed, filing officers enter the relevant data into the database manually; they scan the paper copies and save the images into the database (i.e. the computer system). In case of electronic filing, a similar process will take place, except that in most cases a manual entry is not required: generally, the information is entered into the database automatically upon acceptance of the filing. In both cases, financing statements and supplementing documents are stored in the index, which can be assessed publicly.

While in some states, several search methods are allowed, i.e. permission to search under the secured creditor’s name or use of file numbers, filings are most typically searched under the debtor’s name. This explains why the requirement of the debtor’s name as provided on the financing statements is so strict (see supra subsection 3.3.1.1) and, moreover, why the financing statement is ineffective if this requirement is not observed. In addition to the debtor’s name, however, both the secured party’s name and the file number (if available) may be helpful in distinguishing a particular debtor

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358 I am especially indebted to Katie Zvolanek (Secured Transactions Section Chair for IACA and Corporations Counsel/UCC & Corporations Supervisor for the Ohio Secretary of State), Paul Hodnefield (Associate General Counsel at Corporation Service Company; a specialist in UCC Article 9 search and filing issues) and Randy Moes (Director of the Texas Secretary of State’s Office and President of the IACA) who were most helpful in supporting me to obtain the information that is provided in this subsection and for which I of course take full responsibility.

359 It is beyond the scope of this thesis to investigate the various search methods and types of technology used by all the different filing offices. Nonetheless, it is important to realize that the result of the fact that various technologies have been implemented in the particular systems is that each type of technology creates its own legal problems. Randy Moes, see previous footnote. Cf. LoPucki & Warren 2012, p. 297.

360 After all, most typically, searchers will not know the prior secured party or file number of the financing statement on file. Above all, this is in accordance with § 9-519(c) UCC, which prescribes ‘debtor-based filing’. See supra subsection 3.3.4.1.

361 In a nutshell, filing a financing statement is not effective if the name of the debtor is provided in such a way, that a search under the debtor’s correct name while using the filing office’s standard search logic would not disclose the financing statement; see § 9-506(a),(c) UCC and subsection 3.7.3.

362 I reiterate that in some states a distinction is made between a ‘Financing Statement Number’ – referring to the entire record, i.e. the initial financing statement including any amendments made thereto – and the ‘file number’, a unique number that differentiates the filing offered from all other filings. Some states permit a search by either number.
from other debtors with the same or similar names. More specific information as to how exactly the debtor is searched for will be provided in subsection 3.5.2.

3.5.2. Search systems and search logic

Although not all UCC filing offices permit electronic filing, they do permit computerized searching.363 This was different in the (recent) past, when some filing systems still provided for alphabetic indexes that were searched manually by reference to hard copies from an index. In these systems, searchers interested in ‘Hamwijk’ simply had to start with letter ‘H’ on the piece of paper.

When a searcher starts a computerized search, it has to enter the name in a search field and look for the correct name on the list of matching entries. The rules that determine what the program considers to be equivalent are called ‘search logic’. Each state has its own official standard search logic’ (‘SSL’).364 In addition, filing offices often use an ‘unofficial search logic’ to facilitate searches. Yet, search logic differs greatly from one filing office to another.365 In some systems only the debtor’s identical name entered results in a matching financing statement, whereas in other systems there is more margin for entering equivalents such as ‘D. Hamwijk’ or ‘Hamwijk, Dewi’ to provide the correct result. Systems sometimes inform users as to the particular search logic employed, but in some systems this information is available only to system managers.366

In an attempt to align the file-and-search process, many UCC filing offices have adopted the standard search logic or a variant thereof, of the Model Administrative Rules (‘MARS’) as adopted by the IACA for Art. 9 (2001) UCC (§ 9-526 UCC) in 2007 (hereafter ‘MARS’ SSL’).367 The MARS’ SSL includes e.g. the following rules:368

1. There is no limit to the number of matches that may be returned in response to the search criteria.
2. No distinction is made between upper and lower case letters.
3. The character ‘&’ should be deleted and be replaced with ‘and’.
4. All punctuation marks and accents should be disregarded.

363 Paul Hodnefield, see supra footnote 358.
364 We will see in subsection 3.7.3 that the ultimate test in establishing the sufficiency of the debtor’s name is not whether the searcher actually found the financing statement, but whether a ‘hypothetical search’ under the correct name of the debtor produces the financing statement. In applying this test, the office’s official search logic, i.e. its ‘SSL’ is the only applicable benchmark (§ 9-506(c) UCC).
367 More specifically, the IACA promulgated the MARS at the 2007 Conference in Seattle, Washington, on May 17, 2007. In addition to the SSL, the MARS contains e.g. general provisions, rules for acceptance and refusal of records by filing officers, rules on how filing officers should store, index and retrieve information relating to financing statements, rules on how filing officers should deal with search requests etc.
368 The MARS rules can be found on: <www.iaca.org/secured-transactions/model-administrative-rules/> (last visited February 5, 2014).
5. So-called ‘Ending Noise Words’ — words and abbreviations at the end of an organization name that indicate the existence or nature of the organization — should be disregarded. It is up to the filing office’s programming to adopt its own list of ‘Ending Noise Words’.

6. The word ‘the’ at the beginning of an organization debtor name should be disregarded.

7. All spaces should be disregarded. 370

These rules show that the MARS’ SSL is quite unforgiving: it will only disregard simple variations in spaces, punctuation and ending noise words that designate the type or existence of an entity. Any substantive variation in the name will prevent a search using SSL from disclosing the financing statement. Since the MARS’ SSL offers nothing more than a ‘model’ to guide states, some states have adopted them in their entirety, some adopted only bits and pieces of it, and some did not adopt it at all. As a result, many differences persisted between the used search logics of the different UCC filing offices. 371 Chapter 6 will analyze in detail if and to what extent this causes problems in the search process.

When the debtor who is the object of the search shows up on the list of potential entries, the financing statement can often be viewed as an image. Still, not all filing offices allowing online searches have the images available online; 372 sometimes these images must be ordered separately.

3.5.3. Who may search?

The filing system is searched daily in very large numbers. 373 Filing systems have different stipulations as to who is permitted to search the files. In most systems it is permitted to search the system oneself, for example by physically entering the filing office and logging in on the computers to conduct a general search or by searching online via remote access. 374 Customers can also request certified searches through the filing office. Yet, some filing offices allow only employees to access the files. Those offices will accept search requests concerning most versions of the IACA UCC forms designed for this purpose, on which the search requested is specified by entering the exact name(s) of the

369 A few illustrations of the operation of this MARS’ SSL: if one were to search (individual debtor) Dewi J. Hamwijk, it would ignore the middle initial and it would return all results for Dewi Hamwijk. If one were to search D Hamwijk, it should return all results that have a first name that begins with D and has the last name Hamwijk. So in this case, one might receive results for Denise Hamwijk, Derreck Hamwijk, and Dewi Hamwijk. For organization debtors, the search logic ignores entity endings (e.g., Inc., Co., LLC, etc.) and would focus on the name. If the search entered was Hercules Housing LLC, the search would ignore the LLC and would return any result that began with Hercules Housing, i.e., one might receive results for Hercules Housing LLC, Hercules Housing & Interior Co., and Hercules Housing Building Offices Inc. For more examples see Hodnefield 2010, p. 10 and Harris & Mooney 2006, p. 165-167.

370 Paul Hodnefield, Katie Zvolanek and Randy Moes, see supra footnote 358.

371 When paper financing statements are scanned, word searches are not possible. When financing statements are filed electronically, word searches are often possible. LoPucki & Warren 2012, p. 297-298 and Randy Moes, see supra footnote 358.

372 Paul Hodnefield, see supra footnote 358.

373 Although somewhat outdated, see LoPucki 1995, p. 577 and 606, footnote 101 where he describes Westlaw’s PH-VCC database, which contains information on the amount of searches for UCC filings in 17 states.

debtors.\textsuperscript{375} Still, most searches are conducted through ‘service companies’.\textsuperscript{376} Service companies conduct UCC searches and filings on request for banks, leasing enterprises and other firms specializing in secured transactions.

By simply googling ‘service companies + UCC filing’ or a similar search term, tons of those service companies will show up. Most typically, they offer their services by promising an increase of the accuracy of filings and to reduce the rejection rate on the UCC filings.\textsuperscript{377} Usually, service companies accept search requests by telephone or they provide prescribed forms online.\textsuperscript{378}

The filing officer may provide the requested information in every feasible way, but has to do so no later than two days after the request for information (§ 9-519(h) UCC).

Several states have omitted the 2-day turnaround requirement or adopted a non-uniform version that extended that period. Moreover, in practice some filing offices have been very liberal in how they interpret permissible reasons for delay set forth in § 9-524 UCC. Nonetheless, most filing offices deliver the requested information within a couple of days. Electronic filings are returned even faster.\textsuperscript{379}

3.5.4. Search fees

Although some filing systems do not charge customers who search their indices, most filing offices ask for a search fee. Search fees are specified usually in a state statute.\textsuperscript{380} The search fees vary widely by state, and are different depending on the question as to whether the filing office’s official SSL is employed, whether the search is conducted online or through the filing office. Without taking the number of copies into account – a fact that can significantly influence the costs\textsuperscript{381} – an average fee is between $10 to $75.\textsuperscript{382} Yet, since most of the time lenders and lawyers employ service companies, more often than not, two fees are paid – one to the filing office and one to the search company. Most commonly, the service company charges both the search fee and arranges for payment of the search fee to the filing office. Those fees are approximately $50 per individual search, \textit{i.e.} the search of a single name would cost $50 per state: an additional

\textsuperscript{375} Paul Hodnefield and Randy Moes, see \textit{supra} footnote 358. According to LoPucki & Warren 2012, p. 297-298, this would even apply to many filing offices.


\textsuperscript{378} Cf. LoPucki & Warren 2012, p. 292-293.

\textsuperscript{379} Paul Hodnefield and Randy Moes, see \textit{supra} footnote 358.

\textsuperscript{380} Katie Zvolanek, see \textit{supra} footnote 358. Sigman 2004, p. 77 and LoPucki & Warren 2012, p. 292-293.

\textsuperscript{381} These costs will depend on the complexity of the debtor’s name and/or the debtor’s business structure. The number of copies can vary from a few pages to hundreds and the fee charged for a copy is normally a dollar a page. Randy Moes, see \textit{supra} footnote 358 and LoPucki & Warren 2012, p. 292 et seq.

\textsuperscript{382} Paul Hodnefield, see \textit{supra} footnote 358. In Ohio, for example, the fee for a certified search is $20, whereas the public website search is free. Katie Zvolanek, see \textit{supra} footnote 358. In Texas, a certified search costs $15. Randy Moes, see \textit{supra} footnote 358.
name or the search of a filing system in another state would cost an additional $50. Occasionally, service companies charge extra fees because they have to deliver the results of their search on very short notice or deliver results overnight.383

It is not uncommon for multiple searches being conducted simultaneously if the searcher is not certain as to the filing office where a search or filing should be made. The search fees are then paid for every separate search. This issue of where to search and file is not always self-evident and seems to be one that requires in-depth knowledge of the law and of the operation of the various filing systems. According to LoPucki and Warren: “the search fees, DJYH[...] remain small in relation to the amounts of money involved in most commercial lending transactions. For this reason, a lawyer who is uncertain as to the filing office in which a particular search or filing should be made can often solve the problem by searching or filing in more than one system.”384

3.6. Reasons for refusal of a financing statement

In accepting a financing statement, filing officers do not determine whether the information on the record is accurate as their role is ministerial.385 The only ground for refusal of acceptance is the absence of information. More specifically, a filing officer must refuse a filing if it does not contain: the name of the debtor,386 the name of the secured party,387 the mailing address of the secured party,388 the mailing address of the debtor389 and an indication of whether the name of the debtor is the name of an individual or an organization.390, 391 In addition, filing officers may refuse a filing when the filing fee is not tendered,392 or when the filing officer is unable to read the information or index the record.393 If the filing officer indeed refuses to accept the financing statement, due to failure to comply with these requirements, the filing is not effective.394

383 LoPucki & Warren 2012, p. 292 et seq. and Paul Hodnefield, see supra footnote 358.
384 LoPucki & Warren 2012, p. 293.
385 Official Comment 2 to § 9-516 and Official Comment 3 to § 9-520 UCC.
386 § 9-520(a) and § 9-516(b)(3)(A) UCC.
387 Or their representative; § 9-520(a) and § 9-516(b)(4) UCC.
388 Or the mailing address of the representative; § 9-520(a) and § 9-516(b)(4) UCC.
389 § 9-520(a) and § 9-516(b)(5)(A) UCC.
390 § 9-520(a) and § 9-516(b)(5)(B) UCC.
391 Before the 2010 amendments, § 9-516(b)(5) also contained a subsection (C). This section set forth three more grounds for refusal of a financing statement: the type of organization (§ 9-516(b)(5)(C)(i) (2009) UCC), the debtor’s jurisdiction of organization (§ 9-516(b)(5)(C)(ii) (2009) UCC)) and the debtor’s organizational identification number (or indicate that it has none) (§ 9-516(b)(5)(C)(iii) (2009) UCC). The 2010 amendments deleted this subsection to simplify the filing process. For more information on the motives of deleting this subsection, see Sigman 2011, p. 488.
392 § 9-516(b)(2) UCC.
393 §§ 9-516(b)(1),(3) and (c)(1) UCC. Hence, for the most part, the bases for rejection are limited to those that prevent the filing office from dealing with the financing statement it receives, because the name of the debtor is missing or the financing statement is not communicated by a method or medium that the filing officer accepts, or, because the filing fee has not been paid. See Official Comment 2 to § 9-520 UCC. Cf. Harris & Mooney 2006, p. 174-175 and Picker 2009, p. 109-110 on this subject.
394 The requirement of an indication of the collateral covered is the only requirement that cannot be the basis of refusal of the financing statement by the filing officer. See §§ 9-520 and 9-516(b) in which the requirement of an indication of the collateral covered is not mentioned.
It is not very likely that a refusal occurs often, because the filing officer is obliged to communicate the refusal and the reason thereof to the filer and, in addition, it has to give notice of the time the financing statement would have been filed had the filing officer accepted it (§ 9-520(b) UCC). As already mentioned, this has to be done not later than two days after the filing office receives the record. Customarily, the filer will correct the failure and try again. The same applies when a financing statement is filed electronically: it cannot be electronically submitted if the financing statement omits the data as mentioned in § 9-516(b) UCC because the filing office is required under § 9-520(a) UCC to refuse to accept records that omit that information. The absence of an indication of the collateral may be an exception, because this is not a statutory reason for. However, most, if not all, electronic filing systems will require an indication of the collateral.395

If the filing officer does accept the financing statement despite this failure, the extent to which the financing statement is effective depends on the question of which information is absent. See subsection 3.7.

3.7. Filing office errors in accepting and rejecting filings
3.7.1. Incorrectly accepted filings

Where it comes to financing statements that have been accepted, a distinction is made between the absence of ‘crucial’ information (represented in the first three requirements set out in subsection 3.6)396 and ‘less crucial’ information (represented in the remaining requirements of subsection 3.6).397 If a financing statement does not contain the name of the debtor, the name of the secured party or an indication of the collateral covered—i.e. ‘crucial’ information—the financing statement is not effective at all, even if it is accepted and indexed by the filing officer (§ 9-520(c) UCC).

