These Reporters' Comments will accompany the 1998 Annual Meeting Draft. They were prepared with a view towards assisting the Commissioners in evaluating the draft. They focus on the changes from former Article 9 and explain the considerations that entered into many of the Drafting Committee's decisions. They do not purport to be a complete set of Official Comments.

REVISION OF UNIFORM COMMERCIAL CODE
ARTICLE 9 – SECURED TRANSACTIONS

[9-101]

[There are no Reporters' Comments to § 9-101.]

[9-102]

Reporters' Comments

1. **Source.** Many of the definitions in this section derive from those in former Section 9-105; others are new. In accordance with the current NCCUSL style rules, all terms that are defined in Article 9 and used in more than one section have been consolidated in this section. The following definitions (some were not formal definitions in the earlier drafts) have been moved from the indicated sections of this draft. The sections of the ALI Annual Meeting Draft in which the definitions appeared also are identified.

Defined Term in Section 9-102:	From Section:
Accession	9-335 (ALI 9-332)
Account	N/A (ALI 9-103)
Cash proceeds	9-315 (ALI 9-313)
Commodity account	N/A (ALI 9-107)
Commodity contract	N/A (ALI 9-107)
Commodity customer	N/A (ALI 9-107)
Commodity intermediary	N/A (ALI 9-107)
Consumer goods	N/A (ALI 9-106)

Continuation statement	9-515 (ALI 9-516)
Equipment	N/A (ALI 9-106)
Farm products	N/A (ALI 9-106)
Health-care-insurance receivable	N/A (ALI 9-103)
Inventory	N/A (ALI 9-106)
Investment property	N/A (ALI 9-107)
Noncash proceeds	9-315 (ALI 9-313)
Payment intangible	N/A (ALI 9-103)
Person related to (individual)	9-615 (ALI 9-614)
Person related to (organization)	9-615 (ALI 9-614)
Proceeds	9-315 (ALI 9-313)
Proposal	9-620 (ALI 9-618)
Termination statement	9-513 (ALI 9-511)

2. **Parties to Secured Transactions.**

a.. **“Debtor”; “Obligor”; “Secondary Obligor.”** Determining whether a person is a “debtor under the definition in former Section 9-105(1)(d) requires a close examination of the context in which the word is used. To reduce the need for this examination, this Article redefines “debtor and adds new defined terms, “secondary obligor and “obligor. In the context of Part 6, these definitions distinguish among three classes of persons: (1) those persons who may have a stake in the proper enforcement of a security interest by virtue of their non-lien property interest (typically, an ownership interest) in the collateral, (2) those persons who may have a stake in the proper enforcement of the security interest because of their obligation to pay the secured debt, and (3) those persons who have an obligation to pay the secured debt but have no stake in the proper enforcement of the security interest. Persons in the first class are debtors. Persons in the second class are secondary obligors if any portion of the obligation is secondary or if the obligor that has a right of recourse against the debtor or another obligor with respect to an obligation secured by collateral. One must consult the law of suretyship to determine whether an obligation is secondary. The Restatement (3d), Suretyship and Guaranty § 1 (1996), contains a useful explanation of the concept. Obligors in the third class are neither debtors nor secondary obligors. With one exception (Section 9-614A, as it relates to a consumer obligor), the rights and duties in provided by Part 6 (default and enforcement) affect only obligors that are “secondary obligors.

The revised definition of “debtor renders unnecessary former Section 9-112, governing situations in which collateral is not owned by the debtors.

The definition of “debtor includes a “consignee, as defined in this section, as well as a seller of accounts, chattel paper, payment intangibles, or promissory notes.

By including in the definition of “debtor all persons with a property interest (other than a security interests or other lien), the definition includes transferees of collateral, whether or not the secured party knows of the transfer or the transferee’s identity. Rather than making adjustments in the definition to allow for the secured party’s lack of knowledge, exculpatory provisions in Part 6 protect the secured party in that circumstance. See Sections 9-605 and 9-628.

Secured parties and other lienholders are excluded from the definition of “debtor because the interests of those parties normally derive from and encumber a debtor’s interest. However, if in a separate transaction a secured party grants, as debtor, a security interest in its own interest (i.e., its security interest), the secured party is a debtor *in that transaction*. This typically occurs when a secured party with a security interest in specific goods assigns chattel paper.

Consider the following examples:

Example 1: Mooney borrows money and grants a security interest in his Miata to secure the debt. Mooney is a debtor and an obligor.

Example 2: Mooney borrows money and grants a security interest in his Miata to secure the debt. Harris co-signs the note as maker. As before, Mooney is the debtor and an obligor. Because Harris has a right of recourse against Mooney with respect to an obligation secured by the collateral, Harris would be a secondary obligor, even if the note states that Harris’s obligation is a primary obligation and that Harris waives all suretyship defenses.

Example 3: Mooney borrows money on an unsecured basis. Harris co-signs the note and grants a security interest in his Honda to secure his obligation. Inasmuch as Mooney does not have a property interest in the Honda, Mooney is not a debtor. Having granted the security interest, Harris is the debtor. Because Mooney is a principal obligor, he is not a secondary obligor. Whatever the outcome of enforcement of the security interest against the Honda or Harris’s secondary obligation, Harris will look to Mooney for his losses. The enforcement will not affect Mooney’s aggregate obligations.

When the principal obligor (borrower) and the secondary obligor (surety) each has granted a security interest in different collateral, the status of each is determined by the collateral involved.

Example 4: Mooney borrows money and grants a security interest in his Miata to secure the debt. Harris co-signs the note and grants a security interest in his Honda to secure his obligation. When the secured party enforces the security interest in Mooney's Miata, Mooney is the debtor, and Harris is a secondary obligor. When the secured party enforces the security interest in the Honda, Harris is the "debtor. As in Example 3, Mooney is an obligor, but not a secondary obligor.

b. **"Secured Party."** The definition of "secured party clarifies the status of various types of representatives. The secured party is the person in whose favor the security interest has been created, as determined by reference to the security agreement. This definition controls, among other things, which person has the duties and potential liability that Part 6 imposes upon a secured party.

Consider, for example, a multi-bank facility, under which Bank A, Bank B, and Bank C are lenders and Bank A serves as the collateral agent. If the security interest is granted to the banks, then they are the secured parties. If the security interest is granted to Bank A as collateral agent, then Bank A is the secured party.

The definition of "secured party also includes a "consignee, a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold, and the holder of an agricultural lien.

c. **Other Parties.** A "consumer obligor is defined as the obligor in a consumer transaction. Definitions of "new debtor and "original debtor are used in the special rules found in Sections 9-326 and 9-508.

3. **Definitions Relating to Creation of a Security Interest.**

a. **"Collateral."** As under former Article 9, "collateral is the property subject to a security interest and includes accounts and chattel paper that have been sold. It has been expanded in this draft. The term now explicitly includes proceeds subject to a security interest. It also reflects the broadened scope of the Article. The term now includes property subject to an agricultural lien as well as payment intangibles and promissory notes that have been sold.

b. **"Security Agreement."** The definition of "security agreement is substantially the same as under former Section 9-105–an agreement that creates or provides for a security interest. However, the term frequently was used colloquially in former Article 9 to refer to the document or writing that contained a debtor's security agreement. This draft eliminates that usage, reserving the term for the more precise meaning specified in the definition.

Whether an agreement creates a security interest depends not on whether the parties intend that the law characterize the transaction as a security interest but rather on whether the transaction falls within the definition of “security interest in Section 1-201. Thus, an agreement that the parties characterize as a “lease of goods may be a “security agreement, notwithstanding the parties’ stated intention that the law treat the transaction as a lease and not as a secured transaction.

4. **Goods-Related Definitions.**

a. **“Goods”; “Consumer Goods”; “Equipment”; “Farm Products”; “Farming Operation”; “Inventory.”** The definition of “goods is substantially the same as the definition in former Section 9-105. This draft also retains the four “types of collateral that consist of goods: “consumer goods, “equipment, “farm products, and “inventory. The revisions are primarily for clarification. In particular, the definition of “farm products now (i) clarifies the distinction between crops and standing timber, and (ii) makes clear that aquatic goods produced in aquacultural operations may be either crops or livestock. Although aquatic goods that are vegetable in nature often would be crops and those that are animal would be livestock, this Article leaves the courts free to classify the goods on a case-by-case basis. See Section 9-324, Comment 8. The definition of “farm products uses the newly-defined term, “farming operation. Also, the definition of “inventory has been revised to make clear that the term includes goods leased by the debtor to others as well as goods held for lease. The same result should obtain under the former definition.

b. **“Accession”; “Manufactured Home”; “Manufactured-Home Transaction.”** Other specialized definitions of goods include “accession (see the special priority and enforcement rules in Section 9-335), and “manufactured home (see Section 9-515, permitting a financing statement in a “manufactured-home transaction to be effective for 30 years). The definition of “manufactured home borrows from the federal Manufactured Housing Act, 42 U.S.C. sections 5401 *et seq*.

c. **“As-Extracted Collateral.”** Under this Article, oil, gas, and other minerals that have not been extracted from the ground are treated as real property, to which this Article does not apply. Upon extraction, minerals become personal property (goods) and eligible to be collateral under this Article. See the definition of “goods, which excludes “oil, gas, and other minerals before extraction. To take account of financing practices reflecting the shift from real to personal property, this Article contains special rules for perfecting security interests in minerals which attach upon extraction and in accounts resulting from the sale of minerals at the wellhead or minehead. See Sections 9-301(6) (law governing perfection and priority); 9-501 (place of filing); 9-502 (contents of financing statement); 9-519 (indexing of records). The new term, “as-extracted collateral, refers to the minerals and related accounts to which the special rules apply.

The following examples explain the operation of these provisions.

Example 5: Debtor owns an interest in oil that is to be extracted. To secure Debtor’s obligations to Lender, Debtor enters into an authenticated agreement granting Lender an interest in the oil. Although Lender may acquire an interest in the oil under real-property law, Lender does not acquire a security interest under this Article until the oil becomes personal property, i.e., until is extracted and becomes “goods to which this Article applies. Because the debtor had an interest in the oil before extraction and Lender’s security interest attached to the oil as extracted, the oil is “as-extracted collateral.

Example 6: Debtor owns an interest in oil that is to be extracted and contracts to sell the oil to Buyer at the wellhead. In an authenticated agreement, Debtor agrees to sell to Lender the right to payment from Buyer. This right to payment is an account that constitutes “as-extracted collateral. If Lender then resells the account to Financer, Financer’s acquires a security interest. However, inasmuch as the debtor-seller in that transaction, Lender, had no interest in the oil before extraction, Financer’s collateral (the account it owns) is not “as-extracted collateral.

Example 7: Under the facts of Example 6, before extraction, Buyer grants a security interest in the oil to Bank. Although Bank’s security interest attaches when the oil is extracted, Bank’s security interest is not in “as-extracted collateral, inasmuch as its debtor, Buyer, did not have an interest in the oil before extraction.

5. **Receivables-related Definitions.**

a. **“Account”; “Health-Care-Insurance Receivable”; “As-Extracted Collateral.”** The definition of “account has been expanded and reformulated. Many categories of rights to payment that would have been classified as general intangibles under former Article 9 are accounts under this Article. Thus, if they are sold, a financing statement must be filed to perfect the buyer’s interest in them. The exclusion has been expanded to encompass “other rights to payment for money or funds advanced or sold. The former exclusion of rights to payment for “money was too narrow by virtue of the narrow definition of “money in Section 1-201. We do not believe a definition of “funds is necessary; the Official Comments will explain the concept.

The definition of “health-care-insurance receivable is new. It is a subset of the definition of “account. However, the rules generally applicable to account debtors on accounts do not apply to insurers obligated on health-care-insurance receivables.. See Sections 9-404(e), 9-405(d), 9-406(h).

Note that certain accounts also are “as-extracted collateral. See Comment 4.c., Examples 6 and 7.

b. **Chattel Paper"; "Electronic Chattel Paper"; Tangible Chattel Paper**. Under the revised definition of "chattel paper, the term now includes "a record or records instead of "a writing or writings. "Electronic chattel paper includes nonwritten chattel paper. Traditional, written chattel paper is "tangible chattel paper.

c. **"Instrument"; "Promissory Note."** The definition of "instrument has been modified to make clear that it does not include rights to payment arising out of credit-card transactions. The definition of "promissory note is new, necessitated by the inclusion of sales of promissory notes within the scope of Article 9. It explicitly excludes obligations arising out of "orders to pay (e.g., checks) as opposed to "promises to pay. See Section 3-304.

d. **"General Intangible"; "Payment Intangible."** The definition of "general intangible has been revised to accommodate commercial tort claims, deposit accounts, and letter-of-credit rights as separate types of collateral. One important consequence is that tortfeasors (commercial tort claims), banks (deposit accounts), and persons obligated on letters of credit (letter-or-credit rights) are not "account debtors having the rights and obligations set forth in Sections 9-404, 9-405, and 9-406. In particular, tortfeasors, banks, and persons obligated on letters of credit are not obligated to pay an assignee (secured party) upon receipt of the notification described in Section 9-404(a). See comment 5.h., below. Another important consequence relates to the adequacy of the description in the security agreement. See Section 9-108.

"Payment intangible is a sub-category of general intangibles. The sale of a payment intangible is subject to this Article. See Section 9-109(a)(3). Virtually any intangible right could give rise to a right to payment of money once one hypothesizes, for example, that the account debtor is in breach of its obligation. The term "payment intangible embraces only those general intangibles "under which the account debtor's *principal* obligation is a monetary obligation. (Emphasis added.) Although there may be difficult cases at the margin, attempting a more precise statutory line would not be worthwhile. As with any classification issue, from a planning standpoint it may be necessary for counsel in a sale transaction to make alternative assumptions (i.e., inclusion and exclusion from Article 9).

In classifying intangible collateral, a court should begin by identifying the particular rights that have been assigned. The account debtor (promisor) under a particular contract may owe several types of monetary obligations as well as other, nonmonetary obligations. If the promisee's right to payment of money is assigned separately, the right is an account or payment intangible, depending on how the account debtor's obligation arose. When all the promisee's rights are assigned together, an account, a payment intangible, and a general intangible all may be involved, depending on the nature of the rights.

A right to the payment of money is frequently buttressed by ancillary covenants to insure the preservation of collateral, such as covenants in a purchase agreement, note, or mortgage requiring insurance on the collateral or forbidding removal of the collateral; or covenants to preserve credit-worthiness of the promisor, such as covenants restricting dividends, etc. It is not the intention of this Article to treat these ancillary rights separately from the rights to payment to which they relate. Perfection of an assignment of the right to the payment of a monetary obligation, whether it be an account or payment intangible, will also carry these ancillary rights.

Every “payment intangible is also a “general intangible. Likewise, “software is a “general intangible. See Comment 24. Accordingly, except as otherwise provided, statutory provisions applicable to general intangibles apply to payment intangibles and software.

e. **“Letter-of-credit Right.”** The term “letter-of-credit right replaces the phraseology used in some earlier drafts, “letter of credit and proceeds of the letter of credit. The reference to the letter of credit itself was thought necessary to make it clear that the statute contemplates an assignment of a present interest and not one that would “spring into existence only when a letter of credit is honored and proceeds are collected. However, some letter of credit experts expressed concern that references to a security interest in a letter of credit itself might be confused with the transfer of drawing rights (i.e., the beneficiary’s right to demand payment or performance). See Sections 9-107, Comment 4, and 9-329, Comments 3 and 4. The new term addresses both concerns.

f. **“Supporting Obligation.”** This new term covers the most common types of credit enhancements–suretyship obligations (including guarantees) and letter-of-credit rights that support one of the specified types of collateral. (Earlier drafts used the term “support obligations.) As explained in Comment 2.a., dealing with secondary obligors, suretyship law determines whether an obligation is “secondary for purposes of this definition. Notwithstanding the exclusion of transfers of interests in insurance policies under Section 9-109, this Article covers a secondary obligation (as a supporting obligations) even if the obligation is issued by a regulated insurance company and the obligation is subject to regulation as an “insurance product. The regulation of a secondary obligation as an insurance product does not necessarily mean that it is a “policy of insurance for purposes of the exclusion in Section 9-109.

This Article contains rules explicitly governing attachment, perfection, and priority of security interests in supporting obligations. See Sections 9-203, 9-308, 9-310, and 9-322. These provisions reflect the principle that a supporting obligation is an incident of the collateral it supports.

Collections of or other distributions under a supporting obligations are “proceeds of the supported collateral as well as “proceeds of the supporting obligation itself. See Section 9-102 (defining “proceeds) and Comment 13.b. As such, the collections and distributions are subject to the priority rules applicable to proceeds generally. See Section 9-322. However, under the special rule governing security interests in a letter-of-credit right, a secured party’s failure to obtain control (Section 9-107) of a letter-of-credit right supporting collateral may leave its security interest exposed to a priming interest of a party who does take control. See Section 9-329 (security interest in a letter-of-credit right perfected by control has priority over a conflicting security interest).

Certain types of credit enhancements are not covered by the definition of “supporting obligation. Other law determines the competing claims of a person who takes an outright assignment of these obligations and a person who takes a security interest in the related collateral.

g. **“Commercial Tort Claim.”** This term is new. A tort claim may serve as original collateral under this Article only if it is a “commercial tort claim. See Section 9-109(d).

h. **“Account Debtor.”** An “account debtor is a person obligated on an account, chattel paper, or general intangible. The account debtor’s obligation often is a monetary obligation; however, this is not always the case. For example, if a franchisee uses its rights under a franchise agreement as collateral, then the franchisor is an “account debtor. As a general matter, Article 3, and not Article 9, governs obligations on negotiable instruments. Accordingly, the definition of “account debtor excludes obligors on negotiable instruments constituting part of chattel paper. The principal effect of this change from the definition in former Article 9 is that the rules in Sections 9-403, 9-404, 9-405, and 9-406, dealing with the rights of an assignee and duties of an account debtor, do not apply to an assignment of chattel paper in which the obligation to pay is evidenced by a negotiable instrument. (Section 9-406(d), however, does apply to promissory notes, including negotiable promissory notes.) Rather, the assignee’s rights are governed by Article 3. Similarly, the duties of an obligor on a nonnegotiable instrument are governed by non-Article 9 law unless the nonnegotiable instrument is a part of chattel paper; in which case the obligor is an account debtor.

6. **Investment-property-related Definitions: “Commodity Account”; “Commodity Contract”; “Commodity Customer”; “Commodity Intermediary”; “Investment Property.”** These definitions are substantially the same as the corresponding definitions in former Section 9-115. “Investment property includes securities, both certificated and uncertificated, security accounts, security entitlements, commodity accounts, and commodity contracts. Former Section 9-115 was added in conjunction with Revised Article 8 and contains a variety of rules applicable to security interests in investment property. These rules have been relocated to the appropriate sections of Article 9. See, e.g., Sections 9-203 (attachment); 9-328 (priority).

7. **Consumer-related Definitions: “Consumer Debtor”; “Consumer Goods”; “Consumer-goods transaction”; “Consumer Obligor”; “Consumer Transaction.”** The definition of “consumer goods (as mentioned above) is substantially the same as the definition in former Section 9-105. The definitions of “consumer debtor, “consumer obligor, “consumer-goods transaction, and “consumer transaction have been added in connection with various new (and old) consumer-protection rules. Many of the rules appear in Part 6 and apply to “consumer-goods transactions, i.e., consumer transactions to the extent that the collateral consists of consumer goods or consumer goods and software. However, certain rules apply to consumer transactions, in which the collateral may be of any type if it is held or acquired primarily for personal, family, or household purposes. See, e.g., Sections 9-108; 9-109; 9-403; 9-404; 9-612; 9-620; 9-626.

8. **Filing-related Definitions: “Continuation Statement”; “File Number”;“Filing Office”; “Filing-office Rule”; “Financing Statement”; “Fixture Filing”; “Manufactured-Home Transaction”; “New Debtor”;“Original Debtor”; “Public-Finance Transaction”; “Termination Statement”; “Transmitting Utility.”** These definitions are used exclusively or primarily in the filing-related provisions in Part 5. Most are self-explanatory and are discussed in the Comments to Part 5. A financing statement filed in manufactured-home transaction or a public-finance transaction may remain effective for 30 years instead of the 5 years applicable to other financing statements. See Section 9-515(b).

The definition of "transmitting utility" has been revised. No change in meaning is intended. The term designates a special class of debtors for whom separate filing rules are provided in Part 5, thereby obviating the many local fixture filings that would be necessary under the rules of Section 9-501 for a far-flung public utility debtor. A transmitting utility will not necessarily be regulated by or operating as such in a jurisdiction where fixtures are located. For example, a utility might own transmission lines in a jurisdiction, although the utility generates no power and has no customers in the jurisdiction.

The definitions relating to medium neutrality also are significant for the filing provisions. They are discussed below in comment 9.

9. **Definitions Relating to Medium-neutrality.**

a. **“Record.”** In many, but not all, instances the term “record replaces the term “writing and “written. A “record includes information that is in intangible form (e.g., electronically stored) as well as tangible form (e.g., written on paper). Given the rapid development and commercial adoption of modern communication and storage technologies, requirements that documents or communications be “written, “in writing, or otherwise in tangible form do not necessarily reflect or aid commercial practices.

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. Examples of current technologies commercially used to communicate or store information include, but are not limited to, magnetic media, optical discs, digital voice messaging systems, electronic mail, audio tapes, and photographic media, as well as paper. “Record is an inclusive term that includes all of these methods of storing or communicating information. Any “writing is a record.

A record may be authenticated. See Comment 9.b. A record may be created without the knowledge or intent of a particular party.

Like the terms “written or “in writing, the term “record does not establish the purposes, permitted uses, or legal effect that a record may have under any particular provision of law. Whatever is filed in the Article 9 filing system, including financing statements, termination statements, and amendments, whether transmitted in tangible or intangible form, would fall within the definition. However, in some instances, statutes or filing-office rules may require that a paper record be filed. In such cases, even if this Article permits the filing of an electronic record, compliance with those statutes or rules is necessary. Similarly, a filer must comply with a statute or rule that requires a particular type of encoding or formatting for an electronic record.

This Article sometimes uses the terms “for record, “of record, “record or legal title, and “record owner. Some of these are terms traditionally used in real-property law. The definition of “record in this draft now explicitly excepts these usages from the defined term.

b. **“Authenticate”;“Communicate”; “Send.”** The terms “authenticate and “authenticated generally replace “sign and “signed. “Authenticated replaces and broadens the definition of “signed, in Section 9-201, to encompass authentication of all records, not just writings. Similarly, the terms “communicate and “send contemplate the possibility of communication by nonwritten media. These definitions include the act of transmitting both tangible and intangible records. The definition of “send replaces, for purposes of this Article, the corresponding term in Section 1-201.

10. **Scope-related Definitions.**

a. **Expanded Scope of Article: “Agricultural Lien”; Consignment”; “Payment Intangible”; Promissory Note.”** These new definitions reflect the expanded scope of Article 9, as provided in Section 9-109(a).

b. **Reduced Scope of Exclusions: “Governmental Unit”; Health-care-insurance Receivable”; “Commercial Tort Claims.”** These new definitions reflect the reduced scope of the exclusions, provided in Section 9-109(c) and (d), of transfers by governmental debtors and assignments of interests in insurance policies and tort claims.

11. **Choice-of-law-related Definitions: “Certificate of Title”; “Governmental Unit”; Jurisdiction of Organization”; “Registered Organization”; “State.”** These new definitions reflect the changes in the law governing perfection and priority of security interests and agricultural liens provided in Part 3, Subpart 1.

12. **Deposit-account-related Definitions: “Deposit Account”; “Bank.”** The revised definition of “deposit account incorporates the definition of “bank, which is new. The definition derives from the definitions of “bank in Sections 4-105(1) and 4A-105(a)(2), which focus on whether the organization is “engaged in the business of banking.

All deposit accounts evidenced by Article 9 “instruments are excluded from the term “deposit account. In contrast, some earlier drafts, consistent with former Section 9-104, excluded from the “deposit account definition “an account evidenced by a certificate of deposit [CD]. The change clarifies the proper treatment of non-negotiable or uncertificated CD’s issued to reflect a deposit. Under this Article, the latter would be a deposit account (assuming there is no writing evidencing the bank’s obligation to pay) whereas the former would be a deposit account only if it is not an “instrument as defined in this section (a question that turns on whether the non-negotiable CD is “of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment.)

A deposit account evidenced by an instrument is subject to the rules applicable to instruments generally. As a consequence, a security interest in such a deposit account cannot be perfected by “control (see Section 9-104), and the special priority rules applicable to deposit accounts (see Sections 9-327 and 9-340) do not apply.

The term “deposit account does not include “investment property, such as securities and security entitlements. Thus, the term also does not include, e.g., shares in a money-market mutual fund that are redeemable by check.

13. **Proceeds-related Definitions: “Cash Proceeds”; “Noncash Proceeds”; “Proceeds.”** The revised definition of “proceeds expands the definition beyond that contained in former Section 9-306 and resolves ambiguities in the former section.

a. **Distributions on Account of Collateral.** The phrase “whatever is collected on, or distributed on account of, collateral, in subparagraph (B), is broad enough to cover cash or stock dividends distributed on account of securities or other investment property that is original collateral. Compare former Section 9-306 (“Any payments or distributions made with respect to investment property collateral are proceeds.). This section rejects the holding of *Hastie v. FDIC*, 2 F.3d 1042 (10th Cir. 1993) (holding that post-petition cash dividends on stock subject to pre-petition pledge are not “proceeds under Bankruptcy Code Section 552(b)) to the extent the holding relies on the Article 9 definition of “proceeds.

b. **Distributions on Account of Supporting Obligations.** Under subparagraph (B), collections and distributions on collateral consisting of various credit-support arrangements (“supporting obligations, as defined in Section 9-102) also are proceeds. Consequently, they are afforded treatment identical to proceeds collected from or distributed by the obligor on the underlying (supported) right to payment or other collateral. Proceeds of supporting obligations also are proceeds of the underlying rights to payment or other collateral.

c. **Proceeds of Proceeds.** The definition of “proceeds no longer provides that proceeds of proceeds are themselves proceeds. This idea is expressed in the revised definition of “collateral in Section 9-102. No change in meaning is intended.

d. **Proceeds Received by Person Who Did Not Create Security Interest.** When collateral is sold subject to a security interest and the buyer then resells the collateral, a question has arisen under former Article 9 concerning whether the “debtor has “received what the buyer received on resale and, therefore, whether those receipts are “proceeds. See former Section 9-306(2). This Article contains no requirement that property be “received by the debtor for the property to qualify as proceeds. It is necessary only that the property be traceable, directly or indirectly, to the original collateral.

14. **Consignment-related Definitions: “Consignee”; “Consignment”; “Consignor.”** The definition of “consignment is drawn in part from an earlier draft of revised Article 2. The definition excludes, in subparagraphs (A), (B), and (C), transactions for which filing would be inappropriate or of insufficient benefit to justify the costs. A consignment excluded from the application of this Article by one of those subparagraphs may still be a true consignment; however, it is governed by non-Article 9 law. The definition also excludes, in subparagraph (D), what have been called “consignments intended for security. These “consignments are not bailments but secured transactions. Accordingly, all of Article 9 applies to them. The Official Comments will afford guidance in distinguishing between true and security consignments. The “consignor is the person that delivers goods to the “consignee in a consignment.

15. **“Accounting.”** This definition describes the record and information that a debtor is entitled to request under Section 2-210.

16. **“Document”; “Encumbrance”** These definitions are unchanged in substance from the corresponding definitions in former Section 9-105.

17. **“Fixtures.”** This definition is unchanged in substance from the corresponding definition in former Section 9-313.

18. **“Good Faith.”** This Article expands the definition of “good faith to include “the observance of reasonable commercial standards of fair dealing. The definition in this section applies when the term is used in this Article, and the same concept applies in the context of this Article for purposes of the obligation of good faith imposed by Section 1-203. See subsection (c).

19. **“Lien Creditor”; “Mortgage.”** Theses definitions are unchanged in substance from the corresponding definitions in former Sections 9-301 and 9-105.

20. **“New Value.”** This Article deletes former Section 9-108. Its broad formulation of new value, which embraces the taking of after-acquired collateral for a pre-existing claim, is unnecessary, counterintuitive, and ineffective for its original purpose of sheltering after-acquired collateral from attack as a voidable preference in bankruptcy. The new definition of “new value derives from Section 547(a) of the Bankruptcy Code. The term is used in with respect to temporary perfection of security interests in instruments, certificated securities, or negotiable documents under Section 9-312(e) and with respect to chattel paper priority in Section 9-330. It is also used in the model production money security interest provisions in Appendix II.

21. **“Person Related To.”** Section 9-615 provides a special method for calculating a deficiency or surplus when “the secured party, a person related to the secured party, or a secondary obligor acquires the collateral at a foreclosure disposition. Two separate definitions of the term “person related to are provided. One applies with respect to an individual secured party and the other with respect to a secured party that is an organization. The definitions are patterned on the corresponding definition in Section 1.301(32) of the Uniform Consumer Credit Code (1974).

22. **“Proposal.”** This definition describes a record that is sufficient to propose to retain collateral in full or partial satisfaction of a secured obligation. See Sections 9-620, 9-621, 9-622.

23. **“Pursuant to Commitment.”** This definition is unchanged in substance from the corresponding definition in former Section 9-105.

24. **“Software.”** The definition of “software is adapted from Section 2B-102 of the April 15, 1998, draft of Article 2B. It is used in connection with the priority rules applicable to purchase-money security interests. See Sections 9-103, 9-324. Software, like a payment intangible, is a type of general intangible.

25. **Terminology: Assignment and Transfer.** In numerous provisions the draft refers to the “assignment or the “transfer of property interests. These terms and their derivatives are not defined. The draft generally follows common usage by using the terms “assignment and “assign to refer to transfers of rights to payment, claims, and liens and other security interests. It generally uses the term “transfer to refer to other transfers of interests in property. Except when used in connection with a letter-of-credit transaction (see Section 9-107, Comment 4), no significance should be placed on the use of one term or the other. Depending on the context, each term may refer to the assignment or transfer of an outright ownership interest or to the assignment or transfer of a limited interest, such as a security interest.

[9-103]

Reporters’ Comments

1. **Source.** Former Section 9-107.

2. **“Purchase-money Collateral”; “Purchase-money Obligation”; “Purchase-money Security Interest.** Subsection (a) defines “purchase-money collateral and “purchase-money obligation. These terms are essential to the description of what constitutes a purchase-money security interest under subsection (b). As used in subsection (a)(2), the definition of “purchase-money obligation, the “price of collateral includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, finance charges, interest, administrative charges, expenses of collection and enforcement, attorney’s fees, and other similar obligations.

The concept of “purchase-money security interest requires a close nexus between the acquisition of collateral and the secured obligation. Thus, a security interest does not qualify as a purchase-money security interest if a debtor acquires property on unsecured credit and subsequently creates the security interest to secure the purchase price. Similarly, if a debtor buys property for cash and subsequently creates the security interest in the property to secure a borrowing of an amount equivalent to the purchase price, the security interest does not have purchase-money status.

3. **Cross-collateralization of Purchase-money Security Interests in Inventory.** Subsection (b)(2) deals with the problem of cross-collateralized purchase-money security interests in inventory. Consider a simple example:

> Seller (S) sells an item of inventory (Item-1) to Debtor (D), retaining a security interest in Item-1 to secure Item-1’s price and all other obligations, existing and future, of D to S. S then sells another item of inventory to D (Item-2), again retaining a security interest in Item-2 to secure Item-2’s price as well as all other obligations of D to S. D then pays to S Item-1’s price. D then sells Item-2 to a buyer in ordinary course of business, who takes Item-2 free of S’s security interest.

Under subsection (b)(2), S’s security interest in *Item-1* securing *Item-2’s unpaid price* would be a purchase-money security interest. This is so because S has a purchase-money security interest in Item-1, Item-1 secures the price of (a “purchase-money obligation incurred with respect to) Item-2 (“other inventory), and Item-2 itself was subject to a purchase-money security interest. Note that, to the extent Item-1 secures the price of Item-2, S’s security interest in Item-1 would not be a purchase-money security interest under subsection (b)(1). The security interest in Item-1 is a purchase-money security interest under subsection (b)(1) only to the extent that Item-1 is “purchase-money collateral, i.e., only to the extent that Item-1 “secures a purchase-money obligation incurred with respect to that collateral (i.e., Item-1). See subsection (a)(1).

4. **Purchase-money Security Interests in Goods and Software.** Subsections (b) and (c) limit purchase-money security interests to security interests in goods, including fixtures, and software. Otherwise, no change in meaning from former Section 9-107 is intended. The second sentence of former Section 9-115(5)(f) made the purchase-money priority rule (former Section 9-312(4)) inapplicable to investment property. This section’s limitation makes that sentence unnecessary.

Subsection (c) describes the limited circumstances under which a security interest in goods may be accompanied by a purchase-money security interest in software. The goods and software must be acquired by the debtor in an integrated transaction and the debtor must acquire the software for the principal purpose of using the software in the goods. “Software is defined in Section 9-102.

5. **Consignments.** Under former Section 9-114, the priority of the consignor’s interest is similar to that of a purchase-money security interest. Subsection (d) achieves this result more directly, by defining the interest of a “consignor, defined in Section 9-102, to be a purchase-money security interest in inventory for purposes of this Article. This drafting convention obviates any need to set forth special priority rules applicable to the interest of a consignor. Rather, the priority of the consignor’s interest as against the rights of lien creditors of the consignee, competing secured parties, and purchasers of the goods from the consignee can be determined by reference to the priority rules generally applicable to inventory, such as Sections 9-317, 9-320, 9-322, and 9-324. For purposes other than those of this article, including the rights and duties of the consignor and

consignee as between themselves, the consignor would remain the owner of goods under a bailment arrangement with the consignee. See Section 9-319.

6. **Provisions Inapplicable to Consumer-goods Transactions.**

a. **“Dual-status” Rule.** For transactions other than consumer-goods transactions, this Article approves what some cases have called the “dual-status rule, under which a security interest may be a purchase-money security interest to some extent and a non-purchase-money security interest to some extent. (Concerning consumer transactions, see subsection (h) and comment 7.) Some courts have found this rule to be explicit or implicit in subsections (b)(1) and (b)(2) (“to the extent). It is made explicit in subsection (e). For non-consumer transactions, this Article rejects the “transformation rule adopted by some cases, under which any cross-collateralization, refinancing, or the like destroys the purchase-money status entirely.