It is not very likely that a secured creditor forgets to state the debtor’s name or its own name on the financing statement and that, moreover, such a financing statement is nevertheless accepted by the filing officer. Yet, the last option is conceivable when a financing statement is filed under the flag of multiple secured lenders: one lender may simply be forgotten. In this case, that omitted lender will simply not be perfected.

When a financing statement does contain the name of the debtor, the name of the secured party and an indication of the collateral covered, but does not provide for the other, ‘less crucial’ elements as just mentioned in subsection 3.6 (e.g. the mailing address of the debtor), but the filing officer does accept the financing statement nevertheless, the filing is fully effective (§ 9-520(c) UCC).398

It might seem awkward that a financing statement that should have been rejected is still fully effective. According to LoPucki & Warren this should be explained by the idea that a searcher will not be misled by a financing statement on file with (a few) blank fields; it

395 Paul Hodnefield, see supra footnote 358.
396 I.e. it does not meet the requirements of § 9-502(a) UCC.
397 I.e. it fails to meet the requirements of § 9-520(a) UCC and § 9-516(b) UCC.
398 See also Official Comment 3 to § 9-520 UCC.
will simply know that some information is missing and, consequently, needs further inquiry. Besides that, this rule protects the secured party against errors of which he was not – but could have been – made aware by the filing officer (and could have corrected immediately). Hence, in this case the drafters chose to leave it to the searchers to make further inspections instead of victimizing secured parties. Since filings are offered more and more electronically, this will not occur often since financing statements cannot be electronically submitted if the financing statement omits the data as mentioned in § 9-516 UCC.

### 3.7.2. Incorrectly rejected filings

When a financing statement contains all of the elements mentioned in subsection 3.6, but the filing officer refuses to accept it for other reasons, the filing will not show up in the public filing system during a search. Instead, it will be returned to the filer stamped with the date and time of the attempt to file. Nonetheless, the non-filing is considered to be partly effective to perfect the underlying security interest, namely against lien creditors and the trustee(s) in bankruptcy only (§ 9-516(d) UCC). This partial effectiveness is often referred to as a ‘lien perfected’ financing statement. The implicit purpose of this rule is protection of the secured party against improper actions on the part of the filing officer.

Protecting the secured party against judicial lien creditors (and the trustee in bankruptcy) only, is motivated by the belief of the Art. 9 UCC drafters that judicial lien creditors would not in any way be prejudiced by failure of the financing statements to appear since they do not search the filing system. Therefore, the drafters chose to protect third parties that do rely on the filing system, such as ‘purchasers’ e.g. secured parties.

Non-filing has no effect whatsoever against purchasers of the collateral, who gave value and acted in reasonable reliance upon the absence of the record from the files (§ 9-516(d) UCC). In common parlance, the filing is not ‘purchaser perfected’. Here, ‘purchasers’ – i.e. prospective buyers and secured lenders – are protected against improper actions of the filing officer.

### 3.7.3. Accepted filings containing errors made by the filer

Since filing officers do not check whether the information on the financing statement is correct, what happens if an accepted filing does contain all the required elements, but does

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400 I.e. it satisfies both § 9-502 UCC and § 9-516(b) UCC.
401 § 9-520(b) UCC. Cf. LoPucki & Warren 2012, p. 315.
402 LoPucki & Warren argue that this was a matter of faith, not empirical reality. LoPucki & Warren 2012, p. 315.
403 In the UCC, ‘purchasers’ includes secured parties, but not lien creditors, see § 1-201(b)(29) and (30) UCC.
404 See previous footnote. In section 4, the priority rule of § 9-338 UCC – that a ‘lien perfected’-filing does not have priority over secured creditors and other purchasers – will be discussed since it is dictated by the same motives.
so erroneously, i.e. the financing statement contains an error made by the filing secured party itself? The filer can make two types of errors that should be distinguished.

The first type of error relates to the question of whether or not the financing statement has become seriously misleading due to misstating the name of the debtor – the most crucial part of the financing statement. A financing statement is seriously misleading as a matter of law when it fails to sufficiently provide the name of the debtor (§ 9-502(a) UCC). There is, however, limited protection for minor errors: if the financing statement nevertheless would be discovered in a search under the debtor’s correct name, using the filing office’s (official) SSL, the incorrect name does not make the financing statement seriously misleading (§ 9-506(c) UCC). Put differently: even if a debtor’s name is misstated on the financing statement, this will not be considered ‘seriously misleading’ (and the financing statement is thus effective despite the error) as a matter of law, as long as the search under the debtor’s correct name would locate the financing statement. This rule balances the interests of searchers and filers.

Financing may also wrongly indicate a secured creditor’s name. This may be the case, for example, when it has stated its trade name rather than its legal name on the financing statement (believe it or not: banks are businesses too). Mistakes in the secured creditor’s name will however not yield a financing statement untraceable since these are filed under the debtor’s name. Such mistakes will therefore not yield the financing statement ‘seriously misleading’ on the basis of § 9-502(a) UCC.

This can be explained by the fact that financing statements are indexed by the debtor’s name. As a result, there is a major difference in incorrectly stating the debtor’s name as opposed to incorrectly stating the secured creditor’s name: a mistake in the debtor’s name may prevent the statement from ever being found, while the consequence of incorrectly stating the secured creditor’s name is perhaps that the searcher is confronted with two entities with a similar name.

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405 § 9-506(b) UCC.
406 How forgiving this rule is will depend completely on the nature of the SSL adopted by the filing office where the filing was made. If it has adopted the MARS’ SSL (only), it is rather unforgiving since it will only disregard simple variations in spaces, punctuation and ending noise words that designate the type or existence of an entity. Compare LoPucki 2007, p. 293 in this respect: “From the standpoint of the filer, the rule is a harsh one because virtually any spelling error other than (1) punctuation, spacing, and capitalization and (2) errors in ‘noise ending words’ such as ‘Corp.,’ ‘Corporation,’ ‘Inc.,’ ‘Incorporated,’ ‘Company’ ‘Co.,’ and the like, renders the filing ineffective.”
407 Sigman 1999a, p. 73.
408 According to Official Comment 2 to § 9-506 UCC, an error in the secured party’s name may nonetheless give rise to an estoppel in favor of a particular holder of a conflicting claim to the collateral. Picker illustrates that this could be decided in cases that involve insider relationships on which distinguishing between the various creditors becomes important, e.g. shareholders providing (secured) loans. See Picker 2009, p. 140.
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A financing statement that is seriously misleading is ineffective.\footnote{410} This means that the security interest it covers is neither ‘purchaser’-perfected nor ‘lien’-perfected. Section 4 will focus on this point in more detail: a purchaser of the collateral who gives value and acted in reasonable reliance upon the absence of the record from the files – such as a buyer or a secured party – will be protected in the sense that the prior security interest (which financing statement was seriously misleading) will be subordinated.\footnote{411} Hence, the responsibility of stating the debtor’s name correctly is on the filing party. This enables the searching party to rely on that name. In addition, it eliminates the necessity of multiple searches. The ultimate test in establishing the sufficiency of the debtor’s name is not whether the searcher actually found the financing statement, but whether a ‘hypothetical search’ under the correct name of the debtor and by use of the office’s ‘SSL’, produces the financing statement (§ 9-506(c) UCC).\footnote{412}

Under Art. 9 (1972) UCC, courts had the duty to ignore errors in the debtor’s name in financing statements if they were ‘minor’ and ‘not seriously misleading’ (see § 9-402(8) (1972) UCC). As a result, instead of evaluating the fulfillment of these standards by examining whether the searcher at stake has searched the target-debtor by using the official search logic of the filing office – as is the case since the adoption of Art. 9 (2001) UCC – searchers were expected to conduct ‘reasonable diligent searches’ to find defective filings.\footnote{413} This resulted in a difficult, burdensome and costly search process, since searchers had to search for misspellings and variations of the debtor’s name instead of simply typing the single correct name of the debtor only.\footnote{414} In Art. 9 (2001) UCC the drafters tried to decrease this burden to searchers with respect to registered entities, by requiring filers to state on financing statements the exact, correct, name of the debtor, forgiving only errors that would be caught by the filing office’s official search logic.\footnote{415} By doing so, searchers can simply use the filing office’ SSL and be sure that the filing they found were the only effective ones on file.\footnote{416} If it is really all that simple will be further analyzed in Chapter 6.

The second type of error a filer can make relates to the ‘less crucial’ information as provided by § 9-516 UCC, such as mistakes made in e.g. the mailing address of the debtor.

\footnote{410}§ 9-506(a) UCC provides that if the financing statement provides the name of the debtor, the name of the secured party and a description of the collateral (§ 9-502 UCC), it is effective (despite minor errors or omissions) unless the errors or omissions make the financing statement seriously misleading.\\
\footnote{411}§ 9-338 UCC.\\
\footnote{412}In addition, this rule leads to the conclusion that a financing statement that is seriously misleading is ineffective, even if it is disclosed by (i) using a search logic other than that of the filing office to search the official records, or (ii) using the filing office’s standard search logic to search a database other than that of the filing office. See Official Comment 2 to § 9-506 UCC.\\
\footnote{413}This was held in e.g. In re Summit Staffing of Polk County, Inc., 305 B.R. 347, 354 (Bankr. M.D. Fla. 2003).\\
\footnote{414}LoPucki 2007, p. 281, 284. Under Art. 9 (1972) UCC, courts sometimes even held that financing statements were not seriously misleading even though they stated a debtor’s misspelled name, trade name or previously used name. Adams et al put forward in this respect: “Because of such decisions, a prudent searcher, to increase the likelihood that his search will not miss effective filings, must request information on all the names under which the debtor in question may have transacted business.” Adams et al 1995, p. 897-989, especially footnote 100-102.\\
\footnote{415}§§ 9-301(1), 9-307(e), § 9-503(a)(1), § 9-506(c) UCC.\\
\footnote{416}See e.g. LoPucki 2007, p. 285 and Sigman 1999a, p. 72-74.
If the financing statement does provide for this type of information, but does so erroneously, the financing statement will be effective, but will have limited effect only: the security interest is 'lien perfected' only, not 'purchaser perfected'; § 9-338 UCC).

I reiterate that a financing statement that does not (at all) provide for one of these ‘less crucial’ requirements of § 9-516(b)(5) UCC – e.g. the debtor’s mailing address – but has been accepted nevertheless is still fully effective.\(^{417}\) Again, this is explained by the idea that a searcher will not be misled by a financing statement on file with (a few) blank fields; it will simply know that some information is missing and, consequently, needs further inquiry. Cf subsection 3.7.1 and the references mentioned there.

3.7.4. When a filing officer loses the financing statement or indexes it improperly

When a filing officer loses the financing statement or indexes it improperly – for example by spelling the name incorrectly – it may be inaccessible to any potential creditor despite searching for it in the right place. These prior filings are nevertheless effective according to § 9-516 UCC, which provides that “communication of a record to a filing office and tender of the filing fee or acceptance of the record by the filing office constitutes filing” and § 9-517 UCC which states that the failure of the filing office to index a record correctly does not affect the effectiveness of the filed record. Hence, these sections impose the risk of the filing-office error on those who search the files rather than those who file.\(^ {418}\) Mostly, the filer cannot sue the state or the filing officer since they have sovereign immunity. Hence, the filer who has filed properly wins and the searcher has the responsibility to have title insurance\(^ {419}\) that covers the risk of most kinds of errors in the filing process.

3.7.5. Information duties

Since the filing system under Art. 9 UCC is (no more than) a notice filing system, only a notice with regard to the possible existence of a security interest is filed. Hence, every searcher who needs additional information/details concerning the security agreement is expected to inquire outside the filing system. In principle, a secured party has no obligation to respond to a request for credit information from third parties, such as (potential) subsequent lenders.\(^ {420}\) Therefore, prospective secured parties will often request certain information through the debtor. According to § 9-210 UCC, the secured party has the duty to provide the debtor with exact information regarding the collateral and the obligation(s) secured, at the debtor’s request.\(^ {421}\)

\(^{417}\) § 9-520(c) UCC.

\(^{418}\) Cf Picker 2009, p. 135.

\(^{419}\) Cf subsection 3.4.1.1 on the subject of title insurance, also for further references.

\(^{420}\) Unless otherwise agreed in the security agreement. See LoPucki & Warren 2012, p. 318.

\(^{421}\) The debtor will probably know what it has pledged and what the secured liabilities are, but perhaps will not know the exact amounts. Moreover, the subsequent lender would most likely want to receive this information from the existing lender because the debtor could be wrong or committing deceit.
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With regard to the fact that only debtors can make such a request, Official Comment 3 to § 9-210 UCC provides the following information: “Because creditors of and prospective purchasers from a debtor may have legitimate needs for more detailed information, it is necessary to provide a procedure under which the secured party will be required to provide information. On the other hand, the secured party should not be under a duty to disclose any details of the debtor’s financial affairs to any casual inquirer or competitor who may inquire. For this reason, this section gives the right to request information to the debtor only. The debtor may submit a request in connection with negotiations with subsequent creditors and purchasers, as well as for the purpose of determining the status of its credit relationship or demonstrating which of its assets are free of a security interest.”

In practice, the debtor typically makes an informal request for information first which most lenders respond to simply because they have a business relationship with the debtor. If the secured party refuses to provide the information, the debtor can make a formal request and receive the information after all.

In addition, the debtor can make all sorts of other information requests to the secured party, such as a ‘request for accounting’, a ‘request regarding a statement of account’ and a ‘request regarding a list of collateral’. The secured party has to provide this information within 14 days after the request (§ 9-210(b)-(e) UCC). Here too, giving the right to request information to the debtor only serves the purpose of preventing third parties to acquire confidential information with regard to the debtor’s business.

4. Priority rules
4.1. Introduction

In the preceding section I explained how filing or taking possession results in perfection. One of the main purposes of filing or taking possession, i.e. of perfection, is to give public notice of the security interest. In addition, perfection determines the ranking of competing (security) interests that may exist simultaneously in the same collateral. The following section will discuss these legal consequences of perfection – essentially the priority rules. Third parties who may have competing interests in respect of the same collateral include the following:

i. general unsecured creditors: creditors who do not have the benefit of a security interest or any other preference

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422 Official Comment 3 to § 9-210 UCC.
424 A ‘request for an accounting’ means a record authenticated by a debtor requesting that the recipient provide an accounting of the unpaid obligations secured by collateral and reasonably identifying the transaction or relationship that is the subject of the request. § 9-210(a)(2) UCC.
425 A ‘request regarding a statement of account’ means a record authenticated by a debtor requesting that the recipient approve or correct a statement indicating what the debtor believes to be the aggregate amount of unpaid obligations secured by collateral as of a specified date and reasonably identifying the transaction or relationship that is the subject of the request. § 9-210(a)(3) UCC.
426 A ‘request regarding a list of collateral’ means a record authenticated by a debtor requesting that the recipient approve or correct a list of what the debtor believes to be the collateral securing an obligation and reasonably identifying the transaction or relationship that is the subject of the request. § 9-210(a)(3) UCC.
ii. **judicial lien creditors**: lien creditors who have obtained a so-called ‘judicial lien’ on the debtor’s property by means of attachment, by levy or a similar proceeding  

iii. **secured lenders**: typically (but not necessarily) banks secured by a regular – i.e. not a purchase money – security interest  

iv. **purchase money lenders**: banks or other types of lenders secured by a purchase money security interest, i.e. a PMSI  

v. **purchase money sellers**: purchase money sellers are suppliers of movable assets that are secured by a PMSI  

vi. **buyers**: buyers can be divided in **buyers in the ordinary course of business** (‘BIOCOB’) on the one hand and **buyers not in the ordinary course of business** on the other  

As will become clear from the following subsections, the priority conflicts between these different competitors are very complex and full of exceptions. As a caveat, these subsections do not necessarily offer easy reading and are primarily designed to serve as a reference source. Before discussing the positions of these competitors in more detail in subsections 4.2-4.10, an outline of the main priority rules will be provided (see subsection 4.1.1).