Consider, for example, what happens when a $10,000 loan secured by a purchase-money security interest is refinanced by the original lender, and, as part of the transaction, the debtor borrows an additional $2,000 secured by the collateral. Subsection (f) resolves any doubt that the security interest remains a purchase-money security interest. Under subsection (b), however, it enjoys purchase-money status only to the extent of $10,000.

b. **Allocation of Payments.** Continuing with the example, if the debtor makes a $1,000 payment on the $12,000 obligation, then one must determine the extent to which the security interest remains a purchase-money security interest–$9,000 or $10,000. Subsection (e)(1) expresses the overriding principle, applicable in cases other than consumer-goods transactions, for determining the extent to which a security interest is a purchase-money security interest under these circumstances: freedom of contract, as limited by principle of reasonableness. An unconscionable method of application, for example, is not a reasonable one and so would not be given effect under subsection (e)(1). In the absence of agreement, subsection (e)(2) permits the obligor to determine how payments should be allocated. If the obligor fails to manifest its intention, obligations that are not secured will be paid first. (As used in this Article, the concept of “obligations that are not secured means obligations for which the debtor has not created a security interest. This concept is different from and should not be confused with the concept of an “unsecured claim as it appears in Bankruptcy Code Section 506(a).) The obligor may prefer this approach, because unsecured debt is likely to carry a higher interest rate than secured debt. A creditor who would prefer to be secured rather than unsecured also would prefer this approach.

After the unsecured debt is paid, payments are to be applied first toward the obligations secured by purchase-money security interests. In the event that there is more than one such obligation, payments first received are to be applied to obligations first incurred. See subsection (e)(3). Once these obligations are paid, there are no purchase-money security interests, and so there is no need for additional allocation rules.

In determining whether a security interest is a “purchase-money security interest, the dual-status rule and the allocation formula affect only issues under this Article–primarily perfection and priority. See, e.g., Sections 9-317, 9-324. Whether a security interest is a “purchase-money security interest under other law, however, is determined by that law. For example, decisions under Bankruptcy Code Section 522(f) have applied both the dual-status and the transformation rules. The Bankruptcy Code does not expressly adopt the state law definition of “purchase-money security interest. Where federal law does not defer to this Article, this Article does not, and could not, determine a question of federal law.

Subsection (f) buttresses the dual-status rule by making it clear that in a transaction other than a consumer-goods transaction cross-collateralization and renewals, refinancings, and restructurings do not cause a purchase-money security interest to lose its status as such. The statutory terms “renewed, “refinanced, and “restructured are not defined. Whether the terms encompass a particular transaction depends upon whether, under the particular facts, the purchase-money character of the security interest fairly can be said to survive. Each term contemplates that an identifiable portion of the purchase-money obligation could be traced to the new obligation resulting from a renewal, refinancing, or restructuring.

c. **Burden of Proof.** As is the case when the extent of a security interest is in issue, under subsection (g) the secured party claiming a purchase-money security interest in a transaction other than a consumer-goods transaction has the burden of establishing whether the security interest retains its purchase-money status. This is so whether the determination is to be made following a renewal, refinancing, or restructuring or otherwise.

7. **Consumer-goods Transactions.** Under subsection (h), the limitation of subsections (e), (f), and (g) to transactions other than a consumer-goods transactions are intended to leave to the court the determination of the proper rules in consumer-goods transactions. Subsection (h) also instructs the court not to draw any inference from the limitation as to the proper rules for consumer-goods transactions and leaves the court free to continue to apply established approaches to those transactions.

[9-104]

Reporters’ Comments

1. **Source.** New; derived from Section 8-106.

2. **Why “Control” Matters.** This section explains the concept of “control of a deposit account. “Control under this section may serve two functions. First, “control . . . pursuant to the debtor’s agreement may substitute for a security agreement as an element of attachment. See Section 9-203(b)(3)(D). Second, when a deposit account is taken as original collateral, the only method of perfection is obtaining control under this section. See Section 9-312(b)(1).

3. **Requirements for “Control.”** This section derives from Section 8-106 of Revised Article 8, which defines “control of securities and other investment property. Under subsection (a)(1), the bank with which the deposit account is maintained has control. The effect of this provision is to afford the bank automatic perfection. No other form of public notice is necessary; all actual and potential creditors of the debtor are always on notice that the bank with which the debtor’s deposit account is maintained may assert a claim against the deposit account.

Under subsection (a)(2), a secured party may take control by obtaining the bank’s authenticated agreement that it will comply with the secured party’s instructions without further consent by the debtor. The analogous provision in Section 8-106 does not require that the agreement be authenticated. As mentioned in the Reporters’ Comments to Section 9-106, some uncertainty has arisen concerning the requirements of Section 8-106(d)(2), particularly when a securities intermediary has agreed that it will comply with a secured party’s entitlement orders only if certain conditions are met. An agreement to comply with the secured party’s instructions suffices for “control of a deposit account under this section even if the bank’s agreement is subject to specified conditions, e.g., that the secured party’s instructions are accompanied by a certification that the debtor is in default. (Of course, if the condition is the *debtor’s* further consent, the statute explicitly provides that the agreement would *not* confer control.) See Section 8-106, Revised Official Comment (Appendix I).

Under subsection (a)(3), a secured party may take control by becoming the bank’s customer. As the customer, the secured party would enjoy the right to withdraw funds from the deposit account.

Perfection by control is not available for deposit accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are “instruments and not “deposit accounts. See Section 9-102 (defining “deposit account and “instrument).

Subsection (b) also derives from Revised Article 8. It makes clear that “control need not deprive the debtor of the ability to reach the funds on deposit.

[9-105]

Reporters’ Comment

1. **Source.** New.

2. **"Control" of Electronic Chattel Paper.** The draft covers security interests in "electronic chattel paper, a new term defined in Section 9-102. This section governs how "control of electronic chattel paper may be obtained. Control is necessary to benefit for the special priority rule provided in Section 9-330. In descriptive terms, it provides that control of electronic chattel paper is the functional equivalent of "possession of tangible chattel paper (a term also defined in Section 9-102). The draft leaves to the marketplace the development of systems and procedures for dealing with control of electronic chattel paper in a commercial context.

[9-106]

Reporters' Comment

1. **Source.** Former Section 9-115(e).

2. **"Control" under Article 8.** Experience with arrangements for "control under Section 8-106(d)(2) has identified some uncertainty. Appendix I contains a revised Official Comment to that section.

[9-107]

Reporters' Comments

1. **Source.** New.

2. **"Control" of Letter-of-credit Right.** Whether a secured party has control of a letter-of-credit right determines the secured party's rights as against competing secured parties. See Section 9-329. The draft provides that a secured party can acquire control of a letter-of-credit right by receiving an assignment if the secured party obtains the consent of the issuer or any nominated person, such as a confirmer or negotiating bank, under Section 5-114 or other applicable law or practice. Because both issuers and nominated persons may give or be obligated to give value under a letter of credit, this section contemplates that a secured party obtains control of a letter-of-credit right with respect to the issuer or a particular nominated person only to the extent that the issuer or that nominated person consents to the assignment. For example, if a secured party obtains control to the extent of an issuer's obligations but fails to obtain the consent of a nominated person, the secured party does not have control to the extent that the nominated person gives value. In many cases the person or persons who will give value under a letter of credit will be clear from its terms. In other cases, prudence may suggest

obtaining consent from more than one person. The details of the consenting issuer’s or nominated person’s duties to pay or otherwise render performance to the secured party are left to the agreement of the parties.

3. **“Proceeds of a Letter of Credit.”** Section 5-114 follows traditional banking terminology by referring to a letter of credit beneficiary’s assignment of its right to receive payment thereunder as an assignment of the “proceeds of a letter of credit. However, as the seller of goods can assign its right to receive payment (an “account) before it has been earned by delivering the goods to the buyer, so the beneficiary of a letter of credit can assign its contingent right to payment before the letter of credit has been honored. See Section 5-114(b). If the assignment creates a security interest, the security interest can be perfected at the time it is created. An assignment of, including the creation of a security interest in, a letter-of-credit right is an assignment of a present interest.

4. **“Transfer” vs. “Assignment.”** Letter-of-credit law and practice distinguish the “transfer of a letter of credit from an “assignment. Under a transfer, the transferee itself becomes the beneficiary and acquires the right to draw. Whether a new, substitute credit is issued or the issuer advises the transferee of its status as such, the transfer constitutes a novation under which the transferee is the new, substituted beneficiary (but only to the extent of the transfer, in the case of a partial transfer).

Section 5-114(e) provides that the rights of a transferee beneficiary or nominated person are independent of the beneficiary’s assignment of the proceeds of a letter of credit and are independent and superior to the assignee’s right to the proceeds. For this reason, transfer does not appear in this draft as a means of control or perfection. Section 9-329 recognizes the independent and superior rights of a transferee beneficiary under Section 5-114(e); the priority of a secured party that has obtained control of a letter-of-credit right is made subject to those independent and superior rights.

5. **Supporting Obligation: Automatic Attachment and Perfection.** A letter-of-credit right is a type of supporting obligation, as defined in Section 9-102. Under Sections 9-203 and 9-308, a security in interest in a letter-of-credit right automatically attaches and is automatically perfected if the security interest in the supported obligation is perfected. However, unless the secured party has control of the letter-of-credit right or itself becomes a transferee beneficiary, it cannot obtain any rights against the issuer or a nominated person under Article 5. Consequently, as a practical matter, the secured party’s rights would be limited to its ability to locate and identify proceeds distributed by the issuer or nominated person under the letter of credit.

[9-108]

Reporters’ Comment

1. **Source.** Former Sections 9-110; 9-115(3).

2. **General Rules; After-acquired Collateral.** Subsection (a) retains substantially the same formulation as former Section 9-110. A provision similar to subsection (b) was applicable only to investment property under former Section 9-115(3). Subsection (b) is applicable to all types of collateral, subject to the limitation in subsection (e). It expands upon subsection (a) by indicating a variety of ways in which a description might reasonably identify collateral. Subsection (b) is subject to subsection (c), which follows prevailing case law and adopts the view that an “all assets or “all personal property description for purposes of a *security agreement* is *not* sufficient. Note, however, that under Section 9-504, a *financing statement* sufficiently indicates the collateral if it “covers all assets or all personal property.

Much litigation has arisen over whether a description in a security agreement is sufficient to include after-acquired collateral if the agreement does not explicitly so provide. This question is one of contract interpretation and is not susceptible to a statutory rule (other than a rule to the effect that it is a question of contract interpretation). Accordingly, this section contains no reference to descriptions of after-acquired collateral.

3. **Investment Property.** Under subsection (d), the use of the wrong Article 8 terminology does not render a description invalid (e.g., a security agreement intended to cover a debtor’s “security entitlements is sufficient if it refers to the debtor’s “securities).

4. **Consumer Investment Property; Commercial Tort Claims.** Subsection (e) requires greater specificity of description in order to prevent debtors from inadvertently encumbering certain property. Subsection (e) requires that a description by defined “type of collateral alone of a commercial tort claim or, in a consumer transaction, of a security entitlement, a securities account, or a commodity account, is not sufficient. For example, “all existing and after-acquired investment property or “all existing and after-acquired security entitlements would be insufficient in a consumer transaction. However, if the collateral consists of a securities account or a commodity account, a description of the account is sufficient to cover all existing and future security entitlements or commodity contracts carried in the account. See Section 9-203(h), (i).

Under Section 9-204, an after-acquired collateral clause in a security agreement will not reach future commercial tort claims. It follows that when an effective security agreement covering a commercial tort claim is entered into the claim already will exist. Subsection (e) does not require a description to be specific. For example, a description such as “all tort claims arising out of the explosion of debtor’s factory would suffice, even if the exact amount of the claim, the theory on which it may be based, and the identity of the tortfeasor(s) is not described. (Indeed, those facts may not be known at the time.) the description of the tort claim need not be specific.

[SUBPART 2. APPLICABILITY OF ARTICLE]

[9-109]

Reporters' Comments

1. **Source.** Former Sections 9-102 and 9-104.

2. **Basic Scope Provision.** Subsection (a)(1) derives from former Section 9-102(1) and (2). These subsections have been combined and shortened. No change in meaning is intended.

3. **Agricultural Liens.** Subsection (a)(2) is new. It expands the scope of this Article to cover agricultural liens, as defined in Section 9-102.

4. **Sales of Payment Intangibles, Promissory Notes, and Other Receivables.** Subsection (a)(3) expands the scope of Article 9 by including the sale of a "payment intangible (defined in Section 9-102 as "a general intangible under which the account debtor's principal obligation is a monetary obligation) and a "promissory note (also defined in Section 9-102). To a considerable extent, this Article affords these transactions treatment identical to that given sales of accounts and chattel paper. In some respects, however, sales of payment intangibles and promissory notes are treated differently from sales of other receivables. See, e.g., Sections 9-309 (automatic perfection upon attachment); 9-408 (effect of restrictions on assignment). By virtue of the expanded definition of "account (defined in Section 9-102), this Article now covers sales of (and other security interests in) "health-care-insurance receivables (also defined in Section 9-102). Although this Article occasionally distinguishes between outright sales of receivables and sales that secure an obligation, neither this Article nor the definition of "security interest (Section 1-201(37)) delineates how a particular transaction is to be classified. That issue is left to the courts.

A "sale of an instrument or payment intangible includes a sale of a right in either, such as a sale of a participation interest. The term also includes the sale of a right to enforce an instrument or a payment intangible. For example, a "[p]erson entitled to enforce an instrument (Section 3-301) may sell its ownership rights in the instrument. See Section 3-203, Comment 1 ("Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section 3-203.). For example, the right under Section 3-309 to enforce a lost, destroyed, or stolen instrument may be sold to a purchaser who could enforce that right by causing the seller to provide the proof required under that section. Decisions reaching a contrary result, e.g., *Dennis Joslin Co. v. Robinson Broadcasting*, 977 F.Supp. 491 (D.D.C. 1997), should be rejected.

5. **Consignments.** Subsection (a)(4) is new. This Article applies to every “consignment. The term, defined in Section 9-102, includes many “true consignments (i.e., bailments for the purpose of sale). If a transaction is a “sale or return, as defined in revised Section 2-326 (Appendix I), it is not a “consignment. In a “sale or return transaction the buyer becomes the owner of the goods, and the seller may obtain an enforceable security interest in the goods only by satisfying the requirements of Section 9-203.

Under common law, creditors of a bailee are unable to reach the interest of the bailor (in the case of a consignment, the consignor-owner). Like the former Article, this Article changes the common-law result; however, it does so in a different manner. For purposes of determining the rights and interests of third-party creditors of, and purchasers of the goods from, the consignee, but not for other purposes, such as remedies of the consignor, the consignee acquires under this Article whatever rights and title the consignor had or had power to transfer. See Section 9-319. The interest of a consignor is defined to be a security interest under revised Section 1-201(37) (Appendix I), more specifically, a purchase-money security interest in the consignee’s inventory. See Section 9-103(d). Thus, the rules pertaining to lien creditors, buyers, and attachment, perfection, and priority of competing security interests apply to consigned goods. The relationship between the consignor and consignee is left to other law. Consignors also have no duties under Part 6. See Section 9-601(g).

Sometimes parties characterize transactions that secure an obligation (other than the bailee’s obligation to returned bailed goods) as “consignments. These transactions are not “consignments as contemplated by Section 9-109(a)(4). See Section 9-102. This Article applies also to these transactions, by virtue of Section 9-109(a)(1). They create a security interest within the meaning of the first sentence of Section 1-201(37).

This Article does not apply to bailments for sale that fall outside the definition of “consignment in Section 9-102 and that do not create a security interest that secures an obligation.

6. **Security Interest in Obligation Secured by Transaction Not Subject to Article 9.** Subsection (b) is unchanged in substance from former Section 9-102(3).

7. **Federal Preemption.** Former Section 9-104(a) excludes from Article 9 “a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property. Some may read the former section (erroneously) to

suggest that Article 9 defers to federal law even when federal law does not preempt Article 9. Subsection (c)(1) recognizes explicitly that the Article defers to federal law only when and to the extent that it must–i.e., when federal law preempts it.

8. **Governmental Debtors.** Former Section 9-104(e) excludes transfers by governmental debtors. It has been revised and replaced by the exclusions in new paragraphs (2) and (3) of subsection (c). These paragraphs reflect the view that Article 9 should apply to security interests created by a State, foreign country, or a “governmental unit (defined in Section 9-102) of either except to the extent that another statute governs the issue in question. Under paragraph (2), this Article defers to all statutes of the forum State. (A forum cannot determine whether it should consult the choice-of-law rules in the forum’s UCC unless it first determines that its UCC applies to the transaction before it.) Paragraph (3) defers to statutes of another State or a foreign country only to the extent that those statutes contain rules applicable specifically to security interests created by the governmental unit in question.

> **Example 1:** A New Jersey state commission creates a security interest in favor of a New York bank. The validity of the security interest is litigated in New York. The relevant security agreement provides that it is governed by New York law. To the extent that a New Jersey statute contains rules peculiar to creation of security interests by governmental units generally, to creation of security interests by state commissions, or to creation of security interests by this particular state commission, then that law will govern. On the other hand, to the extent that New Jersey law provides that security interests created by governmental units, state commissions, or this state commission are governed by the law generally applicable to secured transactions (i.e., New Jersey’s Article 9), then New York’s Article 9 will govern.

> **Example 2:** A airline that is an instrumentality of the foreign country creates a security interest in favor of a New York bank. The analysis used in the previous example would apply here. That is, if the matter is litigated in New York, New York law would govern except to the extent that the foreign country enacted a statute applicable to security interests created by governmental units generally or by the airline specifically.

The fact that New York law applies does not necessarily mean that perfection is accomplished by filing in New York. Rather, it means that the court should apply New York’s Article 9, including its choice-of-law provision. Under that provision (assuming New York adopts draft Section 9-301), perfection is governed by the law of the jurisdiction in which the debtor is located. Section 9-307 determines the debtor’s location for choice-of-law purposes.

If a transaction does not bear an appropriate relation to the forum State, then that State's Article 9 will not apply, regardless of whether the transaction would be excluded by paragraph (3).

> **Example 3:** A Belgian governmental unit grants a security interest in its equipment to a Swiss secured party. The equipment is located in Belgium. A dispute arises and, for some reason, an action is brought in a New Mexico state court. Inasmuch as the transaction bears no "appropriate relation to New Mexico, New Mexico's UCC, including its Article 9, is inapplicable. See Section 1-105(1). New Mexico's Section 9-109(c) on excluded transactions should not come into play. Even if the parties agreed that New Mexico law would govern, the parties' agreement would not be effective because the transaction does not bear a "reasonable relation to New Mexico. See Section 1-105(1).

Conversely, Article 9 will come into play only if the litigation arises in a UCC jurisdiction or if a foreign choice-of-law rule leads a foreign court to apply the law of a UCC jurisdiction. For example, if issues concerning a security interest granted by a foreign airline to a New York bank are litigated overseas, the court may be bound to apply the law of the debtor's jurisdiction and not New York's Article 9.

9. **Exclusions: General.** Subsection (d) generally carries forward the exclusions listed in former Section 9-104, with some exceptions and modifications.

10. **Sales of Payment Intangibles and Promissory Notes.** Former Section 9-104(f) excludes certain sales and assignments of accounts and chattel paper. Paragraphs (4), (5), and (7) of subsection (d) add to the exclusions analogous sales and assignments of payment intangibles and promissory notes.

11. **Insurance.** Subsection (d)(8) narrows somewhat the broad exclusion of interests in insurance policies under former Section 9-104(g). This Article now covers assignments by or to a health-care provider of "health-care-insurance receivables (defined in Section 9-102). The Drafting Committee recognized that insurance policies can be important items of collateral in many other business contexts and that the "cash or "loan value of life insurance policies also can be a useful source of collateral for borrowing by individuals. Nevertheless, it decided that other law generally should continue to govern security interests in insurance policies.

12. **Setoff.** Subsection (d)(10) adds two exceptions to the general exclusion of setoff rights from Article 9 under former subsection (i). The first takes account of new Section 9-340, which regulates the effectiveness of a setoff against a deposit account that stands as collateral. The second recognizes Section 9-404, which affords the obligor on an account, chattel paper, or general intangible the right to raise claims and defenses against an assignee/secured party.

13. **Tort Claims.** Subsection (d)(12) narrows somewhat the broad exclusion of transfers of tort claims under former Section 9-104(k). This Article now applies to assignments of “commercial tort claims (defined in Section 9-102) as well as to security interests in tort claims that constitute proceeds of other collateral (e.g., a right to payment for negligent destruction of the debtor’s inventory). The Official Comments will make clear that once a claim arising in tort has been settled and reduced to a contractual obligation to pay (as in, but not limited to, a structured settlement) the right to payment becomes a payment intangible and no longer is a claim arising in tort.

The Article contains two special rules governing creation of a security interest in tort-claim collateral. First, a description of collateral in a security agreement as “all tort claims is insufficient to meet the requirement for attachment. See Section 9-108(e). Second, no security attaches under an after-acquired property clause to a tort claim. See Section 9-204(b). In addition, this Article does not determine whom the tortfeasor must pay to discharge its obligation. Inasmuch as a tortfeasor is not an “account debtor, the rules governing waiver of defenses and discharge of an obligation by an obligor (Sections 9-403, 9-404, 9-405, and 9-406) are inapplicable to tort-claim collateral.

14. **Deposit Accounts.** Deposit accounts may be taken as original collateral under this Article. Under former Section 9-104(*l*), deposit accounts were excluded as original collateral, leaving security interests in deposit accounts to be governed by the common law. The common law is nonuniform, often difficult to discover and comprehend, and frequently costly to implement. As a consequence, debtors who wish to use deposit accounts as collateral sometimes are precluded from doing so as a practical matter. Under paragraph (13) of subsection (d), however, deposit accounts are excluded from the Article’s scope as original collateral in consumer transactions.

This Article contains several safeguards to protect debtors against inadvertently encumbering deposit accounts and to reduce the likelihood that a secured party will realize a windfall from the debtor’s deposit accounts. For example, because “deposit accounts is a separate type of collateral, a security agreement covering general intangibles will not adequately describe deposit accounts. Rather, a security agreement must reasonably identify the deposit accounts that are the subject of a security interest, e.g., by using the term “deposit accounts. See Section 9-108. To perfect a security interest in a deposit account as original collateral, a secured party (other than the bank with which the deposit account is maintained) must obtain “control of the account either by obtaining the bank’s written agreement or by putting the funds into its own account. See Sections 9-312(b)(1), 9-104. Either of these steps requires the debtor’s consent.

This Article also contains new rules that determine which State’s law governs perfection and priority of a security interest in a deposit account (Section 9-304), priority of conflicting security interests in a deposit account (Sections 9-327, 9-340), the rights of transferees of funds from an encumbered deposit account (Section 9-332), the obligations of the bank (Section 9-341), and enforcement of security interests in a deposit account (Section 9-607(c)).

[9-110]

Reporters' Comments

1. **Source.** Former Section 9-113.

2. **Background.** Former Section 9-113, from which this section derives, referred generally to security interests "arising solely under the Article on Sales (Article 2) or the Article on Leases (Article 2A). Views differed as to the precise scope of that section. In contrast, Section 9-110 specifies the security interests to which it applies.

3. **Security Interests under Articles 2 and 2A.** Section 2-505 explains how a seller of goods may reserve a security interest in them. Section 2-401 indicates that a reservation of title by the seller of goods, despite delivery to the buyer, is limited to reservation of a security interest. As did former Article 9, this Article governs a security interest arising solely under one of those sections; however, until the buyer obtains possession of the goods, the security interest is enforceable even in the absence of a security agreement, filing is not necessary to perfect the security interest, and the seller-secured party's rights on the buyer's default are governed by Article 2.

Sections 2-711(3) and 2A-508(5) create a security interest in favor of a buyer or lessee in possession of goods that were rightfully rejected or as to which acceptance was justifiably revoked. As did former Article 9, this article governs a security interest arising solely under one of those sections; however, until the seller or lessor obtains possession of the goods, the security interest is enforceable even in the absence of a security agreement, filing is not necessary to perfect the security interest, and the secured party's (buyer's or lessee's) rights on the debtor's (seller's or lessor's) default are governed by Article 2 or 2A, as the case may be.

4. **Priority.** This section adds to former Section 9-113 a priority rule that, generally speaking, is consistent with the views of the Reporter and Associate Reporter for Article 2: until the debtor obtains possession of the goods, a security interest arising under one of the specified sections of Article 2 or 2A has priority over conflicting security interests created by the debtor. Thus, a security interest arising under Section 2-401 or 2-505 has priority over a conflicting security interest in the buyer's after-acquired goods, even if the goods in question are inventory. Arguably, the same result would obtain under Section 9-322, but even if it would not, a purchase-money-like priority seems appropriate. Similarly, a security interest under Section 2-711(3) or 2A-508(5) has priority over security interests

claimed by the seller's or lessor's secured lender. This result seems appropriate, inasmuch as the major portion of the debt secured by the Article 2 or 2A security interest is likely to constitute the lender's proceeds.

In the event that a security interest referred to in this section conflicts with a security interest that is created by a person other than the debtor, Section 9-325 applies. Thus, if the buyer buys goods subject to a security interest created by the seller, the buyer's security interest under Section 2-711(3) would be subordinate to that of the seller's secured party if the latter security interest is perfected at all times.

5. **Relationship to Other Rights and Remedies under Articles 2 and 2A.** This Article does not specifically address the conflict between (i) a security interest created by the buyer and (ii) the seller's right to withhold delivery under Section 2-702(1), 2-703(a), or 2A-525, the seller's right to stop delivery under Section 2-705 or 2A-526, or the seller's right to reclaim under Section 2-507(2) or 2-702(2). These conflicts are governed by the first sentence of Section 2-403(1), under which the buyer's secured party obtains no greater rights in the goods than the buyer had or had power to convey.

[Part 2]

[9-201]

Reporters' Comments

1. **Source.** Former Sections 9-201 and 9-203(4).

2. **Purpose; Law, Statutes, and Regulations Applicable to Certain Transactions.** This section makes clear that certain transactions, although subject to this Article, also must comply with other applicable law. It also provides that the other law is controlling in the event of a conflict, and that a violation of other law does not *ipso facto* constitute a violation of this Article.

[9-202]

Reporters' Comments

1. **Source.** Former Section 9-202.

2. **When Title Matters.** This section explicitly acknowledges two circumstances in which the effect of certain Article 9 provisions turns on ownership (title). First, the remedies of a consignor under a true consignment and, for the most part, the remedies of a buyer of accounts, chattel paper, payment intangibles, or promissory notes are determined by other law and not by part 6. See Section 9-601(g). Second, in some respects sales of accounts, chattel paper, payment intangibles, and promissory notes receive special treatment. See, e.g., Sections 9-207(a); 9-210(b); 9-615(e). Buyers of receivables under the former Article 9 are treated specially, as well. See, e.g., former Section 9-502(2).

[9-203]

Reporters' Comments

1. **Source.** Former Sections 9-203 and 9-115(2), (6).

2. **Creation, Attachment, and Enforceability.** Subsection (a) states the general rule that a security interest is created and attaches to collateral only when it becomes enforceable against the debtor. Subsection (b) provides the rules for when a security interest becomes enforceable.

3. **Requirement for Agreement; Possession and Control.** Subsection (b) clarifies two points. First, in order to satisfy paragraph (3)(B), in the absence of an authenticated agreement that satisfies paragraph (3)(A), the secured party's

possession must be “pursuant to the debtor’s security agreement. That phrase refers to the debtor’s agreement to the secured party’s possession for the purpose of creating a security interest. The phrase should not be confused with the phrase “debtor has authenticated a security agreement, which is used in paragraph (3)(A) and which contemplates the debtor’s authentication of a record. In the unlikely event that possession were obtained without the debtor’s agreement, it would not suffice as a substitute for an authenticated security agreement. However, once the security interest has become enforceable and has attached, it is not impaired by the fact that the secured party’s possession is maintained without the agreement of a subsequent debtor (e.g., a transferee). Second, possession as contemplated by Section 9-313 is possession for purposes of subsection (b), 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).

Subsection (b) also provides that control of investment property, a deposit account, electronic chattel paper, or a letter-of-credit right pursuant to the debtor’s security agreement is sufficient as a substitute for an authenticated security agreement.

4. **Collateral Covered by Other Statute or Treaty.** One purpose of the formal requisites stated in subsection (b) is evidentiary–to minimize the possibility of future disputes as to the terms of a security agreement and as to what property stands as collateral for the obligation secured. One should distinguish the evidentiary functions of the formal requisites of attachment and enforceability (such as the requirement that a security agreement contain a description of the collateral) from the more limited goals of “notice filing for financing statements under Part 5, explained in former Section 9-402, Official Comment 3. When perfection is achieved by compliance with the requirements of a statute or treaty described in Section 9-311(a), such as a federal recording act or a certificate-of-title act, the manner of describing the collateral in a registry imposed by the statute or treaty may or may not be adequate for purposes of this section and Section 9-108. However, the description contained in the security agreement, not the description in a public registry or on a certificate of title, controls for purposes of this section.

5. **Exceptions to General Rule.** Subsection (c) identifies certain exceptions to the general rule of subsection (b). Section 5-118, mentioned in subsection (c), is found in Appendix I.

6. **Attachment to Limited Rights.** Subsection (b)(2) conditions attachment on the debtor’s having “rights in the collateral or the power to transfer rights in the collateral to a secured party. A debtor’s limited rights in collateral, short of full ownership, are sufficient for a security interest to attach. However, in accordance with basic personal property conveyancing principles, the baseline rule is that a security interest attaches only to whatever rights a debtor may have, broad or limited as those rights may be.

7. **Attachment to Greater Rights than Debtor Has.** Certain exceptions to this baseline rule enable a debtor to transfer, and a security interest to attach to, greater rights than the debtor has. The phrase, “or the power to transfer rights in the collateral to a secured party, accommodates those exceptions. In some cases, a debtor may have power to transfer another person’s rights to a class of transferees that excludes secured parties. See, e.g., Section 2-403(2) (giving certain merchants power to transfer an entruster’s rights to a buyer in ordinary course of business). Under those circumstances, the debtor would not have the power to create a security interest in the other person’s rights.

8. **New Debtors.** Subsection (e) makes clear that the enforceability requirements of subsection (b)(3) are met when a new debtor becomes bound under an original debtor’s security agreement. If a new debtor becomes bound as debtor by a security agreement entered into by another person, the security agreement satisfies the requirement of subsection (b)(3) as to the existing and after-acquired property of the new debtor to the extent the property is described in the agreement.

Subsection (d) explains when a new debtor becomes bound. Persons who become bound under paragraph (2) are limited to those who both become primarily liable for the original debtor’s obligations and succeed to (or acquire) its assets. Thus, the paragraph excludes sureties and other secondary obligors as well as persons who become obligated through veil piercing and other non-successorship doctrines. In many cases, paragraph (2) will exclude successors to the assets and liabilities of a division of a debtor. See also Section 9-508, Reporters’ Comments.

9. **Supporting Obligations.** Under subsection (f), a security interest in a “supporting obligation (defined in Section 9-102) automatically follows from a security interest in the underlying, supported collateral. We believe this to be implicit in current law.

Implicit in subsection (f) is the principle that the secured party’s interest in a supporting obligation extends to the supporting obligation only to the extent that it supports the collateral in which the secured party has a security interest. Complex issues may arise, however, if a supporting obligation supports many separate obligations of a particular account debtor and if the supported obligations are separately assigned as security to several secured parties. The problems may be exacerbated if a supporting obligation is limited to an aggregate amount that is less than the aggregate amount of the obligations it supports. This Article does not contain provisions dealing with competing claims to a limited supporting obligation. As under former Article 9, the law of suretyship and the agreements of the parties will control.

10. **Collateral Follows Right to Payment or Performance.** Subsection (g) codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security

interest or lien. See Restatement (3d) of the Law of Property (Mortgages) § 5.4(a) (1997). See also Section 9-308(e) (analogous rule for perfection).

11. **Investment Property.** Subsections (h) and (i) make clear that attachment of a security interest in a securities account or commodity account is also attachment in security entitlements or commodity contracts carried in the accounts.

[9-204]

Reporters' Comments

1. **Source.** Former Section 9-204.

2. **Sales of Receivables.** This Article validates "after-acquired property and "future advance clauses in security agreements not only when the transaction is for security purposes but also when the transaction is the sale of accounts, chattel paper, payment intangibles, or promissory notes.. We understand this to be the case under existing law.

3. **Consumer Goods.** Subsection (b)(1) is unchanged in substance from the corresponding provision in former Section 9-204(2).

4. **Commercial Tort Claims.** New subsection (b)(2) provides that an after-acquired property clause in a security agreement does not reach future commercial tort claims. In order for a security interest in a tort claim to attach, the claim must be in existence when the security agreement is authenticated. In addition, the security agreement must describe the tort claim with greater specificity than simply "all tort claims. See Section 9-108(e).

[9-205]

Reporters' Comments

1. **Source.** Former 9-205.

2. **Extent of Permissible Freedom for Debtor.** This section recognizes that the broader rights of a debtor to "enforce collateral, as well as to "collect and "compromise collateral, do not jeopardize the validity of a security interest. The reference to collecting and compromising "collateral in lieu of "accounts or chattel paper, used in former Section 9-205, contemplates the many other types of collateral that a debtor may wish to "collect, compromise, or enforce : deposit accounts, documents, general intangibles, instruments, investment property, and letters of credit.

[9-206]

Reporters' Comments

1. **Source.** Former 9-116.

2. **Automatic Attachment.** Subsections (a) and (c) refer to attachment of a security interest. Attachment under this section has the same consequences (right to proceeds, etc.) as attachment under § 9-203. This section overrides the general attachment rules in § 9-203. See § 9-203(c).

2. **Automatic Perfection.** Security interests arising under this section are automatically perfected. See Section 9-309(9).

[9-207]

Reporters' Comments

1. **Source.** Former Section 9-207.