**4.1.1. Outline of the main priority rules**

Under Art. 9 UCC all creditors rank equally, unless a creditor is secured by a security interest: secured creditors – mostly lenders – have priority over unsecured creditors. This applies even if the secured creditor has not perfected its security interest (yet): unperfected security interests still have priority over unsecured creditors. Unperfected security interests, however, run the risk of being subordinated to unsecured creditors as soon as the latter are to be qualified as ‘judicial lien creditors’ (see infra subsection 4.2).

From that moment on, perfected secured creditors and judicial lien creditors rank  

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427 Although in common usage ‘lien creditors’ often connote ‘judicial lien creditor’, in this thesis I will maintain the distinction made under Art. 9 UCC between a ‘lien creditor’ on the one hand and a ‘judicial lien creditor’ on the other. According to § 9-102(a)(52) UCC and in this thesis a ‘lien creditor’ includes four categories of creditors: “(A) a creditor that has acquired a lien on the property involved by attachment, levy, or the like; (B) an assignee for benefit of creditors from the time of assignment; (C) a trustee in bankruptcy from the date of the filing of the petition; or (D) a receiver in equity from the date of appointment.” When referring to ‘judicial lien creditor’ I allude to the category of creditors that is described in sub (A) of § 9-102(a)(52) UCC, i.e. creditors that have obtained a so-called ‘judicial lien’ on the debtor’s property by means of attachment, by levy or a similar proceeding. It should be noted, however, that the rules applicable to ‘lien creditors’ will obviously always apply to ‘judicial lien creditors’, as the former category includes the latter. Furthermore, by means of explanation, in civil law jargon ‘judicial lien creditor’ would allude to an enforcing general unsecured creditor as described in subsection 2.4.2, 2.4.6 and 2.4.8 of Chapter 3, describing Dutch secured transactions law.

428 The idea behind this rule is that unsecured creditors simply have no claim to the collateral whatsoever, whereas **second creditors do**, even unperfected ones (§ 9-201 UCC; § 9-317(a) UCC). See infra subsection 4.2.1.
according to the prior tempore rule: those who have ‘filed or perfected’ the security interest or have ‘obtained the lien’ first, will win. The same applies in bankruptcy: the trustee in bankruptcy can avoid unperfected security interests, after which the collateral becomes part of the bankruptcy estate and can be liquidated by the trustee for the benefit of the general unsecured creditors. Amongst judicial lien creditors, they are ranked according to the same prior tempore rule: a creditor that has become a judicial lien creditor before another has priority over the latter. Perfection is also important in relation to competing secured creditors. A perfected secured creditor has priority over an unperfected secured creditor and perfected security interests also rank according the prior tempore rule; the secured creditor first in time is the creditor who filed or perfected first, whichever is earlier. The first to attach wins as between two unperfected security interests.

The stranger in our midst is the PMSI: its holders are afforded ‘super-priority’ over other security interests, even perfected ones. As already touched upon, a PMSI – and, hence, its priority – is conditioned upon the nature of the finance relationship between the debtor and a purchase money seller or lender which must be to the effect that the debtor has been enabled by the lender to acquire rights in, or the use of, the collateral (see supra subsection 2.3).

The rationale for the ‘super-priority’ is manifold: in the first place, it serves the purpose of protecting its holder – i.e. a purchase money lender or purchase money seller – since it provided the funds used by the debtor to acquire the property in the first place. Moreover, it facilitates the debtors business’ needs to purchase goods in circumstances in which the first-to-file secured lender is unwilling to provide additional funds: by allowing later creditors to step up ahead of earlier creditors in certain limited circumstances, a PMSI protects the debtor from being held hostage by its primary lender that holds overbroad security (e.g. in the form of after acquired property clauses). A third justification for the super-priority concept is the notion that sellers of movable assets – who make use of PMSIs most – should not be forced to inspect the public filing system.

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429 Hence, the concepts ‘perfection’ and ‘filing’ do overlap, but are not the same thing; see infra subsection 4.3.1.
430 This applies to lien creditors in general; see § 9-317(a)(2) UCC and footnote 427. Cf. infra subsection 4.2.2.
431 § 544(a)(1) BC; see infra subsection 4.2.3.
432 This applies to lien creditors in general; see footnote 427 and subsection 4.1.3.
433 See § 9-322(a)(1) UCC; see infra subsection 4.3.1.
434 § 9-322(a)(3) UCC; see infra subsection 4.3.1.
435 White & Summers 2002, § 33-4, LoPucki & Warren 2012, p. 526, White 1995, p. 560, LoPucki & Warren 2012, p. 573: “One important reason for allowing a later purchase-money creditor to have priority over an earlier-filed secured party is to provide some balance of power between the first-filed secured party and the debtor” and: “Purchase money priority provisions provide the debtor some leverage against a secured party who files first but refuses to lend any more money to buy goods needed for the debtor’s business.”
To actually complete this super priority over other secured lenders, (judicial) lien creditors and buyers, purchase money lenders or purchase money sellers must take several procedural steps, which will be set out in the subsequent subsections.\(^{436}\)

Once a security interest is created, it continues in the collateral notwithstanding disposition thereof by the debtor, unless the secured party authorized the disposition free of the security interest.\(^ {437}\) If the lender did not authorize the sale, buyers will nevertheless take free of pre-existing unperfected security interests, when they act in good faith, give value and receive delivery of the collateral. When the security interest in the collateral is perfected, the question whether the security interest remains in the collateral depends on whether or not the buyer can be qualified as a buyer in the ordinary course of business (‘BIOCOB’).\(^ {438}\)

The following two subsections (subsection 4.1.2 and 4.1.3) will address how general unsecured creditors can be satisfied by obtaining a judicial lien on the debtor’s property (and thereby become ‘judicial lien creditors’) and the priority rules between judicial lien creditors among themselves. Subsection 4.1.3 will explain how these rules work in bankruptcy.

### 4.1.2. Remedies available to general unsecured creditors

The only way for an unsecured creditor to force the debtor to pay a due debt is through judicial process; ‘self-help remedies’ are not available to them.

An example of a self-help remedy would be the ‘wrongful exercise of dominion and control over the debtor’s property in denial of or inconsistent with his rights’. This would constitute a so-called ‘(tort of) conversion’. Would a creditor perpetrate this, it may be charged with larceny. In addition, a creditor may incur liability for wrongful collection practices if it coerces payment from the debtor in an unreasonable manner.\(^ {439}\)

The first step in the process of collecting debts is often to obtain a judgment from the court. When the creditor, to use standard legal parlance, ‘reduced its claim to judgment’, it will most typically – besides being referred to as ‘judgment creditor’ – deliver the judgment (or a writ of execution) to the sheriff of the jurisdiction where the debtor’s property is located. The sheriff will, in turn, levy on the property from the debtor. Once the sheriff has levied on the property, he will advertise and sell the property in accordance with customary procedures. This process is called ‘execution’.\(^ {440}\) The creditor will be paid

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\(^{436}\) See infra subsections 4.2.4, 4.3.2, 4.4.1, 4.5.4, 4.6.1. and 4.8.1.  
\(^{437}\) § 9-315(a)(1) UCC; see infra subsection 4.5.  
\(^{438}\) § 9-320(a) UCC; see infra subsection 4.5.1-4.5.2. This rule is not applicable to subsequent secured lenders; in that case § 9-322(a)(1) UCC applies; see infra subsection 4.3.1.  
\(^{439}\) LoPucki & Warren 2012, p. 4-6.  
\(^{440}\) From this moment on the creditor is sometimes referred to as an ‘execution creditor’, but mostly and more importantly: as soon as this process has been completed a creditor is referred to as ‘judicial lien creditor’; see infra subsection 4.1.3.
from the proceeds of sale, after the sheriff has deducted the expenses made to conduct the sale.\textsuperscript{441}

In addition to the above-mentioned means of debt collection, all U.S. states allow some form of pre-judgment ‘attachment’ of assets at the outset of a lawsuit. Both pre-judgment attachment and execution involve property to be seized and held to satisfy an established debt, yet property seized pursuant to attachment is held by the sheriff pending the outcome of a judgment, whereas execution typically occurs after a judgment is entered.\textsuperscript{442} Another procedure by which a creditor can collect its debts is ‘garnishment’. This is a process by which a creditor can collect what a debtor owes by reaching the debtor’s assets while they are in the possession of a third party. For example, it entails the third party (employer) to pay wages directly to the judgment creditor (this is called ‘wage garnishment’). In U.S. practice, the two most common ways for an unsecured creditor to get paid are the garnishing of financial assets such as a bank- or securities account and attachment of tangible piece(s) of property.\textsuperscript{443}

4.1.3. Judicial lien creditors

Unsecured creditors are subject to the ‘race of diligence’\textsuperscript{444}: they must obtain a judicial lien in order to take priority over later-in-time judicial lien creditors.\textsuperscript{445} After an unsecured creditor has acquired a lien on the debtor’s property by attachment, levy, or the like, it becomes a judicial lien creditor (§ 9-102(a)(52) UCC). Under the law of most states, the moment a creditor ‘obtains a lien’ is linked to the moment the sheriff takes possession of the goods, \textit{i.e.} the date of levy;\textsuperscript{446} see supra previous subsection. Other states award a lien priority by connecting to the date of delivery of the writ to the sheriff. Then again, more and more states allow a judgment creditor to ‘perfect’\textsuperscript{447} the lien by filing a judgment (or a

\textsuperscript{441} Picker 2009, p. 2-4, Harris & Mooney 2006, p. 15-18 and LoPucki & Warren 2012, p. 470. The procedures of seizure by the sheriff vary from state to state, but the basics are the same. See Adler, Baird & Jackson 2007, p. 5.

\textsuperscript{442} See \textit{e.g.} LoPucki & Warren 2012, p. 469-470.

\textsuperscript{443} Some property is not liable for seizure. There are so-called ‘exemption statutes’ that ensure that collection does not leave a debtor destitute. The content of these exemption statutes varies from state to state. Note, however, that the concept of exemption is that the debtor is protected against unsecured creditors; if the debtor has given someone a security interest voluntarily, exemptions do not apply. LoPucki & Warren 2012, p. 15 and 17.

\textsuperscript{444} This term connotes the ‘first come, first serve’ principle applying to creditors who are struggling to get to the debtor’s property first and the fact that in this race the most diligent creditor will be rewarded.

\textsuperscript{445} Harris & Mooney 2006, p. 72.

\textsuperscript{446} Adler, Baird & Jackson 2007, p. 9 and Lectures \textit{Second Transactions Law} by Prof. R. Mann, Spring 2010 (Columbia University, New York). Some states acknowledge only actual physical possession by the sheriff; some accept forms of constructive or symbolic possession as sufficient. LoPucki & Warren 2012, p. 280, 471-472.

\textsuperscript{447} Since a creditor ‘becomes a lien creditor’ at the moment that effect vis-à-vis third parties is awarded, one sometimes speaks of ‘perfection’ of the lien. However, this is just a manner of speech: there is no difference between the moment the lien is obtained in the sense of § 9-102(a)(52) UCC and the moment it is ‘perfected’ in common parlance.
notice of it) in the UCC filing office. In this case, one has to search the filing system – not the sheriff’s office – to establish whether there is a judicial lien creditor.\footnote{There is some sense to this, since this is also the way in which a judgment lien against real estate is to be perfected.}

California is an example of a state that prescribes a lien to be created by filing. To obtain a lien, in Californian law an ‘acknowledgement of satisfaction of judgment’ or a clerk’s certificate of satisfaction has to be filed.\footnote{See §§ 724.060, 724.100, 697.640(a) of the Californian Civil Code for Procedure.} As is the case with a security interest, the financing statement lapses (\textit{i.e.} ceases to be effective) after 5 years, unless a continuation statement is filed.\footnote{See § 9515 of the Californian Uniform Commercial Code.}

Judicial lien creditors have priority according to the \textit{prior tempore} rule: a creditor who became a judicial lien creditor before another creditor, has priority over the latter. In the rare case that two or more creditors become judicial lien creditors on the same day, their rank differs from state to state. It also differs from state to state whether or not judicial lien creditors share pro rata if there is not sufficient money to satisfy all concerned.

\subsection*{4.1.4. General unsecured creditors and judicial lien creditors in bankruptcy}

Bankruptcy proceedings are initiated by the filing of a bankruptcy petition. This can be done voluntarily, \textit{i.e.} by the debtor himself, by filing the appropriate documents and paying a filing fee.\footnote{See § 301 of the Bankruptcy Code (‘BC’). Currently, the filing fees are $245 for a Chapter 7 case, and $1000 for a Chapter 11 case. See 28 U.S.C. § 1930(a).} Alternatively, three or more creditors to whom the debtor owes more than roughly $13,000\footnote{This amount is adjusted periodically.} in unsecured claims may force the debtor into bankruptcy, \textit{i.e.} involuntarily.\footnote{See § 303 BC. \textit{Cf.} Picker 2009, p. 525 and Adler, Baird & Jackson 2007, p. 66. The rule is more detailed and complicated than set out here, but it would be going to far to elaborate on this. For more information on the exact details of this rule, see e.g. Adler, Baird & Jackson 2007, p. 66-69.}

Cases filed under Chapter 7 of the Bankruptcy Code (‘BC’) serve the purpose to liquidate the property of the debtor. In this case, a trustee in bankruptcy is appointed, who has the duty to collect the assets of the debtor, to reduce them to money and to distribute the resulting proceeds among creditors in accordance with the priority rules.\footnote{See §§ 704(a)(1), 507 and 726 BC. \textit{Cf.} Harris & Mooney 2006, p. 73 and 449-450.} Alternatively, a bankruptcy case can be filed under Chapter 11 of the BC, which has the purpose of reorganizing and continuing the debtor’s business. Under Chapter 11 no trustee in bankruptcy will be appointed. Instead, the debtor – ‘the-debtor-in-possession’ (‘DIP’)\footnote{See § 1107(a) BC. “[A, DJYH] debtor-in-possession shall have all the rights (...) and powers, and shall perform all the functions and duties (...) of a trustee serving in a case under this chapter.”} – performs most duties and exercises most powers of a trustee.\footnote{In the case of a corporate debtor, the managers of the debtor corporation act as a ‘DIP’. See § 321-333 BC in conjunction with § 1101-1109 BC and Adler, Baird & Jackson 2007, p. 32-41. It is beyond the purpose of this thesis to elaborate further on the details on the different bankruptcy procedures.}
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Despite the fact that Chapter 11 proceedings have the purpose of restructuring and reorganizing corporate debtors, about 70% of them end up in the debtor’s assets being liquidated. This is a result of the fact that many Chapter 11 cases are converted into Chapter 7 cases. In addition, Chapter 11 is often used as a mechanism for liquidation.

The filing of a bankruptcy petition instantaneously stops the race between unsecured and judicial lien creditors, since an ‘automatic stay’ is imposed (§ 362(a) BC). This requires all creditors to immediately cease their debt collection efforts, whichever chapter of the BC is applicable and whether or not the petition was filed voluntarily.

The automatic stay prevents creditors from taking various actions. Creditors cannot demand payment of a claim that arose before commencement of the bankruptcy case or start a lawsuit against the debtor; they cannot enforce judgments against the debtor (for example by levying on the debtor’s property) and must cease litigation activities already in motion (e.g. notify the sheriff to refrain from a planned execution sale); they cannot stipulate for security rights from the debtor for existing unsecured debt or repossess collateral that has already been subject to a security interest, etc.

All unsecured and judicial lien creditors have to file their claims against the bankruptcy estate from the moment the petition is filed. If a judgment creditor seized the assets of the debtor but finds that the debtor is declared bankrupt prior to completion of enforcement, the judgment creditor has to release the assets. The property of the estate generally includes ‘all legal or equitable interests of the debtor in property as of the commencement of the case’ (§ 541 BC). General unsecured creditors are satisfied only to the extent that the value of the collateral exceeds the secured and preferred debt(s). In this (rare) case, general unsecured creditors are paid pro rata, in proportion to their claims. Only after unsecured creditors are paid in full do shareholders receive any distribution.

4.2. Lenders vs. general unsecured creditors & judicial lien creditors

Section 3 explained that a security interest, once it has been created, is in addition to its enforceability against the debtor, enforceable (‘generally effective’) against third parties, unless the UCC provides otherwise:

457 Unless otherwise indicated, “corporate debtor” is used in this thesis in the broad sense to include all registered and non-registered organizations. Hence, it includes limited liability companies and similar entities.


459 See also Harris & Mooney 2006, p. 73.

460 See e.g. Adler, Baird, Jackson 2007, p. 277.

461 A lien gained moments before bankruptcy might be invalidated as a ‘preference’. See e.g. Adler, Baird, Jackson 2007, p. 352-387 for more information on this subject.

462 Some unsecured creditors, such as tax authorities and wage claimants are afforded priority. See § 507(a) BC.

463 § 726(a) BC. See also Harris & Mooney 2006, p. 449-456 and LoPucki & Warren 2012, p. 510-511.
I reiterate that notwithstanding the suggestion of general effectiveness, this rule should not be paraphrased to the effect that a security interest is effective against all third parties, i.e. ‘good as against the world’. In fact this ‘general effectiveness’ applies only to unsecured creditors and subsequent unperfected secured creditors of the debtor.\textsuperscript{465} The following subsection (subsection 4.2.1) will address the position of secured lenders vis-à-vis general unsecured creditors. Subsequently, subsection 4.2.2 will address the position of secured lenders vis-à-vis judicial lien creditors, after which subsection 4.2.3 will address these positions in bankruptcy.

4.2.1. Secured lenders vs. general unsecured creditors

A secured lender has priority over an unsecured creditor, even though the secured lender has not perfected its security interest (yet). The idea behind this rule is that a creditor without a security interest simply has no claim to any specific collateral, whereas a(n) (unperfected but) secured lender does.\textsuperscript{466} Hence, as soon as a security interest has ‘attached’ (Cf. supra subsection 2.3) it is not only enforceable against, for example, a trade creditor that has never intended to create a security interest, but also against another lender whose security interest has not attached (yet), against a lender whose collateral does not cover the whole amount of the loan, against a supplier of goods that does not have the benefit of a PMSI or another means of security and against a buyer that has not completed its transaction with the debtor (and consequently cannot be qualified as a ‘buyer’; see infra subsection 4.5) etc. Hence, security rights have effect against general unsecured creditors, even when they have not been made public through perfection.\textsuperscript{467}

4.2.2. Secured lenders vs. judicial lien creditors

Notwithstanding its enforceability against general unsecured creditors, an unperfected security interest is vulnerable to a judgment creditor, since the former will be subordinate to an interest of the latter as soon as the judgment creditor can be qualified as a ‘lien creditor’ (§ 9-317(a)(2) UCC), which includes a ‘judicial lien creditor’ (§ 9-102(a)(52)(A) UCC).\textsuperscript{468} More specifically, a secured lender prevails over a judicial lien creditor unless the latter achieves this qualification before the secured lender: (i) perfects its security interest,

\textsuperscript{464} § 9-201(a) UCC. See also Official Comment 2 to § 9-201(a) UCC.

\textsuperscript{465} Subsection 4.2.3 will provide further information concerning this is different in bankruptcy: here an unperfected security interest is not effective and can be avoided by the bankruptcy trustee (§ 554(a)(1) BC).

\textsuperscript{466} White & Summers 2002, § 33-2.

\textsuperscript{467} Whether or not this is fair or commercially feasible will be discussed in the Chapter 7.

\textsuperscript{468} See supra footnote 427; hereafter I will refer to ‘judicial lien creditor’ only.
Chapter 5

or (ii) files a financing statement covering the collateral and complies with one of the conditions of § 9-203(b)(3) UCC. This means that if a secured lender competes with a judgment creditor and the former has signed a security agreement but has not perfected its security interest (yet), the only thing it can do to trump the judgment creditor is to file a financing statement before the latter becomes a lien creditor (by having obtained possession of the collateral or, in some states, by having filed its judgment). This also applies when the debtor has no rights in the collateral and even if the secured lender has not extended value.

Another implication of this rule is that an unsecured creditor, when competing with a judgment creditor, can beat the latter by stipulating a security interest and perfect it, or to comply with § 9-203(b)(3) UCC and file a financing statement, before the latter levies upon the property.

4.2.2.1. Future advances

Since ‘future advance clauses’ purport to extend the effect of a security agreement beyond the initial debt, a relevant question is how these advances play a role in priority when a judicial lien creditor comes along. The key issue is whether or not a properly perfected secured party has the same priority with respect to future advances if those advances are made after the conflicting judicial lien arises. The answer to this question is provided by § 9-323(b) UCC:

“(…) a security interest is subordinate to the rights of a person that becomes a lien creditor to the extent that the security interest secures an advance made more than 45 days after the person becomes a lien creditor unless the advance is made: (1) without knowledge of the lien; or (2) pursuant to a commitment entered into without knowledge of the lien.”

According to this definition, a secured lender will have priority over future advances if this lender did not know about the judicial lien or, if the advance was made within 45 days of the creation of the judicial lien, even with knowledge of the judicial lien. In addition, the secured lender has priority with regard to its future advances if the advance is made, even with knowledge of the lien and outside the 45-day window, pursuant to a commitment that was entered into without knowledge of the lien. In sum: this definition

469 In the context of movable assets this will boil down to sub (a) of § 9-203(b)(3) UCC; that the debtor has authenticated a security agreement.
470 For several other examples of the operation of this rule, see Harris & Mooney 2006, p. 29.
471 The operation of future advance clauses has been explained in subsection 2.1.4.
472 See also Official Comment 4 to § 9-323 UCC and also LoPucki & Warren 2012, p. 480-481. I reiterate from footnote 427 that the rules applicable to ‘lien creditors’ will always apply to ‘judicial lien creditors’, as the former category includes the latter; § 9-102(1)(52) UCC.
473 Hence, in this case a (judicial) lien creditor can limit the window of 45 days by giving notice of its interest to the secured creditor. Picker 2009, p. 325.
makes it difficult to imagine a competent secured lender losing future advances to a lien creditor who comes along after the original loan is made.\textsuperscript{474}

Although in practice lenders will often claim advances to be ‘pursuant to a commitment entered into without knowledge of the lien’ (§ 9-323(b) UCC), they typically do not promise to make subsequent advances, not even in revolving credit lines. By contrast, if a bank issues a letter of credit that gives the beneficiary a right to payment upon the occurrence of one or more pre-defined trigger events, this would qualify as a promise to pay to which the rule as set out above applies.\textsuperscript{475}

The 45-day period is not randomly chosen; it is consistent with the federal tax lien statute (\textit{Internal Revenue Code}, ‘IRC’). This statute states that a secured party has priority (which extends to future advances) over a tax lien of the IRS\textsuperscript{476} when the advance is made within 45 days after the IRS has filed a tax lien notice, but only if state law would give the secured party priority over a lien creditor for those future advances. Put differently: a secured lender has priority over a tax lien, provided it would have priority over a judicial lien.\textsuperscript{477}

\textbf{4.2.2.2. Allocation of risks in case of defective filing}
Attachment of the debtor’s property by a judgment creditor will not make (much) sense if there is a prior secured lender that has already perfected its security interest or has filed a financing statement covering the collateral and complies with one of the conditions of § 9-203(b)(3) UCC; see previous subsection. After all, in this case there is probably no(t) much prospect of recovery. Hence, to avoid unnecessary attachment costs, a judgment creditor has an interest in knowing whether there is a prior lender with such position. The judgment creditor can find out by checking the UCC files\textsuperscript{478} if the lender has filed a financing statement properly and under the debtor’s correct name, this can be found by using the ‘SSL’ of the filing office where the financing statement was filed. Such a search may nevertheless not produce a financing statement of a prior secured lender as a result of a mistake made by the prior lender in stating the debtor’s correct name. In that case, the judgment creditor will trump the holder of that security interest as soon as the former has

\textsuperscript{474}White & Summers put it less subtly: they suspect it will be ‘a cool day in hell’ when a secured creditor makes an advance that is subordinate to a lien creditor’s claim. White & Summers 2002 § 33-3. See also Lectures \textit{Secured Transactions Law} by Prof. R. Mann, Spring 2010 (Columbia University, New York) and LoPucki & Warren 2012, p. 486.

\textsuperscript{475}Lectures \textit{Secured Transactions Law} by Prof. R. Mann, Spring 2010 (Columbia University, New York). See on this subject also Picker 2009, p. 323-327.

\textsuperscript{476}The Internal Revenue Service (‘IRS’) is the American government agency responsible for tax collection and tax law enforcement.

\textsuperscript{477}See § 6323(c)(2) and (d) of the Federal Tax Lien Act. Lectures \textit{Secured Transactions Law} by Prof. R. Mann, Spring 2010 (Columbia University, New York) and LoPucki & Warren 2012, p. 481.

\textsuperscript{478}In addition, the judgment creditor has to check whether the lender is not perfected, for example by taking possession of the debtor’s assets (§ 9-313(a) UCC; see supra subsection 3.2.1.)
achieved the status of ‘judicial lien creditor’, due to the secured lender’s, albeit first-on-file, untraceable and thus ‘seriously misleading’ (and therefore ineffective) financing statement.

If a financing statement is found by a judicial lien creditor because it is on file, while it does not contain the name of the debtor, the name of the secured party or an indication of the collateral covered – i.e. ‘crucial’ information – the financing statement is not effective at all, even if it is accepted and indexed by the filing officer (§ 9-520(c) UCC).

If the debtor’s correct name (and the other crucial information) is on file but the searching lien creditor claims to be misled because the debtor’s mailing address or other ‘less crucial’ (i.e. § 9-516(b)(5) UCC-) information is stated incorrectly, the filing is nevertheless effective and has full effect against lien creditors, i.e. including judicial lien creditors (it is only ‘lien-perfected’). The same applies when this type of information is absent; searching creditors are not considered to be misled by a financing statement on file with (a few) blank lines relating to e.g. a mailing address; they ought to know that some information is missing and, consequently, need further inquiry. If a financing statement is not on file, because the filing officer has incorrectly rejected (or improperly indexed) it, it can be nevertheless effective against lien creditors if it has satisfied the necessary conditions for effectiveness (9-516(d) UCC).

I reiterate from subsection 3.7.2 that protecting the secured party against judicial lien creditors (and as we will see in subsection 4.2.3.1; the trustee in bankruptcy) only, is motivated by the belief of the Art. 9 UCC drafters that judicial lien creditors would not in any way be prejudiced by failure of the financing statements to appear since they do not search the filing system. Therefore, the drafters chose to protect third parties that do rely on the filing system, such as ‘purchasers’ e.g. secured parties.

4.2.3. Secured lenders in bankruptcy

If a lender claims collateral under a security interest that has not attached (yet), the trustee in bankruptcy can simply assert the debtor’s claim that the security interest is ineffective

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479 This applies to lien creditors in general. See supra footnote 427.
480 §§ 9-520(c), 9-502(a) and 9-506(c) UCC. See supra subsection 3.7.3.
481 These situations are obviously very rare, since it is hard to imagine how such a filing would be discovered.
482 § 9-520(c) UCC. Only subsequent lenders and buyers will be protected if they relied upon that type of misinformation. See § 9-338 UCC and subsection 3.7.3.
483 See supra subsection 3.7.1.
484 Incorrectly because it contained all of the required information, i.e. it satisfied both § 9-502 UCC and § 9-516(b) UCC.
485 See supra subsection 3.7.2.
487 When used in the UCC, ‘purchasers’ includes secured parties, but not (judicial) lien creditors, see § 1-201(b)(29) and (30) UCC.
U.S. secured transactions law with regard to movable assets

(§ 9-203 UCC) and keep the collateral for the bankruptcy estate. It is much more common, however, that a secured lender’s security interest has attached but has not been perfected yet, or, that the secured lender financing statement has ‘lapsed’. In both cases, the rule that an unperfected but attached security interest has full effect against the debtor and the debtor’s general unsecured creditors (see § 9-201(a) UCC) gives no solace, since that rule is not applicable in bankruptcy: a trustee in bankruptcy (or a ‘debulker-in-possession’ in a Chapter 11 bankruptcy proceeding) is permitted to step into the shoes of and use the subordinating power of a ‘hypothetical lien creditor’ to avoid unperfected security interests (§ 544(a)(1) BC). This rule is known as the ‘strong arm clause’. It applies, even if there is no such actual (judicial) lien creditor and even though the unperfected security interest would only be subordinated, not eliminated, under state law.

The strong arm clause is one of the most important reasons why perfection is crucial and, moreover, why the contest between secured lenders and judicial lien creditors is a fundamental one: if a secured lender can trump a lien creditor, it simply means that it can keep its claim in the collateral in bankruptcy, instead of having to stand back in line with the general unsecured creditors. According to White & Summers, the motive behind this rule is the Code’s policy against secret security.

After avoidance of the security interest, the collateral becomes part of the bankruptcy estate and can be liquidated by the trustee in bankruptcy for the benefit of the general unsecured creditors.

4.2.3.1. Allocation of risks in case of defective filing

If a financing statement is ‘seriously misleading’ as a result of a mistake made by the secured lender in stating the debtor’s correct name, the financing statement is not effective and the trustee in bankruptcy can avoid it. If the debtor’s correct name is on file but the debtor’s mailing address or other ‘less crucial’- § 9-516(b)(5) information is stated incorrectly, the financing statement will be fully effective against the bankruptcy trustee. The same applies when this type of information is absent. If a financing

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488 §§ 541, 558 BC.