2. **Agricultural Liens.** The revised definitions of “collateral , “debtor, and “secured party in Section 9-102 make this section applicable to collateral subject to an agricultural lien if the collateral is in the lienholder's possession.

3. **Buyers of Chattel Paper and Other Receivables; Consignors.** This section has been revised to reflect the fact that a seller of accounts, chattel paper, payment intangibles, or promissory notes normally retains no interest in the collateral and so is not disadvantaged by the secured party's noncompliance with the requirements of this section. Accordingly, subsection (a) applies only to security interests that secure an obligation and to sales of receivables in which the buyer has recourse against the debtor. (Of course, a buyer of accounts or payment intangibles could not have “possession of original collateral, but might have possession of proceeds, such as promissory notes or checks.) The meaning of “recourse in this respect is limited to recourse arising out of the account debtor's failure to pay or other default.

Subsection (e) makes subsections (c) and (d) inapplicable to buyers of accounts, chattel paper, payment intangibles, or promissory notes and consignors. Of course, there is no reason to believe that a buyer of receivables or a consignor could not, for example, create a security interest or otherwise transfer an interest in the collateral, regardless of who has possession of the collateral. However, this section leaves the rights of those owners to law other than Article 9.

4. **“Repledges” and Right of Redemption.** Subsection (d)(3) eliminates the qualification in former Section 9-207 that the terms of a “repledge may not “impair a debtor’s “right to redeem collateral. The change is primarily for clarification.

There is no basis on which to draw from subsection (d)(3) any inference concerning the debtor’s right to redeem the collateral. The debtor enjoys that right under Section 9-621, and this section need not address it. For example, if the collateral is a negotiable note that the secured party (SP-1) repledges to SP-2, nothing in this section suggests that the debtor (D) does not retain the right to redeem the note upon payment to SP-1 of all obligations secured by the note. But, as explained below, the debtor’s unimpaired right to redeem as against the debtor’s original secured party nevertheless may not be enforceable as against the new secured party.

In resolving questions that arise from the creation of a security interest by SP-1, one must take care to distinguish D’s rights against SP-1 from D’s rights against SP-2. Once D discharges the secured obligation, under Section 9-621 or otherwise, D becomes entitled to the note; SP-1 has no legal basis upon which to withhold it. If, as a practical matter, SP-1 is unable to return the note because SP-2 holds it as collateral for SP-1’s unpaid debt, then SP-1 is liable to D under the law of conversion.

Whether SP-2 would be liable to D depends on the priority of SP-2’s security interest. Normally, the *nemo dat* principle will apply, and SP-2’s security interest, which is a security interest in SP-1’s security interest, will be defeated if the debtor discharges its secured obligations under Section 9-621 or otherwise. If so, and if SP-2 fails to deliver the note to D, then D will have a right to replevy the note from SP-2 or recover damages from SP-2 in conversion. In some circumstances, however, SP-2’s security interest will survive discharge of SP-1’s security interest. This will be the case, for example, if SP-2 is a holder in due course. See Sections 9-331, 3-306. Under these circumstances, D has no right to recover the note or recover damages from SP-2. Nevertheless, D will have a damage claim against SP-1.

For the most part this section does not change existing law, but rather eliminates a possible ambiguity. Former Section 9-207(2)(e) permitted the secured party to “repledge the collateral upon terms that do not impair the debtor’s right to redeem it. That language could be read to override the rule of former Section 9-309 (draft Section 9-331), under which a qualifying SP-2 takes its security interest free of D’s interest in the collateral. That would be an erroneous reading. Subsection (d)(3) makes clear that nothing in this Article, including subsection (a), prohibits or restricts a secured party from creating, as a debtor, a security interest in collateral in which it holds a security interest. Eliminating the reference to the debtor’s right of redemption may alter the secured party’s right to repledge in one respect, however. Former Section 9-207 could be read to limit the secured party’s statutory right to repledge collateral to repledge transactions in which the collateral did not secure a greater obligation than that of the original debtor. Inasmuch as this is a matter normally dealt with by agreement between the debtor and secured party, the change would appear to have little practical effect.

5. **“Repledges” of Investment Property.** The rights specified in paragraph (d) are made applicable to secured parties having control of collateral as well as to those in possession of collateral. Important among these rights is the secured party’s right to grant a security interest in (i.e., to “repledge) collateral, especially investment property. This right is equally as important when the secured party has control of collateral (see Sections 9-104, 9-105, 9-106, and 9-107), as when the secured party has possession of collateral. Consider the following example:

> **Example.** Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha does not have an account with Able. Alpha uses Beta Bank as its securities custodian. Debtor instructs Able to transfer the shares to Beta, for the account of Alpha, and Able does so. Beta then credits Alpha’s account. Alpha has control of the security entitlement for the 1000 shares under Section 8-106(d). (These are the facts of Example 2, Section 8-106, Comment 4.) Although, as between Debtor and Alpha, Debtor may have become the beneficial owner of the new securities entitlement, Beta has agreed to act on Alpha’s entitlement orders because, as between Beta and Alpha, Alpha has become the entitlement holder.
>
> Next, Alpha grants Gamma Bank a security interest in the security entitlement that includes the 1000 shares of XYZ Co. stock. In order to afford Gamma control of the entitlement, Alpha instructs Beta to transfer the stock to Gamma’s custodian, Delta Bank, which credits Gamma’s account for 1000 shares. At this point Gamma holds its securities entitlement for its benefit as well as that of its debtor, Alpha. Alpha’s derivative rights also are for the benefit of Debtor.

In many, probably most, situations and at any particular point in time, it will be impossible for Debtor or Alpha to “trace Alpha’s “repledge to any particular securities entitlement or financial asset of Gamma or anyone else. Debtor would retain, of course, a right to redeem from Alpha upon satisfaction of the secured obligation. However, in the absence of a traceable interest, Debtor would retain only a personal claim against Alpha in the event Alpha failed to restore the security entitlement to Debtor. Moreover, even in the unlikely event that Debtor could trace a property interest, in most cases Debtor’s interest would have been cut off. See, e.g., Section 8-502, Official Comment 3, Example 6. Indeed, the purpose of a repledge transaction often may be to permit a secured party such as Alpha to give senior rights to secured party such as Gamma.

[9-208]

Reporters' Comments

1. **Source.** New.

2. **Scope.** This section imposes duties on a secured party that has control of a deposit account, electronic chattel paper, investment property, or a letter-of-credit right. The duty to terminate the secured party's control is analogous to the duty to file a termination statement, imposed by Section 9-513.

The requirements of this section can be varied by agreement under Section 1-102(3). For example, a debtor could by contract agree that the secured party may release its control of investment property under subsection (a)(1) more than three days following demand. Also, these requirements should not be read to conflict with the terms of the collateral itself. For example, if the collateral is a time deposit account, subsection (b)(3) should not require a secured party with control to make an early withdrawal of the funds (assuming that is even possible) in order to pay them over to the debtor or put them in an account in the debtor's name.

3. **Remedy for Failure to Relinquish Control.** If the secured party fails to comply with the requirements of subsection (a), the debtor has the remedy set forth in Section 9-625(e). This remedy is identical to that applicable to failure to provide or file a termination statement under Section 9-513.

4. **Duty to Relinquish Possession.** Although Section 9-207 and former Section 9-207 address directly the duties of a secured party in possession of collateral, neither requires the secured party to relinquish possession when the secured party ceases to hold a security interest. Under common law, absent agreement to the contrary, the failure to relinquish possession of collateral upon satisfaction of the secured obligation would constitute a conversion. This Article could impose an explicit duty to relinquish possession. However, inasmuch as problems apparently have not surfaced in the absence of statutory duties under current law, the common-law duty appears to be sufficient.

[9-209]

Reporters' Comments

1. **Source.** New.

2. **Scope.** Like Sections 9-208 and 9-513, which require a secured party to relinquish control of collateral and to file or provide a termination statement for a financing statement, this section requires a secured party to free up collateral when

there no longer is any outstanding secured obligation or any commitment to give value in the future. This section addresses the case in which account debtors have been notified to pay a secured party to whom the receivables have been assigned. It requires the secured party (assignee) to inform the account debtors that they no longer are obligated to make payment to the secured party.

[9-210]

Reporters’ Comments

1. **Source.** Former Section 9-208.

2. **Scope.** This section resolves some of the issues that have arisen under former Section 9-208 and makes information concerning the secured indebtedness readily available to debtors, both before and after default. It applies to agricultural lien transactions (see the definitions of “debtor, secured party, and “collateral in Section 9-102), but generally not to sales of receivables. See subsection (b).

Subsection (a) contemplates that the debtor can request three types of information by submitting three types of “requests (subsection (a)(1)) to the secured party. First, debtor can request the secured party to prepare and send an “accounting (defined in Section 9-102). Second, the debtor can submit to the secured party a list of collateral for the secured party’s approval or correction. Third, the debtor can submit to the secured party for its approval or correction a statement of the aggregate amount of unpaid secured obligations. Inasmuch as a secured party may have numerous transactions and relationships with a debtor, each request must identify the relevant transactions or relationships. Subsections (b) and (c) require the secured party to respond to a request within 14 days following receipt of the request.

3. **Recipients Claiming No Interest in the Transaction.** A debtor may be unaware that the creditor with whom it has dealt has assigned its security interest or the secured obligation. Subsections (d) and (e) impose upon recipients of requests under this section the duty to inform the debtor that they claim no interest in the collateral or secured obligation, respectively, and to inform the debtor of the name and mailing address of any known assignee or successor. As under subsections (b) and (c), a response to a request under subsection (d) or (e) is due 14 days following receipt.

4. **Waiver; Remedy for Failure to Comply.** The debtor’s rights under this section may not be waived or varied. Section 9-625(e) sets forth the remedy for noncompliance with the requirements of this section.

5. **Limitation on Free Responses to Requests.** Under subsection (f), during a six-month period a debtor is entitled to receive from the secured party one

free response to a request. The debtor is not entitled to a free response to each type of request (i.e., three free responses).

[Part 3]

Reporters' Prefatory Comment

1. **Scope of Choice-of-Law Rules.** Part 3, Subpart 1 contains choice-of-law rules similar to those of former Section 9-103. Former Section 9-103 generally addresses which State's law governs "perfection and the effect of perfection or non-perfection of security interests. See, e.g., former Section 9-103(1)(b). This Article follows the broader and more precise formulation in former Section 9-103(6)(b), which was revised in connection with the recent promulgation of Revised Article 8: "perfection, the effect of perfection or non-perfection, and the priority of security interests. Priority, in this context, subsumes all of the rules in Part 3, including "cut off or "take free rules such as Sections 9-317(b), (c), and (d), 9-320(a), (b), and (d), and 9-332. This subpart does not address choice of law for other purposes. For example, the law applicable to issues such as attachment, validity, characterization (e.g., true lease or security interest), and enforcement would be governed by the rules in Section 1-105; that governing law typically is specified in the same agreement that contains the security agreement. And, another jurisdiction's law may govern other third-party matters addressed in Article 9. See Part 4, Reporters' Prefatory Comment.

2. **Scope of Referral.** In designating the jurisdiction whose law governs, this Article directs the court to apply only the substantive ("local) law of a particular jurisdiction and not its choice-of-law rules.

> **Example:** Litigation over the priority of a security interest in accounts arises in State X. State X has adopted the Official Text of this Article, which sends one to the local law of the jurisdiction in which the debtor is located. See Section 9-301(1). The debtor is located in State Y. Even if State Y has enacted a nonuniform choice-of-law rule (e.g., one that provides that perfection is governed by the law of State Z), a State X court should look only to the substantive law of State Y. State Y's substantive law indicates that financing statements should be filed in State Y. Note, however, that if the identical perfection issue were to be litigated in State Y, the court would look to State Y's nonuniform 9-301 and conclude that a filing in State Y is ineffective. Revision of the Official Text cannot eliminate this problem. A complete solution would require complete uniformity in the enacted text.

3. **Policy.** Eliminating the reference to the choice-of-law rules is likely to minimize the impact of the nonuniformity. Under former Section 9-103(3), which refers to "the law (including the conflict of laws rules) of a jurisdiction, every time a uniform provision refers one to State Y, one winds up having to file in State Z. Inasmuch as there have been relatively few nonuniform amendments to former Section 9-103, lawyers are likely to file in State Y without first checking State Y's

choice-of-laws rules. If this Article, which eliminates the reference to choice-of-laws rules, is widely adopted, then these lawyers will have filed properly if the issue is litigated in any jurisdiction that has adopted a uniform Section 9-301 (i.e., in most jurisdictions other than State Y). The burden now falls on the litigators to file the lawsuit in the "correct place.

The approach of this Article also is likely to reduce the frequency with which the *renvoi* arises.

> **Example:** In the preceding Example, assume that State Y's nonuniform Section 9-301(1) refers to the substantive and choice-of-law rules of State X. If so, State X's referral to State Y's choice-of-law rules would present the classic *renvoi*: State X's Section 9-301 directs one to State Y's choice of law, and State Y's Section 9-301 says to look to State X's choice of law. (The 1972 amendments to former Section 9-103(3) created precisely this scenario with respect to security interests in accounts created by debtors whose chief executive offices were in a State that had the 1962 Official Text but whose records concerning the accounts were located in a State that had adopted the 1972 Official Text.) Eliminating either State's reference to choice-of-laws rules, as Section 9-301(1) does, would eliminate the *renvoi*.

[9-301]

Reporters' Comments

1. **Source.** Former Sections 9-103(1)(a), (b); 9-103(3)(a), (b); 9-103(5), substantially modified.

2. **Law Governing Perfection: General Rule.** Paragraph (1) contains the general rule: the law governing perfection of security interests in both tangible and intangible collateral, whether perfected by filing or automatically, is the law of the jurisdiction of the debtor's location, as determined under Section 9-307.

3. **Law Governing Perfection: Policy of General Rule.** Paragraph (1) substantially simplifies the choice-of-law rules. It eliminates former Section 9-103(1)(c) and (d), which concern nonpossessory security interests in tangible collateral that is removed from one jurisdiction to the other. It is likely to reduce the frequency of cases in which the governing law changes after a financing statement is properly filed. (Presumably, debtors change their own location less frequently than they change the location of their collateral.) The approach taken in paragraph (1) also eliminates some difficult priority issues and the need to distinguish between "mobile and "ordinary goods, and it reduces the number of filing offices in which secured parties must file or search.

There are potential drawbacks, as well. Arguably, determining the location of the debtor is a less certain enterprise than is generally assumed. Purchase-money equipment financers and others may be ill-equipped to determine the debtor's location and the peculiar filing requirements of that jurisdiction without incurring significant additional costs. Local interests may perceive the potential changes in the volume of filings to be so great that they may be motivated to oppose revision on this ground. In addition, all acknowledge the difficulties that would attend the transition from one set of choice-of-law rules to another. The expansion of the scope of this Article, although modest, is likely to exacerbate the difficulties in applying choice-of-law rules during the transition.

4. **Law Governing Perfection: Exceptions.** The general rule is subject to several exceptions. It does not apply to goods covered by a certificate of title (see Sections 9-102; 9-303), deposit accounts (see Section 9-304), investment property (see Section 9-305), or letter-of-credit rights (see Section 9-306). Nor does it apply to possessory security interests, i.e., security interests in which the secured party is in possession (see paragraph (2)), security interests perfected by filing a fixture filing (see paragraph (4)), security interests in timber to be cut (paragraph (5)), or security interests in as-extracted collateral (see paragraph (6)).

a. **Possessory Security Interests.** Paragraph (2) applies to possessory security interests and provides that perfection is governed by the local law of the jurisdiction in which the collateral is located. This is the rule of former Section 9-103(1)(b), except paragraph (2) eliminates the troublesome "last event test of former law.

The distinction between nonpossessory and possessory security interests creates the potential for the same jurisdiction to apply two different choice-of-law rules to determine perfection in the same collateral. For example, were a secured party in possession of an instrument or document to relinquish possession in reliance on temporary perfection, the applicable law immediately would change from that of the location of the collateral to that of the location of the debtor. The applicability of two different choice-of-law rules for perfection is unlikely to lead to any material practical problems. The perfection rules of one Article 9 jurisdiction are likely to be identical to those of another. Moreover, under paragraph (3), the relative priority of competing security interests in tangible collateral is resolved by reference to the law of the jurisdiction in which the collateral is located, regardless of how the security interests are perfected.

b. **Fixtures.** Application of the general rule in paragraph (1) to perfection of a security interest in fixtures would yield strange results. For example, perfection of a security interest in fixtures located in Arizona and owned by a Delaware corporation would be governed by the law of Delaware. Although Delaware law would send one to a filing office in Arizona for the place to file a financing statement as a fixture filing, see Section 9-501, Delaware law would not take account of local, nonuniform real property filing and recording requirements that Arizona law might impose. For this reason, paragraph (4) contains a special rule for security interests perfected by a fixture filing; the law of the jurisdiction where the fixtures are located governs perfection, including the formal requisites of a fixture filing.

c. **Timber to Be Cut.** Application of the general rule in paragraph (1) to perfection of a security interest in timber to be cut would yield undesirable results analogous to those described with respect to fixtures. Paragraph (5) adopts a similar solution: perfection is governed by the law of the jurisdiction where the timber is located. Note that paragraph (5) applies only to “timber to be cut, not to timber that has been cut. Consequently, once the timber is cut, the choice-of-law rule in paragraph (1), which applies to ordinary goods, becomes applicable. To ensure continued perfection, a secured party should file in both the state where the timber to be cut is located and in the state where the debtor is located. The former filing would be with the office at which a real property mortgage would be filed, and the latter would be a central filing. See Section 9-501. The treatment of timber to be cut differs from that provided in paragraph (6) for as-extracted collateral. Under paragraph (5), the law of the jurisdiction where the timber to be cut is located governs perfection, leaving priority to be governed by the law of the debtor’s location under paragraph (1). Under paragraph (6), the law of the jurisdiction where the wellhead or minehead is located governs both perfection and priority.

d. **As-extracted Collateral.** Paragraph (6) adopts the rule of former Section 9-103(5) with respect to certain security interests in minerals and related accounts.