489 This simply means that § 9-317(a)(2) UCC applies; see supra subsection 4.2.2.

490 § 544(a)(1) BC provides: “The trustee shall have (…) the rights and powers of (…) a creditor (…) that obtains (…) a judicial lien on all property [an unsecured creditor could have reached at the commencement of the case, DJYH].” It might be useful to note at this point, that the terminology in the BC is sometimes different from the terminology used in Art. 9 UCC. The BC uses the term ‘lien’ for any type of charge against the property, so it includes both a security interest under Art. 9 UCC and a mortgage under real estate law as well as the judicial liens under the lien creditors of Art. 9 UCC, see § 101(37) BC.


492 See § 554(a)(1) BC and supra subsection 3.7.1 and 3.7.3.

493 After all, the trustee has the same rights as a ‘hypothetical lien creditor’. See 9-317(a)(2) UCC and supra subsection 3.7.3 and 3.7.1.

494 See § 9-520(c) UCC and see supra subsection 3.7.1.
state the cases where the public register because the filing officer has wrongly rejected it, the non-filing is still effective to perfect the underlying security interest against the trustee(s) in bankruptcy; it is, after all, ‘lien perfected’ (§ 9-516(d) UCC).

4.2.4. Purchase money lenders vs. judicial lien creditors

If a lender grants the debtor a loan that makes possible the acquisition of goods or software by the debtor – instead of a regular working capital loan – the security interest the lender takes in this collateral is called a ‘PMSI’ and the lender is a ‘purchase money lender’.

A purchase money lender takes priority over the rights of a judicial lien creditor if the former files a financing statement with respect to the PMSI before or within 20 days after the debtor receives delivery of the collateral and the judicial lien has arisen between the time the security interest attaches and the time of filing (§ 9-317(e) UCC).

Put in more straightforward terms: the lender has a 20 day grace period to perfect its PMSI and thereby trump a lien that came into existence between the dates of attachment and perfection of the PMSI.

Example: Lender A funds the purchase of a machine by the debtor. Two days after delivery, a creditor of the debtor levies upon the machine to recover a debt owing to the debtor. As long as Lender A files the financing statement with 20 days from the date of delivery, Lender A takes priority over the judicial lien creditor.

The 20-day grace period was created to facilitate sales of personal property on secured credit, since it permits suppliers of goods and banks to fund the debtor promptly without being forced to delay the funding until after filing.

It may speak for itself, that this rule leads to uncertainty for general unsecured creditors and judgment creditors: despite the fact that such a creditor has checked the filing system, a levy can be unsuccessful due to an existing prior unknown security interest.

4.2.5. Purchase money lenders in bankruptcy

Since § 544(a)(1) BC permits the trustee in bankruptcy to step into the shoes of and use the subordinating power of a ‘hypothetical lien creditor’, a purchase money lender must...
perfect the PMSI within the 20-day period in order to prevail over the bankruptcy trustee (§ 9-317(c) UCC). As long as this perfection takes place within the 20 days, it can even take place after the debtor has filed for bankruptcy. In that case, the perfection relates back to the (pre-petition) date the security interest was created (provided that the security interest was created before bankruptcy).

This is an exception to the automatic stay and is provided by § 362(b)(3) BC which permits a creditor “…to perfect, or to maintain or continue the perfection of, an interest in property in the extent that the trustee’s rights and powers are subject to such perfection under section 546 (b) [BC] ….”. Subsequently, § 546(b) BC is to be read that it recognizes grace periods for perfection of security interests created by applicable state law, that is: Art. 9 UCC.

If the secured party fails to file even within those 20 days, the trustee can avoid the security interest, after which the goods become part of the bankruptcy estate and the lender becomes a mere general unsecured creditor.

4.3. Lenders vs. lenders
4.3.1. Secured lenders vs. secured lenders
When two lenders hold a security interest in the same collateral the first to file or perfect has priority (§ 9-322(a)(1) UCC). This rule has two main implications, which can only be understood if one recalls that filing and perfection do not refer to the same process (or action), and therefore, may or may not occur simultaneously.

503 Or a ‘debtor-in-possession’ in a Chapter 11 bankruptcy proceeding.
504 Hence, § 9-317(a)(2) UCC applies.
505 See infra footnote 548.
506 Pre-petition date marks the period prior to the date of filing under Chapters 7 or 11. See supra Chapter 4.1.4.
507 § 546(b)(1) states that a bankruptcy trustee’s rights: “(…) are subject to any generally applicable law that - (A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of such perfection; or (B) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation.”
508 For more details on this subject, see Adler, Baird & Jackson 2007, p. 275-299. For the lender’s protection to be complete, the PMSI must be protected from intervening bona fide buyers and secured lenders during the period of grace. This will be discussed in subsection 4.5 and 4.3.2.
509 As stipulated between two unperfected security interests, the first to attach wins (§ 9-322(a)(3) UCC). See also Official Comment 11 to § 9-322 UCC, Sigman 2004, p. 73, White & Summers 2002, § 33-3 and LoPucki & Warren 2012, p. 520.
First of all, perfected security interests will have priority over security interests that have not been perfected or filed at all. The second implication relates to the priority conflict between two perfected security interests: in that case, the rule is that the first to file or perfect has priority. The – at first sight confusing – consequences of this last implication can be understood best if one focuses on the question how the competitors at stake have established perfection. If they perfected their security interest by filing, the first to file will win. Hence, if two lenders grant a loan to the debtor and thereby attach more or less at the same time, the first to file will determine priority. See White & Summers 2002, § 33-3. As will become clear in Chapter 7, Book IX has adopted a ‘pure notice’ statute.

For a creditor to know whether it will be first filer, it has to file a financing statement before lending anything and, at the same time, ask the filing officer for a so-called ‘search report’. A search report shows the filer whether its filing is the only one on file as of the effective date of the search. If a creditor checks the filing system (i.e. asks for a search report) at a later time, it will run the risk that a security interest is created in between, but has not yet been processed (and therefore not publicly accessible). To summarize, the order of conduct should ideally be: (1) file, (2) search, (3) establish that you have priority, (4) grant the loan.

The Official Comment provides: “The justification for determining priority by order of filing lies in the necessity of protecting the filing system — that is, of allowing the first secured party who has filed to make subsequent advances without each time having to check for subsequent filings as a condition of protection”. In addition, a justification for the rule is sought in legal certainty since no disputes will arise with regard to the questions who knew what, about what, at what time: if a creditor filed or perfected first, that is simply ‘the end of it’.

Hence, and by means of illustration: if Lender A files a financing statement on January 1 but neither grants a loan nor signs a security agreement, the security interest is deemed unperfected simply because it has not attached yet (see § 9-308(a) UCC). If Lender B files a financing statement on January 7 against the same collateral, while granting a loan at the same time, it would be perfected. If Lender A eventually grants the debtor a loan on January 15, it will have priority even though Lender B’s loan was made earlier and was unperfected simply because it has not attached yet (see § 9-308(a) UCC).

510 ‘Filing’ refers to the filing of an effective financing statement (see subsection 3.3.1 for the requirements of an effective financing statement). Official Comment 4 to § 9-322 UCC.

511 In a pure ‘race-statute’, whoever files first wins, even if the first to file had knowledge of an earlier security interest. A ‘notice race-statute’ refers to a system that protects a subsequent purchaser only if it has filed before and purchased without notice of the earlier secured party. A pure ‘notice statute’, to conclude, refers to a system in which any subsequent purchaser without notice is protected, regardless of whether it has filed before the first purchaser did. See White & Summers 2002, § 33-3. As will become clear in Chapter 7, Book IX has adopted a ‘pure notice’ statute.

512 In addition to searching the filing system, the secured lender should check whether the debtor has possession of the assets in order to make sure that no other secured lenders have priority by means of taking possession. See subsection 3.2.1.

513 Cf. Harris, Kilborn & Livingston 2012, p. 472: “(…) a filer in a deal of any magnitude would conduct its own search after filing to see whether, in fact, its financing statement is going to be shown.”

514 Official Comment 4 to § 9-322 UCC. Moreover, Official Comment 3 provides that the rules may be regarded as adaptations of the idea, deeply rooted in common law, of a race of diligence among creditors. See also LoPucki & Warren 2012, p. 521 and Sigman 2004, p. 73.

January 15, it will have priority even though Lender B’s loan was made earlier and was perfected at the time the loan was made. Hence, Lender A has priority because it ‘filed or perfected’ (i.e. it filed on January 1 and attached or perfected on January 15) before Lender B did (i.e. Lender B filed and perfected on January 7). It makes no difference whether Lender A knew of Lender B’s security interest when Lender A advanced its loan.516 This rule incites lenders to file immediately a potential security interest while (still) negotiating with the debtor on whether and to what extent they should grant a loan to the latter.517 The rationale of giving public notice is to make later potential lenders aware of earlier lenders. Therefore, the system is set up in such a way that later lenders should have the possibility to actually adjust to rights that are already on file.518 The mechanism underlying this rule is sometimes referred to as the ‘Filing Priority Principle’.519

If one or both of the competing secured parties have perfected their security interest by a means other than filing, § 9-322 UCC must also be interpreted such that the first to file or perfect wins. I reiterate that this makes sense only, if one recalls that filing and perfection are not the same legal process, and therefore, may or may not occur simultaneously. Since taking possession of the collateral, for example520, can also result in perfection of a security interest; hence, if this occurs before another creditor files, the former will have priority over the latter. Likewise, if a creditor files before another creditor takes possession of the collateral, the former creditor wins.521 Hence, if a lender wants to perfect its security interest by filing a financing statement, it must also make sure that no lender has taken possession of the collateral.522

516 This example was inspired by the several examples provided by Official Comment 4 to § 9-322 UCC and by Plank 2013, p. 456 and LoPucki & Warren 2012, p. 521.
517 See § 9-502(d) UCC in this respect: “A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.”
518 As LoPucki & Warren put it: “(...) a secured party can file a financing statement before either lending or agreeing to lend (...) search the filing system at its leisure (...) to make sure its financing statement is the first on file, and then lend without worrying that a competing secured party might have perfected since the filing”. LoPucki & Warren 2012, p. 521. As a result, the UCC’s filing office contains many financing statements that do not represent an existing security interest. This is caused also by the fact that secured creditors do not have the duty to remove obsolete filings (see supra subsection 3.4.3.1), unless the debtor asks for them.
519 See for example Plank 2013, p. 443: “(...) the Filing Priority Principle favors a subsequent transferee that provides notice of a potential interest in a property item by filing such notice pursuant to an established filing or recordation regime over an earlier transferee that acquired its interest after the filing but before the subsequent transferee completes the steps necessary to acquire its interest. (...) The most prominent and innovative application of the Filing Priority Principle is the relatively new (...) ‘first-to-file-or-perfect rule’ for competing perfected security interests of UCC section 9-322(a)(1) (...)”.
520 Or, with respect to vehicles (e.g. cars, motor vehicles, trucks, buses), airplanes and waterborne vessels (e.g. boats) security interests are perfected through a system of notation on ‘certificates of title’; see supra subsection 3.2.2.
521 The next subsection shows a (rather atypical) application of this rule, when a security interest is automatically perfected. In this case an earlier filed security interest will be ranked after a later filed security interest, because the latter was ‘automatically perfected’ before the former has filed its financing statement.
Chapter 5

4.3.1.1. After-acquired property

Priority in respect of after-acquired property dates back to the original time of priority (§ 9-322(a)(1) UCC).523

Example: On January 1 Lender A agrees with the debtor to provide the latter a loan. The security agreement states that the security interest covers all of the debtor’s property, including after acquired property. A financing statement is filed on the same day. One month later, on February 1 Lender B does exactly the same: a loan is agreed upon with the debtor, the security interest is deemed to cover all of the debtor’s (existing and after acquired) property and a financing statement is filed on the same day. On March 1 the debtor acquires rights in a new piece of collateral, for example a machine. At that moment both Lender A and Lender B acquire a security interest in the machine, however; Lender A has priority over Lender B, simply because it filed before Lender B did.524

4.3.1.2. Future advances

When a lender takes a security interest and perfects the security interest by filing, this lender will be perfected also with regard to future advances the debtor draws on the underlying line of credit.525 Future advances will be covered by the initial financing statement filed by the initial secured creditor, without the need for any new filing.526 As a result, a second-in-time secured lender cannot claim priority with regard to a future advance if a first-in-time secured lender has priority under § 9-322(a)(1) UCC.527

4.3.1.3. Allocation of risks in case of defective filing

For the first filer in the context of the above-mentioned rule, I reiterate that lenders should ideally rely on the following order of conduct: (1) file, (2) search,528 (3) establish that they have priority, (4) grant the loan.529 If a first-in-time lender has properly filed a financing statement, it will simply show up after a search under the debtor’s correct name when using the ‘SSL’ of the filing office where the financing statement is filed. If such a search does not produce a financing statement of a prior secured lender as a result of a mistake made by this lender in stating the debtor’s correct name, the subsequent secured lender will trump the prior lender. Although the financing statement was first-on-file; it is untraceable and thus ‘seriously misleading’ and therefore ineffective.530 If the debtor’s correct name is on file but the debtor’s mailing address or other § 9-516(b)(5) information

523 This is irrelevant of whether this priority is established by means of filing or by another method of perfection. See also Official Comment 5 to § 9-322 UCC. Cf. White & Summers 2002, § 33-3(a) on this subject.
524 This is a paraphrase of the example 4 of Official Comment 5 to § 9-322 UCC.
525 See supra Chapter 6, subsection 3.1.
526 § 9-322(a)(1) UCC and § 9-323 UCC. Although it is no requirement to be perfected in future advances, it is common practice that future advances are mentioned in the financing statement.
527 I refer to subsection 3.4.1.5 for further more details on this subject.
528 See supra footnote 512.
529 See supra subsection 4.3.1.
530 §§ 9-520(c), 9-502(a), 9-506(c) UCC. See supra subsection 3.7.3.
is stated incorrectly and the subsequent lender claims to be misled by that mistake, the security interest of the first-on-file secured lender is not ‘purchaser perfected’. This means that first security interest will be subordinate to a conflicting perfected secured creditor if the latter has given value in reasonable reliance upon the incorrect information (§ 9-338(1) UCC). Hence, on the rare occasion that a subsequent lender relies on the misinformation to its detriment, the lender will rank before the first-on-file lender (whose financing statement is effective, but flawed). Yet, this does not apply if this type of § 9-516(b)(5) information is simply missing; here too, secured lenders are expected not be misled by a financing statement on file with (a few) blank fields as to the mailing address or so; they will simply know that some information is missing and, consequently, need further inquiry. If a financing statement does not show up in a search because it has been wrongly refused by a filing officer (or is improperly indexed), it has no effect whatsoever against subsequent secured lenders, who give value and acted in reasonable reliance upon the absence of the record from the files (§ 9-516(d) UCC). If necessary, the damaged filing party can try to sue the state official for the wrongful rejection.

4.3.2. Purchase money-lenders vs. secured lenders

If a lender qualifies as a purchase money-lender, different priority rules apply. I reiterate that the holder of a PMSI is afforded ‘super-priority’ if the holder takes the procedural steps provided by § 9-324 UCC. This article shows that which steps need to be taken depend on the nature of the collateral concerned: a distinction is made between a PMSI transaction in which ‘non-inventory collateral’ and ‘inventory collateral’ is financed.

When purchase money-lenders finance ‘non-inventory collateral’, they will have priority over ordinary (i.e. a non-purchase money) secured lenders, if the former perfects the PMSI no later than 20 days after the debtor receives possession of the non-

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531 Official Comment 2 to § 9-338 UCC provides that a purchaser (e.g. a buyer) who has not made itself aware of the information in the filing office with respect to the debtor cannot act in ‘reasonable reliance’ upon incorrect information.

532 See supra subsection 3.7.1.

533 See Official Comment 3 to § 9-516 UCC: ‘(…) subsection (d) imposes upon the filer the risk: that a record failed to make its way into the filing system because of the filing office’s wrongful rejection of it.’

534 See supra subsection 3.7.2.

535 § 9-324 UCC overrides the otherwise-applicable first-to-file-or-perfect rule of § 9-322(a)(1) UCC.

536 ‘Non-inventory collateral’ refers to goods other than inventory, farm-products and livestock.

537 § 9-102(a)(48) UCC: “Inventory” means goods, other than farm products, which: (A) are leased by a person as lessee; (B) are held by a person for sale or lease or to be furnished under a contract of service; (C) are furnished by a person under a contract of service; or (D) consist of raw materials, work in process, or materials used or consumed in a business.”

538 Official Comment 3 to § 9-324 UCC provides that it is usually quite clear when the debtor receives possession of the collateral. In addition, the Official Comment provides: “However, sometimes the debtor buys goods and takes possession of them in stages, and then assembly and testing are completed by the seller or the debtor-buyer at the debtor’s location. Under these circumstances, the buyer ‘takes possession’ within the meaning of subsection (a) when, after an inspection of the portion of the goods in the debtor’s possession, it would be apparent to a potential lender to the debtor that the debtor has acquired an interest in the goods taken as a whole. A similar issue concerning the time when “the debtor receives possession” arises when a person acquires possession of goods under a transaction that is not governed by this Article.”
inventory collateral (§ 9-324(a) UCC).\textsuperscript{539} Thus, the purchase money-lender must have filed a financing statement before that time.\textsuperscript{540} This priority is granted even if the purchase money-lender knows that a conflicting security interest has been created or that a conflicting financing statement covering the same collateral has been filed by another lender: if the financing statement is filed within those 20 days, the PMSI is – with retro-active effect – automatically perfected when the debtor receives possession of the collateral.\textsuperscript{541}

In the situation addressed here, perfection takes place at an earlier time than the PMSI is filed in the public filing system. The same goes for the situation in which a creditor perfects its security interest by taking possession: this (‘prior’) claim is not in the filing system. This means that, for a creditor to know who has – not only filed but also perfected first, it should in addition to checking the filing system (i.e. asking for a search report) and viewing the collateral to make sure it is not in the possession of the holder of a competing security interest, also take into account the possibility of a PMSI being automatically perfected.\textsuperscript{542}

When ‘inventory collateral’ is financed, the standard is less flexible. In order to achieve priority over an earlier-filed ordinary security interest, the purchase money-lender must achieve perfection – that is: file – before the debtor receives possession of the inventory (§ 9-324(b) UCC).\textsuperscript{543} (Thus, the 20-day grace period does not apply to inventory). Secondly, the purchase money-lender must notify the earlier-filed lender that it has or expects to acquire a PMSI in the described inventory (§ 9-324(c) UCC). Hence, the purchase money-lender has to search the files to know whom it has to notify. Although a PMSI-notification is supposed to be able to encompass multiple transactions, this notice should


\textsuperscript{540} In theory, the lender can also perfect its PMSI by taking possession, but this is not common in view of the interruption this would cause with regard to the debtor’s business and it would in fact be somewhat contrary to the nature of PMSIs.

\textsuperscript{541} See Official Comment 3 to § 9-324 UCC.

\textsuperscript{542} Cf. LoPucki & Warren 2012, p. 526.

\textsuperscript{543} Filing is unnecessary only in the case of ‘consumer goods’ because the PMSI will be automatically perfected.
be received before, but not more than five years before, the debtor receives possession of the inventory (§ 9-324(b)(3) UCC).\(^{544}\) When the so-called ‘inventory lender’, \(i.e.\) the secured lender has not received notification (or if the other security interest does not qualify as a PMSI), any advance made in normal circumstances will have priority under the basic priority rule of § 9-322 UCC.

The exception to the 20-day grace period in § 9-324(a) UCC in case of inventory is designed to accommodate the commercial practice of inventory financing, in which ‘revolving credit lines’ – arrangements for periodic advances against incoming goods – are common.\(^{545}\) The notification requirement is adopted to protect these inventory lenders: absent this rule, one fears that the debtor has the possibility of applying to the inventory lender to make periodic advances, while it already has given a PMSI in the inventory to another lender or seller. Notification would make fraud of this kind more difficult, since it enables inventory lenders to consciously decide to not make other advances, without having to search the filing system.\(^{546}\)

4.3.2.1. Priority despite exchange of the collateral (i.e. priority in proceeds)

If a purchase money-lender obtains a PMSI in the goods sold to the debtor, it is quite conceivable that the debtor will on-sell the goods to third parties prior to paying the purchase money-lender.\(^{547}\) The question then arises whether the PMSI will also cover the proceeds and whether it takes priority over a competing security interest that had been filed prior to the PMSI sale.

I reiterate that a secured party can ‘trace’ the value of the collateral as it changes or is disposed by the debtor, since a secured party is given a right to so-called ‘proceeds’. In a nutshell, proceeds are whatever is received by the debtor upon the sale of its assets. See supra subsection 2.2.2 for more detailed information.

The answer to this question depends again on the nature of the goods. If the collateral consists of non-inventory, such as equipment the purchase money-lender’s PMSI priority will indeed extend to the proceeds.\(^{548}\) If the collateral consists of inventory, the purchase money-lender’s PMSI priority will extend to the proceeds only if such proceeds consist of

\(^{544}\) This means that the notice is good for five years. See Official Comment 3 to § 9-324 UCC and Sigman 2004, p. 74.

\(^{545}\) Outside the inventory field, ‘revolving credit lines’ are fairly unusual. Despite this, Baird and Jackson argue that a notification requirement should also be required for non-inventory PMSIs. See Baird & Jackson 1982, p. 194-196. For a different view on this, see Harris 1982, p. 338, note 60.


\(^{547}\) The same applies to purchase money sellers; see infra subsection 4.4.1

\(^{548}\) However, this priority extends to the proceeds only if the PMSI in the original collateral is perfected no later than 20 days after the debtor receives possession of that non-inventory collateral and the proceeds are ‘identifiable’, § 9-324(a) UCC.
chattel paper, instruments or cash, but it will not if the proceeds consist of accounts (§ 9-324(b) UCC).\(^{549}\)

4.3.2.2. Fixtures

The question is what happens with a PMSI, if the goods covered by the PMSI become affixed to land or a building that is subject to a mortgage in such a way that the PMSI goods are to be qualified as ‘fixtures’: will the PMSI in the fixture have priority or the real estate claimant (i.e. encumbrancer or owner of the building)?

I recall that a secured lender has two ways to perfect its security interest in goods that are, or are to become, fixtures.\(^{550}\) First, it may perfect a security interest in the fixture by the filing of a regular financing statement in the UCC’s office as designated by § 9-501(a)(2) UCC. This is called a ‘non-fixture filing’.\(^{551}\) Second, the secured lender may perfect a security interest in the fixture by the filing in the office that is designated for the filing or recording of mortgages on the real property to which such collateral relates, i.e. in the local real-property mortgage office (§ 9-501(a)(1)(B) UCC). This is a so-called ‘fixture filing’.\(^{552}\) Hence, ‘fixture filings’ – which, by definition, are recorded in the real property records – should be distinguished from ‘UCC filings covering fixtures’, which are filed in the Art. 9 UCC index.\(^{553}\) See supra subsection 3.3.3.2.

If the PMSI in the fixture is filed as a ‘fixture filing’ in the real estate records, the purchase money-lender has priority as against the prior recorded real-estate claimants, if the interest of the real estate claimant has arisen before the goods become fixtures, and the fixture filing took place before the goods become fixtures, or within 20 days thereafter (§ 9-334(d) UCC).\(^{554}\) If, on the other hand, the purchase money-lender files the PMSI on a fixture in the UCC’s filing office, it will only be protected against lien creditors and the trustee in bankruptcy (§ 9-334(e)(3)).\(^{555}\) No protection will be afforded against later mortgagees or fixture filers who perfected their interest in the real estate records (§ 9-334(e) UCC). Hence, the best way to ensure priority is to file a fixture filing in the real property records.

\(^{549}\) However, this priority extends to these proceeds (chattel paper, instruments or cash) only if these proceeds are identifiable and if they are received on or before the delivery of the inventory to the buyer (§ 9-324(b) UCC).

\(^{550}\) See also Official Comment 4 to § 9-501 UCC.


\(^{552}\) Under § 9-102(a)(40) UCC, a ‘fixture filing’ is the filing of a financing statement covering goods that are or are to become fixtures and satisfying the requirements of § 9-502(a) and (b) UCC.

\(^{553}\) § 9-501(a) and Comments 3 and 4; § 9-102(a)(6), (40), (41), Sigman 1999a, p. 62 and White & Summers 2002, § 31-13 and § 33-5.

\(^{554}\) This priority rule corresponds to the priority rule of § 9-324 UCC. See also Official Comment 7 to § 334 UCC and LoPucki & Warren 2012, p. 526 for an illustration of this rule.

\(^{555}\) See also Official Comment 9 to § 9-334 UCC.
There are some limited exceptions to the general fixtures priority rule provided in § 9-334(e)(2) and § 9-334(f) UCC. It is beyond the scope of this thesis to elaborate on this.556

4.3.2.3. Accession and commingling
The priority rules on accessions and commingled goods are similar to the priority rules on fixtures and will be discussed briefly.557 In case of conflict as a result of accession, the regular provisions determining priority apply.558 Most typically, the person with the claim on accession is a purchase money-seller or purchase money-lender who will have priority on the basis of § 9-324 UCC.559 I recall that in the case of ‘commingling’, the security interest attaches to the product or mass it becomes part of and continues to be perfected if the security interest in the goods was perfected before the commingling (§ 9-336(b) or (c) UCC). If more than one perfected security interest attaches to a product or mass as a result of commingling, the interests rank equally in the proportion to the value of the collateral. If one of the two competitors is not perfected at the time of commingling, the competitor will be subordinated to the perfected security interest (§ 9-336(f) UCC).560

4.3.3. Purchase money-lenders vs. purchase money-lenders
In the relatively unusual situation that two lenders grant the debtor a loan that enables the latter to buy collateral – hence a situation of multiple lenders having a PMSI – § 9-324(g) UCC applies. In brief, this section makes clear that, when neither of the creditors is a seller, the first-to-file-or-perfect rule of § 9-322(a) UCC applies: the first to file or perfect wins.561

4.4. Lenders vs. sellers
4.4.1. Secured lenders vs. purchase money sellers
Traditionally, a lender provides the debtor with a regular (working capital) loan in exchange for a perfected security interest in all of the debtor’s assets, while a seller conducts business with the debtor by supplying goods on credit. If the seller follows the very specific steps to obtain a PMSI for the goods that it is selling to the debtor, the seller will be able to trump the security interest of an ordinary secured lender. The priority conflict between an ordinary secured lender and a purchase money seller will be

556 See the Official Comments to § 9-334 UCC and White & Summers 2002, § 33-5 for more details on these exceptions.
557 As a reminder, ‘accession’ occurs when goods are physically united with other goods in such a manner that the identity of the original goods is not lost (§ 9-102(a)(1) UCC). When ‘commingling’ occurs, the identity of collateral does get lost (§ 9-336(a) UCC). See supra subsection 2.1.5.
558 This follows from § 9-335(c) UCC.
559 This rule has an exception if a secured creditor has perfected its security interest by notation on the certificate of title; see § 9-335(d) UCC.
560 For more details and illustrations concerning these rules see e.g. the Official Comments to § 9-335 UCC and § 9-336 UCC, White & Summers 2002, § 33-6 and LoPucki & Warren 2012, p. 530-513.
561 For the operation of § 9-322(a) UCC and illustrative examples, see supra subsection 4.3.1.
addressed in this subsection. As already explained in subsection 4.3.2, the holder of a PMSI is afforded ‘super-priority’ when it takes the procedural steps as set out by § 9-324 UCC. Obviously, this rule also applies when the purchase money secured creditor is a seller. Therefore, for more details on this priority rule (including the rules for priority in proceeds) I refer to subsection 4.3.2.

As a reminder: in a nutshell, this rule implies that when ‘non-inventory’ collateral is financed by the seller, it will have priority over a conflicting ordinary security interest in the same goods, if it is perfected when the debtor receives possession of the collateral or within 20 days thereafter (§ 9-234(a) UCC). If ‘inventory’ is financed, the purchase money seller will have priority over a conflicting ordinary security interest of a lender if the PMSI is perfected before the debtor receives possession of the inventory and if the seller has notified the earlier-filed lender that it has acquired or expects to acquire a purchase-money security interest in the described inventory (§ 9-234(b) UCC).

### 4.4.2. Secured lenders vs. sellers using other means of protection

In practice, many inventory lenders do not permit their debtors to allow PMSIs to exist in favor of their sellers, by simply declaring it a basis for default (i.e. enabling them to accelerate the loan when it is breached). As a result, many sellers are unable to retain (purchase money) security interests in what they sell. There are a few things sellers can do to ‘beat’ secured (inventory) lenders besides stipulating for a PMSI and asking for cash against delivery; some of those tools work, others do not. For the sake of clarity, this subsection will discuss these weapons briefly.

### 4.4.2.1. Retention of title

Some sellers believe that they can trump inventory lenders by stipulating a retention of title. This is a contract stating that title will not pass until after the debtor has paid for the goods. However, under the UCC retention of title is treated as an immediate sale, with the seller retaining a security interest (§ 2-401(1) UCC). Therefore, in practice the retention of title is a ‘trap for the unwary’: since it is a security interest it will lose against other security interests that were first to file.

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562 § 9-324 UCC overrides the otherwise-applicable first-to-file-or-perfect rule of § 9-322(g)(1) UCC.
563 Just to give you some insight in common practice, LoPucki wrote in 1995 that “[m]any, if not most, UCC filings are made to perfect purchase money security interests created at the time a manufacturer or dealer sells the collateral to an end user or reseller.” LoPucki 1995, p. 587. There is not much reason to assume that this is very different anno 2013.
564 This is called a ‘negative pledge’.
566 In describing these weapons, I will use LoPucki & Warren 2012’s order, p. 582 et seq.
567 § 2-401(1) UCC provides: “(…). Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. (…).”
568 Cf. LoPucki & Warren 2012, p. 582 on this subject.
4.4.2.2. Consignments

The seller may also try to consign the goods to the debtor for sale. ‘Consignments’ under Art. 9 UCC are narrowly defined in § 9-102(a)(20) UCC. In a nutshell, this article requires the seller to deliver the goods to a merchant for the purpose of sale and: (A) the merchant: (i) deals in goods of that kind under a name other than the name of the person making delivery; (ii) is not an auctioneer; and (iii) is not generally known by its creditors to be substantially insolvent; (B) with respect to each delivery, the aggregate value of the goods is $1,000 or more at the time of delivery; (C) the goods are not consumer goods immediately before delivery; and (D) the transaction does not create a security interest that secures an obligation.” These consignments are covered by Art. 9 UCC (rather than Art. 2 UCC) see, § 9-109(a)(4) UCC. See supra subsection 1.3.4.