5. **Law Governing the Effect of Perfection and Priority: Goods, Documents, Instruments, Money, Negotiable Documents, and Tangible Chattel Paper.** Under former Section 9-103, the law of a single jurisdiction governs both questions of perfection and those of priority. This Article generally adopts that approach. See paragraph (1). But the approach may create problems if the debtor and collateral are located in different jurisdictions. For example, assume a security interest in equipment is perfected by filing in Illinois (where the debtor is located). The equipment is located in Pennsylvania. If the law of the jurisdiction in which the debtor is located were to govern priority, then the priority of an execution lien on the goods located in Pennsylvania would be governed by rules enacted by the Illinois legislature.

To address this problem, paragraph (3) divorces questions of perfection from questions of “the effect of perfection or nonperfection and the priority of a security interest. Under paragraph (3), the rights of competing claimants to tangible collateral are resolved by reference to the law of the jurisdiction in which the collateral is located. Although this bifurcated approach may introduce complexities, its appearance in prior drafts with respect to agricultural liens met with generally favorable reviews. A similar bifurcation applies to security interests in investment property under former Section 9-103(6). See Section 9-305. The principal efficiencies of moving from the location-of-collateral rule to a location-of-debtor rule concern where to file and search and what to file. The bifurcated approach generally preserves these benefits.

Paragraph (3) applies the law of the situs to determine priority only with respect to goods (including fixtures), instruments, money, negotiable documents, and tangible chattel paper. Compare former Section 9-103(1), which applies the law of the location of the collateral to documents, instruments, and "ordinary (as opposed to "mobile) goods. This Article does not distinguish among types of goods. The ordinary/mobile goods distinction appears to address concerns about where to file and search, rather than concerns about priority. There appears to be no reason to preserve this distinction under the bifurcated approach.

Particularly serious confusion may arise when the choice-of-law rules of a given jurisdiction result in each of two competing security interests in the same collateral being governed by a different priority rule. The potential for this confusion exists under former Section 9-103(4) with respect to chattel paper: Perfection by possession is governed by the law of the location of the paper, whereas perfection by filing is governed by the law of the location of the debtor. Consider the mess that would be created if the language or interpretation of former Section 9-308 were to differ in the two relevant States, or if one of the relevant jurisdictions (e.g., a foreign state) had not adopted Article 9. The potential for confusion could be exacerbated when a secured party perfects both by taking possession in the State where the collateral is located (State A) and by filing in the State where the debtor is located (State B)–a common practice for some chattel paper financers. By providing that the law of the jurisdiction in which the collateral is located governs priority, paragraph (3) substantially diminishes this problem.

6. **Non-U.S. Debtors.** This Article deletes former Section 9-103(3)(c), which contained the choice-of-law rule governing security interests created by debtors located in a non-U.S. jurisdiction. The rule has proven unsatisfactory for several reasons. First, it determines the applicable law for non-U.S. debtors by reference to the location of the debtor's "major executive office in the United States. Some, perhaps many, non-U.S. debtors lack any "executive office at all in the U.S.; with respect to others, determining which of the executive offices in the United States is the "major one has proven quite difficult.

Second, the rule permits perfection of security interests in accounts and payment intangibles by notification to account debtors. This means of perfection often is not feasible and, even when accomplished, is not likely to afford effective public notice.

This Article applies the same choice-of-law rules to all debtors, foreign and domestic. For example, it adopts the bifurcated approach for determining the law applicable to goods and other tangible collateral. See Comment 4, above. The

Article contains a new rule governing the location of non-U.S. debtors. The rule appears in Section 9-307 and is explained in the Reporters' Comments following that section.

[9-302]

Reporters' Comments

1. **Source.** New.

2. **Agricultural Liens.** This section provides choice-of-law rules for agricultural liens on farm products. Perfection, the effect of perfection or nonperfection, and priority all are governed by the law of the jurisdiction where the farm products are located. Other choice-of-law rules, including Section 1-105, will determine which law governs other matters, such as remedies on default. Nonuniformity in the law governing agricultural liens and in non-UCC choice-of-law rules may engender some confusion in this area. Nevertheless, this section's approach seems generally consistent with current law applicable to agricultural liens.

[9-303]

Reporters' Comments

1. **Source.** Former Section 9-103(2)(a), (b), substantially revised.

2. **External Constraints on This Section.** This section, like former Section 9-103(2), proceeds from the premise that, for goods covered by a certificate of title on which a security interest may be indicated, compliance with the certificate-of-title statute is a more appropriate method of perfection than filing. The concept of perfection by notation on a certificate is simple; however, certificate-of-title statutes are not. Unlike the Article 9 filing system, which is designed to afford publicity to security interests, certificate-of-title statutes were created primarily to deter theft. The need to coordinate Article 9 with a variety of nonuniform certificate-of-title statutes, the need to provide rules to take account of goods that are covered by more than one certificate, and the need to govern the transition from perfection by filing to perfection by notation all create pressure for a detailed and complex set of rules. In particular, much of the complexity arises from the possibility that more than one certificate of title issued by more than one jurisdiction can cover the same goods. That possibility results from defects in certificate-of-title laws and the interstate coordination of those laws, not from deficiencies in Article 9. As long as that possibility remains, the potential for innocent parties to suffer losses will continue. At best, Article 9 can identify clearly which innocent parties will bear the losses in familiar fact patterns.

3. **Scope of This Section.** This section applies to “goods covered by a certificate of title. The new definition of “certificate of title in Section 9-102 makes clear that this section applies not only to certificate-of-title acts under which perfection occurs upon notation of the security interest on the certificate but also to those that contemplate notation but provide that perfection is achieved by other means, e.g., delivery of designated documents to an official. Subsection (a) explains that goods become “covered by a certificate of title when a valid application for a certificate and the applicable fee are delivered to the appropriate issuing authority. The time when goods become “covered determines when this section begins to apply to perfection of security interests in the goods, and thus when the law of the jurisdiction under whose certificate the goods are covered will begin to apply. Subsection (c), which is also new, makes clear that this section applies to certificates of a jurisdiction having no other contacts with the goods or the debtor. This result comports with most of the reported cases on the subject and with contemporary business practices in the trucking industry.

4. **Law Governing Perfection.** Subsection (b) is the basic choice-of-law rule for goods covered by a certificate of title. Perfection is governed by the law of the jurisdiction under whose certificate the goods are covered from the time the goods become covered until the earlier of (i) the time the certificate becomes ineffective under the law of that jurisdiction or (ii) the time the goods become covered subsequently by a certificate of title from another jurisdiction.

Normally, under the law of the relevant jurisdiction, the perfection step would consist of compliance with that jurisdiction’s certificate-of-title act and a resulting notation of the security interest on the certificate of title. See Section 9-311(b). In the typical case of an automobile or over-the-road truck, a person who wishes to take a security interest in the vehicle can ascertain whether it is subject to any security interests by looking at the certificate of title. But certificates of title cover certain types of goods in some States but not in others. A secured party who does not realize this may extend credit and attempt to perfect by filing in the jurisdiction where the debtor is located. If the goods had been titled in another jurisdiction, the lender would be unperfected.

Subsection (b) explains when the law of the jurisdiction under whose certificate the goods are covered ceases to apply. Former Section 9-103(2)(b) provides that the law of the jurisdiction issuing the certificate ceases to apply upon “surrender of the certificate. In the case of automobiles, certificate-of-title statutes generally require tender of any outstanding certificate as a condition for issuance of a new certificate. See, e.g., Uniform Motor Vehicle Certificate of Title and Anti-Theft Act § 6(c)(1). This tender is the “surrender to which former subsection (2)(b) refers. The former rule reflects the idea that notation of a security interest on a certificate of title affords notice to third parties only so long as the certificate is outstanding.

This Article eliminates the concept of "surrender. Instead, the law of the original jurisdiction ceases to apply when the certificate "becomes ineffective under the law of that jurisdiction. Given the diversity in certificate-of-title statutes, the term "ineffective is not defined. Depending on the certificate-of-title law, this revision may ameliorate somewhat the problem of certificates that are wrongfully surrendered. Note, however, that if the certificate is surrendered in conjunction with an appropriate application for a certificate to be issued by another jurisdiction, the law of the original jurisdiction ceases to apply for another reason: the goods became covered subsequently by a certificate of title from another jurisdiction.

The last sentence of subsection (b) indicates that, when the certificate becomes ineffective or the goods subsequently become covered by a certificate of title from another jurisdiction, the goods are "not covered by the certificate of title.

> **Example:** The goods are covered by a certificate of title from State X, and a security interest is perfected in accordance with State X's law. Thereafter, the goods are covered by a certificate of title from State Y. Under subsection (b), the law of State X no longer governs perfection of the security interest. The goods no longer are covered by "*the* certificate of title (i.e., the *State X* certificate of title). They are, however, covered by *a* certificate of title (i.e., the *State Y* certificate) as defined in Section 9-102, so that the law of the jurisdiction under whose certificate of title the goods are covered (State Y) governs perfection.

5. **Continued Perfection.** The fact that the law of one State ceases to apply under subsection (b) does not mean that a security interest perfected under that law becomes unperfected automatically. In most cases, the security interest will remain perfected. See Section 9-316(d), (e).

6. **Inventory.** Compliance with a certificate-of-title act generally is *not* the method of perfecting security interests in inventory. Section 9-311(d) provides that a security interest created in inventory held by a person in the business of selling or leasing goods of that kind is subject to the normal filing rules; compliance with a certificate-of-title act is not necessary or effective to perfect the security interest. Most certificate-of-title acts are in accord.

The following example explains the subtle relationship between this rule and the choice-of-law rules in Section 9-303(b) and former Section 9-103(2):

> **Example:** Goods are located in State A and covered by a certificate of title issued under the law of State A. The State A certificate of title is "clean : it does not reflect a security interest. Owner takes the goods to State B and sells (trades in) the goods to Dealer, who is located (within the meaning of Section 9-307) in State B. As is customary, Dealer retains the duly assigned State A certificate of title pending resale of the goods. Dealer's inventory

financer, SP, obtains a security interest in the goods under its after-acquired property clause.

Under Section 9-311(d) of both State A and State B, Dealer's inventory financer, SP, must perfect by filing instead of complying with a certificate-of-title law. If under Section 9-303(b) the law applicable to perfection of SP's security interest is that of State A, because the goods are covered by a State A certificate, SP would be required to file in State A under State A's Section 9-501. That result would be anomalous, to say the least, since the principle underlying Section 9-311(d) is that the inventory should be treated as ordinary goods.

Section 9-303(b) (and former Section 9-103(2)) should be read as providing that the law of State B, not State A, applies. A court looking to the forum's Section 9-303(b) would find that the subsection applies only if two conditions are met: (i) the goods were "covered by the certificate as explained in Section 9-303(a), i.e., application had been made for a State (here, State A) to issue a certificate of title covering the goods and (ii) the certificate is a "certificate of title as defined in Section 9-102, i.e., a statute "provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor. Stated otherwise, Section 9-303(b) applies only when compliance with a certificate-of-title statute, and not filing, is the appropriate method of perfection. Under the law of State A, *for purposes of perfecting SP's security interest in the dealer's inventory*, the proper method of perfection is filing–not compliance with State A's certificate-of-title act. For that reason, the goods are not covered by a "certificate of title, and the second condition is not met. Thus, Section 9-303(b) does not apply to the goods. Instead, Section 9-301 applies, and the applicable law is that of State B, where the debtor (dealer) is located.

7. **Relation Back.** Section 9-303 assumes that the applicable certificate-of-title act does not have a relation-back provision. A Legislative Note to Section 9-311 recommends the elimination of relation-back provisions in certificate-of-title laws affecting perfection of security interests.

[9-304]

Reporters' Comments

1. **Source.** New. Derived from Section 8-110(e) and former Section 9-103(6).

2. **Deposit Accounts.** Under this section, the law of the "bank's jurisdiction governs perfection and priority of a security interest in deposit

accounts. Subsection (b) contains rules for determining the “bank’s jurisdiction. The substance of these rules is substantially similar to that of the rules determining the “security intermediary’s jurisdiction under former Section 8-110(e), except that subsection (b)(1) provides more flexibility than the analogous provision in former Section 8-110(e)(1). Subsection (b)(1) permits the parties to choose the law of one jurisdiction to govern perfection and priority of security interests and a different governing law for other purposes. Section 8-110(e)(1) (included in Appendix I) has been conformed to subsection (b)(1) of this section, and Section 9-305(b)(1), concerning a commodity intermediary’s jurisdiction, makes a similar departure from former Section 9-103(6)(e)(i).

[9-305]

Reporters’ Comments

1. **Source.** Former Section 9-103(6).

2. **Change from Former Law.** Subsection (b)(1) has been revised to provide more flexibility for the parties to select the commodity intermediary’s jurisdiction. See also Section 9-304(b) (bank’s jurisdiction); Section 8-110(e)(1) (securities intermediary’s jurisdiction) (included in Appendix I).

[9-306]

Reporters’ Comments

1. **Source.** New. Derived in part from Sections 8-110(e) and 9-305 and former Section 9-103(6).

2. ***Sui Generis* Treatment.** This section governs the applicable law for perfection and priority of security interests in letter-of-credit rights, other than a security interest perfected only under Section 9-308(d) (i.e., as a supporting obligation). The treatment differs substantially from that provided in Section 9-304 for deposit accounts. The basic rule is that law of the issuer’s or nominated person’s jurisdiction, derived from the terms of the letter of credit itself, controls perfection and priority, but only if the issuer’s or nominated person’s jurisdiction is a State, as defined in Section 9-102. If the issuer’s or nominated person’s jurisdiction is not a State, the baseline rule of Section 9-301 applies–perfection and priority are governed by the law of the debtor’s location, determined under Section 9-307. Export transactions typically involve a foreign issuer and a domestic nominated person, such as a confirmer, located in a State. The principal goal of this section is to reduce the likelihood that perfection and priority would be governed by the law of a foreign jurisdiction in a transaction that is essentially domestic from the standpoint of the debtor-beneficiary, its creditors, and a domestic nominated person.

3. **Issuer's or Nominated Person's Jurisdiction.** Subsection (b) defers to the rules established under Section 5-116 for determination of an issuer's or nominated person's jurisdiction.

4. **Scope of this Section.** This section addresses only the applicable law for purposes of perfection, the effect of perfection or nonperfection, and priority. Section 5-116 deals with the law applicable to liability, and Article 5 (or other applicable law) deals with the rights and duties of an issuer or nominated person. Stated otherwise, perfection, nonperfection, and priority have no effect on the rights and duties of an issuer or nominated person.

[9-307]

Reporters' Comments

1. **Source.** Former Section 9-103(3)(d), as substantially revised.

2. **General Rule.** As a general matter, the location of the debtor determines the jurisdiction whose law governs perfection of a security interest. See Sections 9-301(1) and 9-305(c). This section determines the location of the debtor. Subsection (b) states the baseline rules: An individual debtor is deemed to be located at the individual's residence with respect to both personal and business assets. Any other debtor is deemed to be located at its place of business if it has only one, or at its chief executive office if it has more than one place of business. As used in this section, a "place of business means a place where the debtor conducts its affairs. See subsection (a). Thus, every organization, even eleemosynary institutions and other organizations that do not conduct "for profit business activities, have a "place of business. See subsection (a)(3). Under subsection (d), a person that ceases to exist, have a residence, or have a place of business continues to be located in the jurisdiction determined by subsection (b). The baseline rule is subject to several exceptions, each of which is discussed below.

3. **Non-U.S. Debtors.** The Reporters' Comments to Section 9-301 explain the shortcomings of former Section 9-103(3)(c), which contains special choice-of-law rules for debtors who are located in a non-U.S. jurisdiction. Under the baseline rule of this section, a non-U.S. debtor normally would be located in a foreign jurisdiction and, as a consequence, foreign law would govern perfection. When foreign law affords no public notice of security interests, the baseline rule yields unacceptable results.

Accordingly, subsection (c) provides that the normal rules for determining the location of a debtor (i.e., the rules in subsection (b)) apply only if they yield a location that is either a State (as broadly defined in Section 9-102) or "a jurisdiction, other than a State, whose law requires information concerning the existence of a security interest to be made publicly available as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. In other cases, the debtor is located in the District of Columbia. Note that the law of the jurisdiction in which the debtor is located governs not only perfection but also, with respect to accounts and other intangible collateral, "the effect of perfection or nonperfection, and the priority of a security interest. Section 9-301(1). With respect to goods and other tangible collateral, these issues are governed by the law of the jurisdiction in which the collateral is located. See Section 9-301(3).