Essentially, there is another, third, group of consignments that is governed by Art. 9 UCC, but not because it is a consignment, but because it is a consignment-like situation that is, in fact, a secured transaction. If a transaction is structured such that the debtor (consignee) is not entitled to return the goods the consignment will be qualified as a disguised security interest, for which reason all of Art. 9 UCC applies.\(^573\)

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569 § 9-102(a)(20) UCC: “‘Consignee’ means a person that delivers goods to a consignee in a consignment.”

570 The seller is the consignor. § 9-102(21) UCC: “‘Consignor’ means a person that delivers goods to a consignee in a consignment.”

571 The debtor is the consignee. § 9-102(19) UCC: “‘Consignee’ means a merchant to which goods are delivered in a consignment.”

572 The exceptions to this definition are transactions for which the consequences of this rule – the need to file – would be inappropriate, such as consumer goods (see subsection (c)), or for which filing would be of insufficient benefit to justify the costs, such as transactions below 1000 dollar (see subsection (d)). These consignments are mostly governed by non-Art. 9 UCC statutes. See Official Comment 14 to § 9-102 UCC.

573 § 9-103(d) UCC: “[Consignor’s inventory purchase-money security interest.] The security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.”

574 See Official Comment 6 to § 9-103 UCC, Official Comment 2 and 3 to § 9-319 UCC.

575 See §§ 9-102(a)(20)(D) UCC, 9-109(a)(1) and 1-201(b)(35) UCC. See also LoPucki & Warren 2012, p. 583.
4.4.2.3. Right of reclamation from insolvent debtor

If a seller discovers that it has sold goods to a buyer – i.e. the debtor – and the latter is insolvent, the seller can reclaim the goods upon demand within a reasonable time after the buyer’s receipt of the goods. Such a demand does not have to be in writing and has no time limit (§ 2-702(2) UCC). Any receipt of goods on credit by the buyer amounts to a tacit business representation of solvency and therefore is fraudulent against any particular seller. Thus, the premise of reclamation is that the seller was defrauded, unless the debtor proves the contrary.577

A similar right to reclaim the goods exists in case of the debtor’s bankruptcy, but the requirements differ from the requirements for reclaiming goods under Art. 2 UCC. In bankruptcy, a reclamation demand must be in writing. In addition, the seller has 45 days of the debtor’s receipt of the goods, but not later than 20 days after the commencement of the bankruptcy case (§ 546(c) BC).

The relevant question for this subsection is to what extent this right of reclamation can be upheld against an intervening secured inventory lender. In practice, the reclaiming seller loses the battle most of the time: § 2-702(3) UCC recognizes the secured lender as a good faith578 purchaser whose security interest will attach to purchased inventory immediately upon their identification to the contract for sale. This gives secured lenders the right to (retain) possession of the goods.579 Accordingly, in relation to a secured lender, the seller will lose if the former is perfected. However, this right will have effect against the debtor and the trustee in bankruptcy.580

4.4.2.4. Express or implied agreement with the inventory lender

The most direct way for a seller to be protected from priority of the debtor’s secured (inventory) lender would be an agreement between a seller and an inventory lender

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576 According to the original version of Art. 2 UCC, the demand should be made within ten days after receipt of the goods. The amended version of Art. 2 UCC omits the 10-day limitation.
577 Official Comment 2 to § 2-702 UCC, Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York) and LoPucki & Warren 2012, p. 584.
578 Under former § 1-201(19) UCC ‘good faith’ was defined as ‘honesty in fact in the conduct or transaction concerned’. In Rev. § 1-201(b)(21) ‘good faith’ is defined as ‘honesty in fact and the observance of reasonable commercial standards of fair dealing’. From these definitions it can be seen that the standard for determining good faith was traditionally subjective, not a party’s negligence or stupidity was decisive, but his actual knowledge (i.e. its motive). Therefore, it was often referred to as the ‘pure heart, empty head’ standard. By incorporating an element of fairness, the drafters of Revised Art. 1 UCC adopted an objective standard. Moses 2002, p. 48. The definition of good faith in Rev. § 1-201(b)(21) corresponds to the definition of good faith in Art. 9 UCC (see § 9-102(a)(43) UCC) and in most other UCC articles. See also Official Comment to § 1-201 UCC.
579 When the right to reclaim is invoked in bankruptcy, there is no ‘good faith’ requirement (see § 546(c) BC). A secured lender that agreed upon an after acquired property clause will simply prevail over the reclaiming seller if it has ‘prior rights’; see LoPucki & Warren 2012, p. 588-589.
580 For more details on the seller’s right to reclaim, see Harris & Mooney 2006, p. 21-25 and LoPucki & Warren 2012, p. 583-788.
providing for direct disbursement to the seller (for its supplies) by the (inventory) lender out of the loan advanced to the debtor. An only slightly less robust variation is an arrangement whereby the inventory lender and seller agree that the loans advanced will be used to pay the latter. There are several reasons why nonetheless such arrangements are not common. First, these agreements are not attractive to the debtor who does not want to be deprived of a ‘float’. In addition, suppliers are not keen to be seen as insisting on direct payment from the inventory lender because they have no interest in becoming tainted by the suggestion they are aware that the debtor is in financial difficulty. After all, the result might be that the debtor feels inclined to move its business to a supplier willing to fund him directly. Additionally, such practices are not customary in some particular fields of industry.581

4.4.2.5. Equitable subordination

In extreme cases the seller may be able to defeat the lender on the basis of ‘equitable subordination’ (§ 510(c) BC). In these cases, courts use their power and authority to subordinate a secured lender’s claims on the debtor’s assets to the claims of the (junior) (unsecured) seller(s) based on principles of equity. For this to happen, the secured lender must have engaged in some type of inequitable conduct, which has resulted in injury to the debtor’s creditors or conferred an unfair advantage on the lender.582 In addition, equitable subordination of the claim must not be inconsistent with bankruptcy law.

4.4.2.6. Unjust enrichment ‘feeding the lien’

Some circumstances justify the secured lender to be liable to an unsecured seller based on the theory of unjust enrichment. According to (what is considered to be) the leading case on this matter, this occurs “(…) when a secured creditor initiates or encourages transactions between the debtor and the supplier of goods and services, and benefits from the goods or services supplied to produce such debt”.583 Put differently, if the secured lender tries to make unsecured sellers to spend money to preserve the collateral, which improves the lien, the secured lender has to compensate the sellers to avoid unjust enrichment.584

4.4.3. Purchase money-lenders vs. purchase money-sellers

If both the lender and the seller have a security interest that qualifies as a PMSI, the seller’s interest takes priority under § 9-324(g)(1) UCC.

582 Such as fraud, illegality, or breach of fiduciary duty.
In practice, the bank and the seller usually agree that the seller’s lien goes first. If they have not made such agreement, this usually means that the debtor has been dishonest and that both the lender and the seller are not aware of each other’s existence. The Art. 9 UCC drafters decided that this risk was for the bank to bear.  

4.5. Lenders vs. buyers

This subsection will deal with the priority rules on the relationship between the debtor’s lenders and buyers. It is important to remember that ‘buyer’ refers to someone who acquires something in a sale transaction. A ‘purchaser’, by contrast, is someone who takes assets “(…) by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction (…)”, which includes, most importantly: a secured creditor. Hence, ‘buyer’ and ‘purchaser’ are not interchangeable terms. As some priority rules only apply to buyers while others apply to all purchasers (which, for the sake of clarity, includes buyers) it is important to bear this distinction in mind. This subsection deals solely with the position of buyers in relation to lenders.

When a lender has stipulated a security interest, it continues in the collateral in the hands of a buyer when the debtor disposes of it, unless Art. 9 UCC provides otherwise (§ 9-315(a)(1) UCC). The first exception to this rule presents itself when the secured lender has authorized the disposition of the collateral free of the security interest:

“(1) a security interest (…) continues in collateral notwithstanding (…) disposition thereof unless the secured party authorized the disposition free of the security interest.”  

Despite the fact that the authorization needs not to be expressly provided, the lender should take care not to ‘waive’ a prohibition in the security agreement not to sell certain collateral by not objecting if it knows that the debtor does so contrary to the security agreement. If a secured lender has not authorized a sale, the question whether a pre-existing security interest remains in the collateral notwithstanding a disposition depends on two main issues: a distinction must be made between the question whether or not the security interest is perfected and, moreover, the question whether or not the buyer can be qualified as a ‘buyer in the ordinary course of business’.

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585 Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).
586 § 1-201(29) and (30) UCC.
587 This is in line with the main rule governing sales of encumbered personal property, provided by § 9-201 UCC: “Except as otherwise provided in [the UCC, DJYH] a security agreement is effective according to its terms (…) against purchasers of the collateral (…)”. Cf. Sigman 2004, p. 71 and White & Summers 2002, § 33-8 on this subject. This rule approximates the notion of droit de suite employed by civil law systems: if the secured lender has not authorized the disposition of particular collateral, the security interest continues to remain with that collateral.
588 For an in-depth discussion on how a secured lender must authorize the disposition of collateral free of its security interest, see Harris & Mooney 2006, p. 277-279.
589 Although courts have taken this stance in numerous cases, mere inattention or inaction is not sufficient for a secured lender to waive its security interest. See Livingston 2011, p. 213 and LoPucki & Warren 2012, p. 606.
If a pre-existing security interest has not been perfected by the secured lender, the distinction between a buyer in and not in the ordinary course of business is irrelevant: a buyer can receive the goods free from security at all times if the buyer acts in good faith, gives value and receives delivery of the collateral (§ 9-317(b) UCC).

Example: Lender A has stipulated a security interest in the debtor’s machine. Buyer B buys this machine before the lender has filed a financing statement with respect to the security interest in the machine. If B acts in good faith with regard to the security interest, has paid for and has received delivery of the machine, it will take free of A’s security interest.

If a security interest in the collateral is perfected, the question as to whether a buyer can receive the asset free of security, does depend on the question of whether it qualifies as a buyer in the ordinary course of business; see next subsection.

4.5.1. Secured lenders vs. subsequent buyers in the (seller’s) ordinary course of business (‘BIOCOB’)

When a security interest in the collateral is perfected, ‘buyers in ordinary course of business’ can receive the goods free from these security interests (§ 9-320(a) UCC). This rule is prompted by the belief that some types of buyers do not deserve to play the search-and-file-game: it facilitates sales transactions between the debtor and its customers. A buyer in the ordinary course of business is defined in Rev. § 1-201(b)(9) UCC:

“‘Buyer in ordinary course of business’ means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller’s own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Article 2 may be a buyer in ordinary course of business. ‘Buyer in ordinary course of business’ does not include a person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.”

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589 See infra footnote 578.
590 See § 1-201(44) UCC. See supra subsection 2.1.1.
591 ‘Delivery’ is defined in Rev. § 1-201(15) UCC, but ‘goods’ are omitted in this definition. White & Summers argue that it should by applied by analogy to goods, which would mean that, for delivery to have taken place, the buyer must have received possession of the goods. White & Summers 2002, § 33-8.
First, § 9-320(a) UCC requires a buyer to act in good faith and without knowledge that the sale violates the rights of another person in the goods. Hence, it is irrelevant if a buyer, at the time of transfer, knows that the goods were subject to a security interest; what matters is that the buyer knows that the sale violates a term in an agreement with the secured party. In that case the buyer would not qualify as a BIOCOB and would take subject to the security interest.

This is a sound result given that subsection (a) to § 9-320 UCC applies primarily to inventory collateral. In this context security agreements will normally authorize the debtor to sell the collateral free from security if such sale was conducted in the ordinary course of the security provider's business. Buyers are deemed to be aware of this practice. Consequently, as long as they do not have reason to ask questions they are protected by this rule.

The next three requirements to qualify as a BIOCOB are: the transaction must not relate to bulk trade (requirement no. 2), the buyer has to give some form of new value for the goods (requirement no. 3) and the purchase has to take place in the ordinary course of the seller's business (requirement no. 4). With regard to this last requirement, the nature of the buyer's business is irrelevant. Moreover, the seller must do business in selling goods of that kind. This means, e.g., that if the debtor sells equipment the ordinary course of business requirement would not be met if it sells inventory, or, alternatively if a seller that normally sells lamps sells machines. According to the fifth and sixth requirements, the sale may not concern farm products and the competing security interest must be created by the buyer's seller. This requirement contemplates that the security interest remains in the collateral if a buyer in the ordinary course of business buys the collateral from a person who did not buy the collateral in the ordinary course of business.

The consequence of this rule is that a buyer in the ordinary course of business always has to take into account the risk that not its own seller, but a former seller in the chain has created a security interest in favor of a third party, without that buyer having, at the same time, the opportunity to verify this in the public register (§ 9-507(a) UCC). Considered from the perspective of the secured (inventory) lender, this rule implies that its own debtor can cause the security interest to become ineffective but only when

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594 See supra footnote 578 for a definition of ‘good faith’.
595 These requirements seem to be twofold, but in American literature little attention is paid to the difference.
596 Picker 2009, p. 289. According to Sigman this is a rule based on efficiency that enables goods to move freely from inventory, fully in accordance with the expectations of the secured lender, who intends (indeed, desires) the inventory to be sold and whose security interest continues in the proceeds. See Sigman 2004, p. 72. See also Official Comment 3 to § 9-320 UCC, LoPucki & Warren 2012, p. 597 and Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).
597 For illustrative case law on this requirement, see White & Summers 2002, § 33-8.
598 The farm product exception seems to be not much of an exception at all, see LoPucki & Warren 2012, p. 610.
599 Aside from that, it could be automatically perfected if it is a PMSI in consumer goods. See § 9-309(1) UCC.
selling to a buyer in the ordinary course of its business. This means that this rule has relevance specifically in the context of onward sales.

The last requirement is that the buyer has to take possession of the goods or a right to recover the goods from the seller under Art. 2 UCC. As a result, a buyer who has not received possession yet is (no more than) an unsecured creditor.

If a buyer buys goods that remain in the possession of the secured lender this will not affect the secured lender’s security interest (§ 9-320(c) UCC). As discussed before, this applies also when the lender possesses the collateral through an agent. This is an overturn of the Tanbro Fabrics case, which was one of the most controversial cases under the predecessor to § 9-320(a) UCC: § 9-307(1) UCC. The main question in this case was, in brief, whether or not a buyer of goods would qualify as a ‘BIOCOB’ and take free of the security interest when the goods were held by the secured lender at the time the sale was conducted. The court answered this question affirmatively. Not surprisingly, this case generated dispute among American scholars specialized in secured financing, one of the main concerns being that secured lenders were left without any means to protect themselves against buyers in ordinary course of business. The drafters of Art. 9 (2001) UCC could not stomach the Tanbro result, and adopted § 9-302(e) UCC, which dictates that § 9-320(a) and (b) UCC does not affect a security interest in goods in possession of the secured party under § 9-313 UCC.

4.5.2. Secured lenders vs. subsequent buyers outside ordinary course of business

If a buyer cannot be qualified as a buyer in the ordinary course of business (see supra previous subsection), the buyer will acquire the asset subject to a perfected security interest. Hence, those who buy outside the ordinary course of business – irrespective of whether these are commercial buyers or consumers – are expected to search the UCC filing system and are charged with constructive notice of the financing statements they would have found. Hence, in this case a financing statement does not lose its effectiveness following a disposition of the collateral. This effectiveness will last until the financing statement lapses (§ 9-507(a) UCC).

600 White & Summers 2002, § 33-8 and LoPucki & Warren 2012, p. 597. Normally, a right to recover the goods from the seller under Art. 2 UCC exists only when the buyer receives the goods through physical delivery. Despite this, under some circumstances, a consumer has such a right, even without possession. For more details on this subject, see White & Summers 2002, § 33-8.

601 See Official Comment 3 to § 9-313 UCC. It is beyond the scope of this thesis to elaborate further on this requirement. Relevant to note is that there is several case law on this requirement which has been adopted in Rev. § 1-201(9) UCC. This rule is interpreted as such that only a buyer who takes possession of the goods or has a right to recover the goods from the seller under Article 2 may be a buyer in ordinary course of business. See LoPucki & Warren 2012, p. 599 et seq. Cf. Livingston 2011, p. 208.

602 See e.g. Kripke 1978, p. 153 and 159.


605 This applies even if the secured lender knows or consents to a disposition. Obviously, this would be different if the secured lender consents to a disposition free of the security interest; in that case the security
4.5.2.1. Future advances

A buyer in the ordinary course of business that acquires the goods free from the security interest under § 9-320 UCC is not exposed to any issues concerning future advances. This is different for buyers outside the ordinary course of business. Since ‘future advance clauses’ purport to extend the effect of a security agreement beyond the initial debt, a relevant question is how these advances fit for the purposes of determining priority vis-à-vis an ‘intervening’ buyer (not in the ordinary course). The key issue is whether or not a properly perfected secured lender has the same priority with respect to future advances if those advances are made after the conflicting interest of that buyer. As a main rule, a buyer not in the ordinary course of business acquires the goods free of a security interest to the extent that it secures advances made after the purchase, unless the advances were made pursuant to a commitment entered into before the expiration of the 45-day period and without knowledge of the purchase, see § 9-323(d) and (e) UCC. An example is a buyer that purchases the goods in an execution sale.

4.5.2.2. Allocation of risks in the case of defective filing

I reiterate that those who buy not in the ordinary course of business – irrespective of whether they are commercial buyers or consumers – are expected to search the UCC filing system and are charged with constructive notice of the financing statements they would have found. If an existing secured lender has properly filed a financing statement under the debtor’s correct name, it will show up after a search while using the ‘SSL’ of the filing office where the financing statement has been filed. Yet, if such a search does not

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interest would not continue in the collateral despite the ‘effective’ financing statement. See also Harris & Mooney 2006, p. 276-277.

606 Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).

607 The operation of future advance clauses has been explained in subsection 2.1.4.


609 Lectures Secured Transactions Law by Prof. R. Mann, Spring 2010 (Columbia University, New York).
produce a financing statement of a prior secured lender as a result of a mistake made by the lender in stating the debtor’s name, the buyer will acquire the goods free of the security interest, due to the latter’s, albeit first-on-file, untraceable and thus ‘seriously misleading’ (and thereby ineffective) financing statement. If the debtor’s correct name is on file but the debtor’s mailing address or other § 9-516(b)(5) UCC information is stated incorrectly, the security interest of the first-on-file lender is not ‘purchaser perfected’ (§ 9-338(2) UCC). As a result, the buyer will acquire the goods free of the security interest if it has given value in reasonable reliance upon the incorrect information and has received delivery of the collateral. This does not apply when the § 9-516(b)(5) UCC information is missing; buyers will not be misled by a financing statement on file with (a few) blank fields; they will simply know that some information is missing and, consequently, need further inquiry. If a financing statement is not on file because it has been wrongly refused by a filing officer, it has no effect whatsoever against prospective buyers, which give value and acted in reasonable reliance upon the absence of the record from the files (§ 9-516(d) UCC). If necessary, the damaged filing party can sue the state official for the wrongful rejection.

4.5.3. Secured lender vs. consumers (‘garage sale’ - exception)

A buyer that purchases goods from a person who used or bought ‘consumer goods’ receives the goods free from a perfected security interest, if the buyer buys the good (i.e. for value) without knowledge of the security interest. In addition, in this so-called ‘consumer-to-consumer sale’ the seller must have used the goods primarily for personal, family, or household purposes and the buyer must do the same (hence, it must be from consumer to consumer). However, if the secured lender is perfected by filing a financing statement covering the (consumer) goods (§ 9-320(b) UCC) the consumer will take subject to the security interest. Hence, when a sale is conducted outside the seller’s ordinary course of business (see supra subsection 4.5.1) also consumers are expected to search the filing system.

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610 §§ 9-520(c), 9-502(a) and 9-506(c) UCC. See supra subsection 3.7.1 and subsection 3.7.3.
611 More specifically, § 9-338(2) UCC refers to a ‘purchaser, other than a secured party’.
612 Official Comment 2 to § 9-338 UCC provides that a purchaser (e.g. a buyer) who has not made itself aware of the information in the filing office with respect to the debtor cannot act in “reasonable reliance” upon incorrect information.
613 See supra subsection 3.7.1.
614 See Official Comment 3 to § 9-516 UCC: “(... subsection (d) imposes upon the filer the risk that a record failed to make its way into the filing system because of the filing office’s wrongful rejection of it.”
615 See supra subsection 3.7.2.
616 These are goods used primarily for personal, family, or household purposes (§ 9-102(a)(23) UCC).
617 Hence, if the seller is in the business of selling such goods, or, if the buyer buys the goods for its business, this rule does not apply. See White & Summers 2002, § 33-8.
618 See Official Comment 5 to § 9-320 UCC.
In practice, ordinary security interests will mostly be filed. Consequently, in the above mentioned context consumer buyers will take subject to these security interests.

4.5.4. Purchase money-lenders vs. all buyers (incl. consumers)

If a lender qualifies as a purchase money-lender, the following rules apply as against buyers. A buyer in the ordinary course receives the goods free from a PMSI (§ 9-320(a) UCC), just as it receives the goods free from an ordinary security interest. I refer to subsection 4.5.2 for more details on the operation of this rule.

With regard to buyers not in the ordinary course of business, different rules apply. The 20-day grace period that purchase money-lenders have against judicial lien creditors (see supra subsection 4.2.4.) is similarly applicable as against these buyers (§ 9-317(e) UCC). Hence, a purchase money-lender takes priority over the rights of a buyer outside the ordinary course of business if the former files a financing statement with respect to the PMSI before or within 20 days after the debtor receives delivery of the collateral and the buyer’s interest has arisen between the time the security interest attaches and the time of filing (§ 9-317(e) UCC. In other words, the position is no different than between a purchase money-lender and a judicial lien creditor: the purchase money-lender has a 20 day grace period in which the PMSI can be perfected and thereby defeat a sale performed between the dates of attachment and perfection of the PMSI.

Example: Bank A funds the purchase of a machine by the debtor. Two days after delivery, the debtor sells the machine to a buyer outside its ordinary course of business. As long as Bank A files the financing statement 20 days from the date of delivery of the machine to the buyer, Bank A takes priority over the buyer.

If a buyer buys ‘consumer goods’ that are subject to a PMSI, the PMSI is automatically perfected upon attachment (see supra subsection 2.3.1). Nonetheless, a buyer of consumer goods receives the goods free from the PMSI even if it is perfected, if the buyer buys without knowledge of the security interest and for value (§ 9-320(b) UCC). In addition, the seller must have used the goods primarily for personal, family, or household purposes and so must do the buyer (hence, it must be from consumer to consumer) and the sale must take place before the filing of a financing statement covering the goods.

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619 I reiterate that this grace period starts when the debtor receives possession. As touched upon before, the 20-day grace period is adopted because of reasons of efficiency, allowing a debtor to buy goods promptly without being forced to delay delivery until the lender has filed a financing statement. Cf. Sigman 2004, p. 72.

620 A PMSI is protected against all buyers not in the ordinary course of business, not only against transferees in bulk. This was the case under Art. 9 (1972) UCC (see § 9-301(2) (1972) UCC). See Official Comment 8 to § 9-317 UCC.

621 §§ 9-309(1) UCC, 9-310(b)(2) UCC.

622 See Official Comment 5 to § 9-320 UCC.
This rule is the antidote for § 9-309(1) UCC under which rule consumer goods are automatically perfected upon attachment, as a result of which consumer-buyers have no means to know of an existing PMSI in the goods.\textsuperscript{623}

**4.6. Sellers vs. general unsecured creditors & judicial lien creditors**

**4.6.1. Purchase money sellers vs. judicial lien creditors**

This subsection discusses what happens when a purchase money-seller finances particular collateral that is levied upon by a judicial lien creditor: who takes priority? As explained in subsection 4.2.4, the holder of a PMSI takes priority over a judicial lien creditor\textsuperscript{624} if the former files a financing statement with respect to the PMSI before or within 20 days after the debtor receives delivery of the collateral and the judicial lien has arisen between the time the security interest attaches and the time of filing (§ 9-317(e) UCC). This rule also applies when the purchase money secured creditor is a seller. In fact, their position is the same as the position of purchase money-lenders vis-à-vis judicial lien creditors and buyers. For more details on this priority rule (including the rules for priority in proceeds) see supra subsections 4.2.4 and 4.5.4.

Example: Seller A sells a machine to the debtor. Two days after delivery, a creditor of the debtor levies upon the machine to recover a debt owing to it by the debtor. As long as Seller A files the financing statement with 20 days from the date of delivery, Seller A takes priority over the judicial lien creditor.

**4.6.2. Purchase money-sellers in bankruptcy**

Purchase money-sellers like purchase money-lenders must perfect their PMSI within the 20-day period\textsuperscript{625} required by § 9-317(e) UCC to prevail over the a bankruptcy trustee. I recall that § 544(a)(1) BC permits the trustee in bankruptcy\textsuperscript{626} in this respect to step into the shoes of and use the subordinating power of a ‘hypothetical lien creditor’.\textsuperscript{627} This perfection can even take place after the debtor has filed for bankruptcy as long as it is effectuated within 20 days. In that case, the perfection relates back to the (prepetition) date the PMSI was created (provided that the PMSI was created before bankruptcy). If the seller fails to file even within those 20 days, the trustee can avoid the PMSI, after which the goods become part of the bankruptcy estate and the purchase money seller becomes a mere general unsecured creditor.\textsuperscript{628, 629}


\textsuperscript{624} This applies to lien creditors in general; see § 9-317(a)(2) UCC and supra footnote 427.

\textsuperscript{625} That is: within 20 days after the debtor has received possession of the goods (§ 9-317(e) UCC).

\textsuperscript{626} Or a ‘debtor-in-possession’ in a Chapter 11 bankruptcy proceeding

\textsuperscript{627} Hence, § 9-317(a)(2) UCC applies.

\textsuperscript{628} For more details on this subject, see Adler, Baird & Jackson 2007, p. 275-299.

\textsuperscript{629} For the seller's protection to be complete, the PMSI must be protected from intervening bona fide buyers and secured lenders during the period of grace. This has been discussed in subsection 4.5 and 4.3.2.
4.7. Sellers vs. sellers
4.7.1. Purchase money-sellers vs. purchase money-sellers
If two sellers have a PMSI that secures an obligation incurred as all or part of the price of the collateral, the ranking between two purchase money-sellers should be determined by the main rule of ‘first to file or perfect’. See supra subsection 4.3.3 for more details.

4.8. Sellers vs. buyers (incl. consumers)
Purchase money-sellers have the same 20-day grace period against buyers as purchase money-lenders do (§ 9-317(e) UCC; see supra subsection 4.5.4). Hence, a purchase money-seller takes priority over the rights of a buyer if the former files a financing statement with respect to the PMSI before or within 20 days after the debtor receives delivery of the collateral and the buyer’s interest has arisen between the time the security interest attaches and the time of filing (§ 9-317(e) UCC). A buyer in the ordinary course, however, receives the good free of a PMSI (§ 9-320(a) UCC), regardless of whether this PMSI is held by a lender or a seller. I refer to subsection 4.5.4 and 4.5.2 for more details on the operation of this rule.

Example: Seller A sells a machine to the debtor and retains a PMSI. Two days after delivery, the debtor sells the machine to a buyer not in the ordinary course of business. As long as seller A files the financing statement within 20 days from the date of delivery of the machine to the buyer, seller A takes priority over the buyer.

If ‘consumer goods’ are subject to a PMSI, the PMSI is automatically perfected upon attachment. However, a buyer of consumer goods will receive this type of goods free of an PMSI even if it is perfected, if the buyer buys without knowledge of the PMSI and for value (§ 9-320(b) UCC). In addition, it must be a consumer-to-consumer sale and the sale must take place before the filing of a financing statement covering the goods.

4.9. Buyers vs. general unsecured creditors & judicial lien creditors
A buyer can buy collateral from the debtor subject to the interest of a judicial lien creditor. Alternatively, a judgment creditor can take levy upon a good that has already been sold. As explained in subsection 4.1.2-4.1.3, creation of a lien differs from state to state: it can be created by taking possession of the debtor’s property, by execution, by delivering the writ of execution to the sheriff and, in a growing number of states, by filing a financing statement with the UCC filing’s office. It is beyond the scope of this thesis to

630 § 9-324(g)(2) UCC applies to this priority conflict, referring back to § 9-322(a) UCC.
631 It is beyond the scope of this thesis to elaborate on the relation between sellers using other means of protection (e.g. retention of title etc.) among themselves.
632 Here too, a PMSI is protected against all buyers, not only against transferees in bulk. This was the case under Art. 9 (1972) UCC (see § 9-301(2) (1972) UCC). See Official Comment 8 to § 9-317 UCC.
633 §§ 9-309(1) UCC, 9-310(b)(2) UCC.
634 See also Official Comment 5 to § 9-320 UCC.
describe all the different ways a buyer of the debtor can come into conflict with debtor's judicial lien creditors. The following, however, is noteworthy. If a state allows the creation of a lien by filing it in the records (such as California; see supra subsection 4.1.3), the filing mostly constitutes constructive notice to potential buyers, second-in-time judicial creditors and lenders at penalty of losing or not obtaining their interest or priority position vis-à-vis a first-in-time lien creditor. In this case, the filing procedure is a little different in comparison to perfecting a security interest in property under the UCC: instead of a financing statement, ‘notice of judgment lien’ has to be filed in the UCC filing office.635 In relation to debtors in the State of California, only a buyer in the ordinary course of business receives the goods free of a judgment lien, provided that California’s version of Art. 9 of the UCC would provide this.636

635 Once the judgment creditor has received payment, the debtor can ask the creditor to file an ‘acknowledgment of satisfaction of judgment’.