> **Example:** Debtor is an English corporation with 7 offices in the United States and its chief executive office in London, England. Debtor creates a security interest in its accounts. Under subsection (b)(3), Debtor would be located in England. However, subsection (c) provides that subsection (b) applies only if English law conditions perfection on giving public notice. Otherwise, Debtor is located in the District of Columbia. Under Section 9-301(1), perfection, the effect of perfection, and priority are governed by the law of the jurisdiction of the debtor's location–here, England or the District of Columbia (depending on the content of English law).

> **Example:** Debtor is an English corporation with 7 offices in the United States and its chief executive office in London, England. Debtor creates a security interest in equipment located in London. Under subsection (b)(3) Debtor would be located in England. However, subsection (c) provides that subsection (b) applies only if English law conditions perfection on giving public notice. Otherwise, Debtor is located in the District of Columbia. Under Section 9-301(1), perfection is governed by the law of the jurisdiction of the debtor's location, whereas the law of the jurisdiction in which the collateral is located–here, England–governs priority. See Section 9-301(3).

The foregoing discussion assumes that each transaction bears an appropriate relation to the forum State. In the absence of an appropriate relation, the forum State's entire UCC, including the choice-of-law provisions in Article 9 (Sections 9-301 through 9-307), will not apply. See Section 9-109, Comment 8.

4. **Registered Organizations Organized under the Law of a State.** Under subsection (e), a registered organization (e.g., a corporation or limited partnership) organized under the law of a "State (as defined in Section 9-102) is located in its State of organization. Subsection (g) makes clear that events affecting the status of a registered organization, such as the dissolution of a corporation or revocation of its charter, do not affect its location for purposes of subsection (e).

Determining the registered organization-debtor's location by reference to the jurisdiction of organization could provide some important side benefits for the filing systems. A jurisdiction could structure its filing system so that it would be impossible to make a mistake in a registered organization-debtor's name on a financing statement. A filing designating an incorrect corporate name for the debtor would be rejected, for example. Linking filing to the jurisdiction of organization also could reduce pressure on the system imposed by transactions in which registered organizations cease to exist. The jurisdiction of organization might prohibit such transactions unless steps were taken to ensure that existing filings were refiled against a successor or terminated by the secured party.

During discussions of the proposal to change the location of a registered organization to its jurisdiction of organization, concerns were expressed that the change might cause a significant shift in filing revenues from some States to others, and to Delaware in particular. That prospect, it was argued, could render the proposal politically impractical. According to a recent study, however, the impact would not be material. See Lynn M. LoPucki, *Why the Debtor's State of Incorporation Should Be the Proper Place for Article 9 Filing*, 79 Minn. L. Rev. 577 (1995). Professor LoPucki's study also suggests that for the vast majority of filings, the change would have no impact at all. Most collateral, it appears, is located in the same jurisdiction where the debtor is located (and where corporate debtors are incorporated).

5. **Registered Organizations Organized under Law of United States; Branches and Agencies of Banks that Are Not Organized under the Law of the United States.** Subsection (f) specifies the location of a debtor that is a registered organization organized under the law of the United States. It defers to law of the United States, to the extent that that law determines, or authorizes the debtor to determine, the debtor's location. Thus, if the law of the United States designates a particular State as the debtor's location, that State is the debtor's location for purposes of this Article's choice-of-law rules. Similarly, if the law of the United States authorizes the registered organization to designate its State of location, the State that the registered organization designates is the State in which it is located for purposes of this Article's choice-of-law rules. In other cases, the debtor is located in the District of Columbia.

Subsection (f) also determines the location of branches and agencies of banks that are registered organizations and not organized under the law of the United States or a State. However, if all the branches and agencies of the bank are licensed only in one State, then they are located in that State. See subsection (i).

6. **United States.** To the extent that Article 9 governs (see Sections 1-105; 9-109(c)), the United States is located in the District of Columbia for purposes of this Article's choice-of-law rules. See subsection (h).

7. **Foreign Air Carriers.** Subsection (j) follows former Section 9-103(3)(d).

[9-308]

Reporters’ Comments

1. **Source.** Former Sections 9-303, 9-115(2).

2. **General Rule.** Subsection (a) explains that a security interest is perfected only when it has attached and when a required “perfection or “public notice step has been taken. The “except clause refers to the perfection-upon-attachment rules appearing in Section 9-309. It also reflects that other subsections of this section, e.g., subsection (d), contain automatic-perfection rules.

3. **Agricultural Liens.** Subsection (b) is new. It describes the elements of perfection of an agricultural lien.

4. **Supporting Obligations.** Subsection (d) is new. It provides for automatic perfection of a security interest in a supporting obligation for collateral if the security interest in the collateral is perfected. This is unlikely to effect any change in current law.

> **Example:** Buyer is obligated to pay Debtor for goods sold. Buyer’s president guarantees the obligation. Debtor creates a security interest in the right to payment (account) in favor of Lender. Under Section 9-203(f), the security interest attaches to Debtor’s rights under the guarantee (supporting obligation). Under subsection (d), perfection of the security interest in the account constitutes perfection of the security interest in Debtor’s rights under the guarantee.

5. **Right to Payment Secured by Mortgage.** Subsection (e) is new. It deals with the situation in which a mortgagee of real property creates a security interest in an obligation (e.g., a note) secured by a real property mortgage. Section 9-203(g) adopts the traditional view that the transferee of the note acquires the mortgage, as well. This subsection adopts a similar principle: perfection of a security interest in the right to payment constitutes perfection of a security interest in the mortgage securing it.

An important consequence of the rules in Section 9-203(g) and subsection (e) is that, by acquiring a perfected security interest in a mortgage note, the secured party acquires a security interest in the mortgage that is senior to the rights of a person who becomes a lien creditor of the mortgagee (Article 9 debtor). See Section 9-317(a)(2). This result helps prevent the separation of the mortgage from the note.

Under this Article, attachment and perfection of a security interest in a right to payment secured by a mortgage do not of themselves affect the payment obligation of the mortgagor. If, for example, the obligation is evidenced by a negotiable note, then Article 3 dictates the person whom the mortgagor must pay to discharge the mortgage. See Section 3-602. Similarly, this Article does not determine who has the power to release a mortgage of record. That issue is determined by real-property law.

6. **Investment Property.** Subsections (f) and (g) follow former Section 9-115(2).

[9-309]

Reporters' Comments

1. **Source.** Derived from former Sections 9-302(1); 9-115(4)(c), (d); 9-116.

2. **Automatic Perfection.** This section contains the perfection-upon-attachment rules previously located in former Sections 9-302(1), 9-115(4)(c), (d), and 9-116. Rather than continue to state the rule by indirection, this section explicitly provides for perfection upon attachment.

3. **Purchase-money Security Interest in Consumer Goods.** Former Section 9-302(1)(d) has been revised and appears here as paragraph (1). No filing or other step is required to perfect a purchase-money security interest in consumer goods, other than goods that are subject to a statute or treaty described in Section 9-311(a). However, filing is necessary to prevent a buyer of the goods from taking free of the security interest under Section 9-320(b), and a fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9-334.

4. **Payment Intangibles; Promissory Notes.** Paragraph (2) expands upon former subsection (1)(e) by affording automatic perfection to certain assignments of payment intangibles as well as accounts. Paragraphs (3) and (4), which are new, afford automatic perfection to sales of payment intangibles and promissory notes, respectively. They reflect the practice under former Article 9. Under that Article, filing a financing statement does not affect the rights of a buyer of payment intangibles or promissory notes, inasmuch as the Article does cover those sales. To the extent that the exception in paragraph (2) covers outright sales of payment intangibles, which automatically are perfected under paragraph (3), the exception is redundant.

5. **Health-care-insurance Receivables.** Paragraph (5) extends automatic perfection to assignments of health-care-insurance receivables if the assignment is made to the health-care provider that provided the health-care goods or services. The primary effect is that, when an individual transfers a right to payment under an insurance policy to the person who provided health-care goods or services, the provider has no need to file a financing statement against the individual. The normal filing requirements apply to transfers of health-care-insurance receivables from the health-care provider, e.g., to a financer.

6. **Investment Property.** Paragraph (9) replaces the last clause of each subsection of former Section 9-116. Paragraphs (10) and (11) replace former Section 9-115(4)(c) and (d). The last two indicated that, with respect to certain security interests created by a securities intermediary or commodity intermediary, "[t]he filing of a financing statement . . . has no effect for purposes of perfection or priority with respect to that security interest. No change in meaning is intended by the deletion of the quoted phrase.

7. **Beneficial Interests in Trusts.** Under former Section 9-302(1)(c), filing was not required to perfect a security interest created by an assignment of a beneficial interest in a trust. Because beneficial interests in trusts are now used as collateral with greater frequency in commercial transactions, under this Article filing is required to perfect a security interest in a beneficial interest.

[9-310]

Reporters' Comments

1. **Source.** Former Section 9-302(1), (2).

2. **General Rule.** Subsection (a) establishes a central Article 9 principle: Filing a financing statement is necessary for perfection of all security interests and agricultural liens unless subsection (b) specifies otherwise.

3. **Supporting Obligations.** New subsection (b)(1) reflects the rule in new Section 9-308(d), which provides for automatic perfection of a security interest in a supporting obligation for collateral if the security interest in the collateral is perfected.

4. **Perfection upon Attachment.** The perfection-upon-attachment rules of former Section 9-302(1) have been relocated to new Section 9-309, to which subsection (b)(2) now makes reference.

5. **Preemptive Federal Law; Certificate-of-title Acts.** New subsection (b)(3) excepts from the filing requirement property covered by a statute, regulation, or treaty described in Section 9-311(a). Perfection as to this property is governed by Section 9-311(b).

6. **Security Interests Perfected by Control.** Subsection (b)(7) is new. It reflects that a security interest in deposit accounts, electronic chattel paper, investment property, and letter-of-credit rights may be perfected by control under Section 9-314.

7. **Assignments of Perfected Security Interests.** Subsection (c) concerns assignment of a perfected security interest or agricultural lien. It provides that no

filing is necessary in connection with an assignment by a secured party to an assignee in order to maintain perfection as against creditors and transferees of the debtor. Although subsection (c) addresses explicitly only the absence of an additional filing requirement, the same result normally will follow in the case of an assignment of a security interest perfected in a manner other than by filing, such as by control, by possession, or by compliance with a statute, regulation, or treaty under Section 9-311(b). For example, as long as possession of collateral is maintained by an assignee or by the assignor or another person on behalf of the assignee, no further perfection steps need be taken on account of the assignment. Of course, additional action may be required for perfection of the assignee's interest as against creditors and transferees of the *assignor*.

[9-311]

Reporters' Comments

1. **Source.** Former Section 9-302(3), (4).

2. **Federal Statutes, Regulations, and Treaties.** Subsection (a)(1) provides explicitly that the filing requirement of this Article defers only to federal statutes, regulations, or treaties whose requirements for a security interest's obtaining priority over the rights of a lien creditor preempt Section 9-310(a). The provision eschews reference to the term "perfection, inasmuch as Section 9-308 specifies the meaning of that term and a preemptive rule may use other terminology.

3. **Certificate-of-title Statute.** The description of certificate-of-title statutes in subsections (a)(2) and (a)(3) tracks the language of the definition of "certificate of title in Section 9-102.

4. **Inventory Covered by a Certificate of Title.** Under subsection (d), perfection of a security interest in the inventory of a dealer is governed by the normal perfection rules, even if the inventory is covered by a certificate of title. Under former Section 9-302(3), a secured party who finances a dealer may need to perfect by filing for goods held for sale and by compliance with a certificate-of-title statute for goods held for lease. In some cases, this may require notation on thousands of certificates. The problem is compounded by the fact that dealers, particularly of automobiles, often do not know whether a particular item of inventory will be sold or leased. Under subsection (d), notation is both unnecessary and ineffective.

The filing and other perfection provisions of this Article apply to goods covered by a certificate of title only "during any period in which collateral is inventory held for sale or lease or leased. If the debtor takes goods of this kind out of inventory and uses them, say, as equipment, a filed financing statement would not remain effective to perfect a security interest.

The phrase “held for sale or lease or leased by a person who is in the business of selling or leasing goods is intended to include inventory in the possession of a lessee from a dealer. The definition of “inventory (former Section 9-101(4)) contains a similar phrase, but omits any reference to goods that are “leased. Section 9-102 conforms the definition of “inventory to Section 9-311(d) by including a reference to “leased goods. (See also former Section 9-103(3)(a), which seems to distinguish goods “leased and goods “held for lease.)

5. **Compliance with Perfection Requirements of Other Statute as Equivalent to Filing.** Subsection (b) clarifies former Section 9-302(4) by providing that compliance with the perfection requirements (i.e., the requirements for obtaining priority over a lien creditor), but not other requirements, of a statute, regulation, or treaty described in subsection (a) (former Section 9-302(3)) “is equivalent to the filing of a financing statement.

The meaning of the quoted phrase currently is unclear, and many questions have arisen concerning the extent to which and manner in which Article 9 rules referring to “filing are applicable to perfection by compliance with a certificate-of-title statute. This Article takes a variety of approaches for applying Article 9's filing rules to compliance with other statutes and treaties. First, as discussed in Comment 6 below, it leaves the determination of some rules, such as the rule establishing time of perfection (Section 9-516(a)), to the other statutes themselves. Second, this Article explicitly applies some Article 9 filing rules to perfection under other statutes or treaties. See, e.g., Section 9-505. Third, this Article makes other Article 9 rules applicable to security interests perfected by compliance with another statute through the “equivalent to . . . filing provision in the first sentence of Section 9-311(b). The third approach will be reflected for the most part in the Official Comments. Official Comments could be added to various sections to explain how particular rules apply when perfection is accomplished under Section 9-311(b). In the alternative, the Official Comments to Section 9-311 could be expanded to explain the “equivalent to . . . filing concept as making applicable to the other statutes and treaties all references in Article 9 to “filing, “financing statement, and the like.

6. **Compliance with Perfection Requirements of Other Statute.** Subsection (b) makes clear that compliance with the perfection requirements (i.e., the requirements for obtaining priority over a lien creditor), but not other requirements, of a statute, regulation, or treaty described in subsection (a) is sufficient for perfection under this Article.

The interplay of this section with the certain certificate-of-title acts may create confusion and uncertainty. For example, acts under which perfection does not occur until a certificate of title is issued will create a gap between the time that the goods are covered by the certificate under Section 9-303 and the time of perfection. If the gap is long enough, it may result in turning some unobjectionable transactions into avoidable preferences under Bankruptcy Code § 547. (The preference risk arises if more than ten days (or 20 days, in the case of a purchase-money security interest) passes between the time a security interest attaches (or the debtor receives possession of the collateral, in the case of a purchase-money security interest) and the time it is perfected.) Accordingly, the Legislative Note to this section instructs the legislature to amend the applicable certificate-of-title act to provide that perfection occurs upon receipt by appropriate State officials of a properly tendered application for a certificate of title on which the security interest is to be indicated.

Under some certificate-of-title statutes, including the Uniform Motor Vehicle Certificate of Title and Anti-Theft Act, perfection generally occurs upon delivery of specified documents to a state official but may, under certain circumstances, relate back to the time of attachment. This relation-back feature can create great difficulties for the application of the rules in Sections 9-303 and 9-311(b). Accordingly, the Legislative Note recommends to legislatures that they remove any relation-back provisions from certificate-of-title laws affecting security interests.

7. **Perfection by Possession of Goods Covered by a Certificate-of-title Statute.** A secured party that has perfected a security interest under the law of State A in goods that subsequently are covered by a State B certificate of title may face a predicament. Ordinarily, the secured party will have four months under State B's Section 9-316(c) and (d) in which to (re)perfect as against a purchaser of the goods by having its security interest noted on a State B certificate. This procedure is likely to require the cooperation of the debtor and any competing secured party whose security interest has been noted on the certificate. Official Comment 4(e) to former Section 9-103 observes that "that cooperation is not likely to be forthcoming from an owner who wrongfully procured the issuance of a new certificate not showing the out-of-state security interest, or from a local secured party finding himself in a priority contest with the out-of-state secured party. According to the Comment, "[t]he only solution for the out-of-state secured party under present certificate of title laws seems to be to reperfect by possession, i.e., by repossessing the goods. But the "solution may not work: Former Section 9-302(4) provides that a security interest in property subject to a certificate-of-title statute "can be perfected only by compliance therewith.

Sections 9-316(d) and (e), 9-311(c), and 9-313(b) of this Article resolve the conflict by providing that a security interest that remains perfected solely by virtue of Section 9-316(e) can be (re)perfected by the secured party's taking possession of the collateral. These sections contemplate only that taking possession of goods covered by a certificate of title will work as a method of perfection. None of these sections creates a right to take possession. Section 9-609 and the agreement of the parties define the secured party's right to take possession.

[9-312]

Reporters’ Comments

1. **Source.** Former Section 9-304, with additions and some minor changes.

2. **Instruments.** Under subsection (a), a security interest in instruments may be perfected by filing. This security interest is subject to defeat by subsequent purchasers (including secured parties). Section 9-331 provides that filing a financing statement does not constitute notice that would preclude a subsequent purchaser from becoming a holder in due course and taking free of all claims under Section 3-306. Moreover, under Section 9-330(d), purchasers for value who take possession of an instrument generally would achieve priority over a security interest in the instrument perfected by filing.

3. **Deposit Accounts**. Under new subsection (b)(1), the only means of perfecting a security interest in a deposit account as original collateral is by control. Filing is ineffective, except as provided in Section 9-315 with respect to proceeds. As defined in Section 9-104, “control can arise as a result of an agreement among the secured party, debtor, and bank, whereby the last agrees to comply with instructions of the first with respect to disposition of the funds on deposit, even though the debtor retains the right to direct disposition of the funds. Thus, subsection (b)(1) takes an intermediate position between certain non-UCC law, which conditions the effectiveness of a security interest on the secured party’s enjoyment of such dominion and control over the deposit account that the debtor is unable to dispose of the funds, and the approach this Article takes to securities accounts (approved by the Conference as part of the Article 8 revisions in 1994), under which a secured party who is unable to reach the collateral without resort to judicial process may perfect by filing. By conditioning perfection on “control, subsection (b)(1) accommodates the views of those who think that a secured party who wishes to rely upon a deposit account should take steps to be able to reach the funds upon the debtor’s default without having to resort to the judicial process. It also accommodates those who think that a more stringent perfection requirement--e.g., requiring the secured party to achieve absolute dominion and control, to the exclusion of the debtor--would prevent perfection in transactions in which the secured party actually relies on the deposit account and maintains some meaningful control over it.

4. **Letter-of-credit Rights.** Letter-of-credit rights commonly are “supporting obligations, as defined in Section 9-102. Perfection as to the related account, chattel paper, document, instrument, general intangible, or investment property will perfect as to the letter-of-credit rights. See Section 9-308(d). Subsection (b)(2) provides, except for perfection under Section 9-308(d) as supporting obligations, a security interest in a letter-of-credit right may be perfected only by control. “Control, for these purposes, is explained in Section 9-107.

5. **Goods in Possession of Bailee.** Subsection (c) applies to goods in the possession of a bailee that has issued a negotiable document. The rule in subsection (d) has been limited to goods in the possession of a bailee that has issued a nonnegotiable document of title, including a document of title that is “non-negotiable under Section 7-104. Section 9-313 governs perfection of a security interest in goods in the possession of a bailee that has not issued a document of title.

Subsection (c) clarifies the perfection and priority rules in former Section 9-304(2). Under the former, a security interest in goods covered by a negotiable document may be perfected by perfecting a security interest in the document. The security interest also may be perfected by another method, e.g., by filing. The priority rule governs only priority between (i) a security interest in goods which is perfected by perfecting in the document and (ii) a security interest in the goods which becomes perfected by another method while the goods are covered by the document

> **Example 1:** While wheat is in a grain elevator and covered by a negotiable warehouse receipt, Debtor creates a security interest in the wheat in favor of SP-1 and SP-2. SP-1 perfects by filing a financing statement covering “wheat. Thereafter, SP-2 perfects by filing a financing statement describing the warehouse receipt. Subsection (c)(1) provides that SP-2's security interest is perfected. Subsection (c)(2) provides that SP-2's security interest is senior to SP-1's.

> **Example 2:** The facts are as in Example 1, but SP-1's security interest attached and was perfected before the goods were delivered to the grain elevator. Subsection (b)(2) does not apply, because SP-2's security interest did not become perfected during the time that the wheat was in the possession of a bailee. Rather, the first-to-file-or-perfect priority rule applies. See Section 9-322.

The perfection step under subsection (d) occurs when the bailee receives notification of the secured party’s interest in the goods, regardless of who sends the notification. Receipt of notification is effective to perfect regardless of whether the bailee attorns to the secured party. Compare Section 9-313(c) (perfection by possession as to goods not covered by a document requires bailee’s acknowledgment).

6. **Maintaining Perfection After Surrendering Possession.** The temporary-perfection rule in former Section 9-304(5) has been divided between subsections (f) and (g). “Enforcement has been added in subsection (g) as one of the special and limited purposes for which a secured party can release an instrument or certificated security to the debtor and still remain perfected.

7. **Length of Temporary Perfection.** The time periods in subsections (e), (f), (g), and (h) have been reduced from to 21 to 20 days, which is the time period generally applicable in this Article.

[9-313]

Reporters' Comments

1. **Source.** Former Sections 9-305; 9-115(6).

2. **Certificated Securities.** The second sentence of subsection (a) reflects the traditional rule for perfection of a security interest in certificated securities. Compare Sections 9-115(4)(a), 8-106(a), 9-115(6) (1994 Official Text); Sections 8-321, 8-313(1)(a) (1978 Official Text); Section 9-305 (1972 Official Text). It has been modified to refer to "delivery under Section 8-301. For delivery to occur when a person other than a secured party holds possession for the secured party's benefit, the person may not be a securities intermediary. Corresponding changes appear in Section 9-203(b). The Official Comments should explain that subsections (e) and (f) apply to a person in possession of security certificates or holding security certificates for the secured party under Section 8-301.

Under new subsection (e), a possessory security interest in a certificated security remains perfected until the debtor obtains possession of the security certificate. This rule is analogous to that of Section 9-314(c), which deals with perfection of security interests in investment property by control. See Section 9-314, Comment 3.

3. **Goods Covered by a Certificate of Title.** Subsection (b) is necessary to effect changes to the choice-of-law rules governing goods covered by a certificate of title. These changes are described in the Reporters' Comments to Section 9-311. Subsection (b), like subsection (a), does not create a right to take possession. Rather, it indicates the circumstances under which the secured party's taking possession of goods covered by a certificate of title is effective to perfect a security interest in the goods.

4. **Goods in Possession of a Third Party: Perfection.** Former Section 9-305 permits perfection of a security interest by notification to a bailee in possession of collateral. This Article distinguishes between goods in the possession of a bailee that has issued a document of title covering the goods and goods in the possession of a third party that has not issued a document. Section 9-312(c) or (d) applies to the former, depending on whether the document is negotiable; Section 9-313(c) applies to the latter.

Notification of a third person does not suffice to perfect under Section 9-313(c). Rather, perfection does not occur unless the third person authenticates an acknowledgment that it holds possession of the collateral for the secured party's benefit. Compare Section 9-312(d), under which receipt of notification of the security party's interest by a bailee holding goods covered by a nonnegotiable document is sufficient to perfect, even if the bailee does not acknowledge receipt of the notification. A third person may acknowledge that it will hold for the secured party's benefit goods to be received in the future. Under these circumstances, perfection by possession occurs when the third person obtains possession of the goods.

Under subsection (c), acknowledgment of notification by a lessee in ordinary course of business (as defined in Section 2A-103) does not suffice for possession. The section thus rejects the reasoning of *In re Atlantic Systems, Inc.*, 135 B.R. 463 (Bankr. S.D.N.Y. 1992) (holding that notification to debtor-lessor's lessee sufficed to perfect security interest in leased goods). See Steven O. Weise, *Perfection by Possession: The Need for an Objective Test*, 29 Idaho Law Rev. 705 (1992-93) (arguing that lessee's possession in ordinary course of debtor-lessor's business does not provide adequate public notice of possible security interest in leased goods). Inclusion of a per se rule concerning lessees is not meant to preclude a court, under appropriate circumstances, from determining that a third person is so closely connected to or controlled by the debtor that the debtor has retained effective possession. If so, the third person's acknowledgment would not be sufficient for perfection.

5. **Goods in Possession of a Third Party: No Duty to Acknowledge; Consequences of Acknowledgment.** Subsections (f) and (g) are new and address matters as to which former Article 9 is silent. They derive in part from Section 8-106(g). Subsection (f) provides that a person in possession of collateral is not required to acknowledge that it holds for a secured party. Subsection (g)(1) provides that an acknowledgment is effective even if wrongful as to the debtor. Subsection (g)(2) makes clear that an acknowledgment does not give rise to any duties or responsibilities under this Article. Arrangements involving the possession of goods are hardly standardized. They include bailments for services to be performed on the goods (such as repair or processing), for use (leases), as security (pledges), for carriage, and for storage. This Article leaves to the agreement of the parties and to any other applicable law the imposition of duties and responsibilities upon a person who acknowledges under subsection (c). For example, by acknowledging, a third party does not become obliged to act on the secured party's direction or to remain in possession of the collateral unless it agrees to do so or other law so provides.

6. **"Possession."** This section does not define "possession. In determining whether a particular person has possession, the principles of agency apply. For example, if the collateral clearly is in possession of an agent of the secured party for the purposes of possessing on behalf of the secured party, and if the agent is not also an agent of the debtor, the secured party has taken actual possession without the need to rely on a third-party acknowledgment. However, if

the agent is an agent of both the secured party and the debtor, prudence might suggest that the secured party obtain the agent's acknowledgment in order to ensure perfection by possession.

7. **Delivery to Third Party by Secured Party.** New subsection (h) addresses the practice of mortgage warehouse lenders. These lenders typically send mortgage notes to prospective purchasers under cover of letters advising the prospective purchasers that the lenders hold security interests in the notes. The lenders rely on notification to maintain perfection under former 9-305. They have expressed the view that requiring them to obtain authenticated acknowledgments from each prospective purchaser under subsection (c) would be unduly burdensome and disruptive of their established practices. Under subsection (h), when a secured party in possession itself delivers the collateral to a third party, instructions to the third party would be sufficient to maintain perfection by possession; an acknowledgment would not be necessary. Under subsection (i), the secured party does not relinquish possession even if the delivery violates the rights of the debtor. That subsection also makes clear that a person to whom collateral is delivered under subsection (h) does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this Article provides otherwise.

[9-314]

Reporters' Comments

1. **Source.** New.

2. **Control.** This section provides for perfection by control with respect to investment property, deposit accounts, letter-of-credit rights, and electronic chattel paper. For explanations of how a secured party takes control of these types of collateral, see Sections 9-104 through 9-107.

3. **Investment Property.** Subsection (c) provides a special rule for investment property. Once a secured party has control, its security interest remains perfected by control until the secured party ceases to have control and the debtor receives possession of collateral that is a certificated security, becomes the registered owner of collateral that is an uncertificated security, or becomes the entitlement holder of collateral that is a security entitlement. The result is particularly important in the "repledge context. See Section 9-207, Comment 5.

In a transaction in which a secured party that has control grants a security interest in investment property or sells outright the investment property, a purchaser from the secured
party typically will cut off the debtor's rights in the investment property or be immune from the

debtor’s claims. See Sections 8-303 (protected purchaser); 8-502 (acquisition of a security entitlement); 8-503(e) (action by entitlement holder). If the investment property is a security, the debtor normally would retain no interest in the security, and a claim of the debtor against the secured party for redemption (Section 9-623) or otherwise with respect to the security would be a purely personal claim. If the investment property transferred by the secured party is a financial asset in which the debtor had a security entitlement credited to a securities account maintained with the secured party as a securities intermediary, the debtor’s claim could arise as a part of its securities account notwithstanding its personal nature. (This claim would be analogous to a “cash balance in the securities account.) In the case in which the debtor may retain an interest in investment property notwithstanding a repledge or sale by the secured party, subsection (c) makes clear that the security interest will remain perfected by control.

[9-315]

Reporters’ Comments

1. **Source.** Former Section 9-306.

2. **Continuation of Security Interest or Agricultural Lien Following Disposition of Collateral: Effect of Secured Party’s Authorization.** Subsection (a)(1), which derives from former Section 9-306(2), contains the general rule that a security interest survives disposition of the collateral. The general rule does not apply if the secured party authorized the disposition. Subsection (a)(1) makes explicit that the authorized disposition to which it refers is an authorized disposition “free of security interests. See PEB Commentary No. 3. The change in language is not intended to address the frequently-litigated situation in which the effectiveness of the secured party’s consent to a disposition is conditioned upon the secured party’s receipt of the proceeds. In that situation, subsection (a) would leave the determination of authorization to the courts, as under current law.

3. **Continuation of Security Interest or Agricultural Lien Following Authorized Dispositions: Entrustment.** The general rule that a security interest survives disposition does not apply if the secured party entrusts goods-collateral to a merchant who deals in goods of that kind and the merchant sells the collateral to a buyer in ordinary course of business. Section 2-403(2) gives the merchant the power to transfer all the secured party’s rights to the buyer, even if the sale is wrongful as against the secured party. Thus, under subsection (a)(1), an entrusting secured party runs the same risk as any other entruster.

4. **Identifiability; Tracing.** Subsection (b) is new. It indicates when proceeds commingled with other property are identifiable proceeds. The “equitable principles to which subsection (b)(2) refers may include the “lowest intermediate balance rule. See Restatement of Trusts, Second, § 202.

5. **Automatic Perfection in Proceeds.** This Article extends the period of automatic perfection in proceeds from 10 days to 20 days. Generally, a security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds. See subsection (d). The loss of perfected status under subsection (d) is prospective only. Compare, e.g., Section 9-515(c) (deeming security interest unperfected retroactively).

a. **Proceeds Acquired with Cash Proceeds.** Subsection (d)(1) derives from former Section 9-306(3)(a). It carries forward the basic rule that a security interest in proceeds remains perfected beyond the period of automatic perfection if a filed financing statement covers the original collateral (e.g., inventory) and the proceeds are collateral in which a security interest may be perfected by filing in the office where the financing statement has been filed (e.g., equipment). A different rule applies if the proceeds are acquired with cash proceeds, as is the case if the original collateral (inventory) is sold for cash (cash proceeds) that is used to purchase equipment (proceeds). Under these circumstances, the security interest in the equipment proceeds remains perfected only if the description in the filed financing indicates the type of property constituting the proceeds (equipment). This draft reaches the same result but takes a different approach. It recognizes that the treatment of proceeds acquired with cash proceeds under former Section 9-306(3)(a) essentially was superfluous. In the example, had the filing covered “equipment as well as “inventory, the security interest in the proceeds would have been perfected under the usual rules governing after-acquired equipment (see former Sections 9-302, 9-303); paragraph (3)(a) added only an exception to the general rule. Subsection (d)(1)(C) of this section takes a more direct approach. It makes the general rule of continued perfection inapplicable to proceeds acquired with cash proceeds, leaving perfection of a security interest in those proceeds to the generally applicable perfection rules.

Security interests in the proceeds of bank accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are not “deposit accounts, would be governed by the rules applicable to proceeds of instruments generally.

b. **Continuation of Perfection in Cash Proceeds.** Former subsection (3)(b) provides that if a filed financing statement covers original collateral, a security interest in cash proceeds of the collateral remains perfected beyond the ten-day period of automatic perfection. Subsection (d)(2) extends the benefits of former paragraph (3)(b) to proceeds of original collateral in which a security interest is perfected by a method other than filing. This subsection provides that if the security interest in the original collateral was perfected, a security interest in identifiable cash proceeds will remain perfected indefinitely, regardless of whether the security interest in the original collateral remains perfected.

6. **Transferees of Cash Proceeds.** The former text of and Official Comments to Section 9-306 do not deal adequately with the rights of a person to

whom the debtor has transferred cash proceeds, such as a person who receives payment of a check drawn on a deposit account constituting proceeds. Section 9-332 addresses this issue.

7. **Insolvency Proceedings; Returned and Repossessed Goods.** This Article deletes former subsection (4), which deals with proceeds in insolvency proceedings, and former subsection (5), which deals with returned and repossessed goods. In the absence of former Section 9-306(5), Official Comments to Section 9-330 will explain and clarify the application of priority rules to returned and repossessed goods as proceeds of chattel paper.

8. **Lapse or Termination of Financing Statement During 20-day Period.** Subsection (f) provides that a security interest in proceeds perfected under subsection (d)(1) ceases to be perfected when the financing statement covering the original collateral lapses or is terminated. If the lapse or termination occurs before the 21st day after the security interest attaches, however, the security interest in the proceeds remains perfected until the 21st day. Section 9-311(b) provides that compliance with the perfection requirements of a statute or treaty described in Section 9-311(a) “is equivalent to the filing of a financing statement. It follows that collateral subject to a security interest perfected by such compliance under Section 9-311(b) is covered by a “filed financing statement within the meaning of Section 9-315(d) and (e).

9. **Proceeds of Collateral Subject to Agricultural Lien.** This Article does not determine whether a lien extends to proceeds of farm products encumbered by an agricultural lien. If, however, the proceeds are themselves farm products on which an “agricultural lien (as defined in Section 9-102) arises under other law, then the agricultural-lien provisions of this Article apply to the agricultural lien on the proceeds in the same way in which they would apply had the farm products not been proceeds.

[9-316]

Reporters’ Comments

1. **Source.** Former Section 9-103(1)(d), (2)(b), (3)(e), as modified.

2. **Continued Perfection.** This section deals with continued perfection of security interests that have been perfected under the law of another jurisdiction. The fact that the law of a particular jurisdiction ceases to govern perfection under Sections 9-301 through 9-307 does not necessarily mean that a security interest perfected under that law automatically becomes unperfected. This section generally provides that a security interest perfected under the law of one jurisdiction remains perfected for a fixed period of time (four months or one year, depending on the circumstances), even though the jurisdiction whose law governs perfection changes.

However, cessation of perfection under the law of the original jurisdiction cuts short the fixed period. If a secured party properly reperfects a security interest before it becomes unperfected under subsection (a), then the security interest remains perfected thereafter. See subsection (b).

Example 1: Debtor is a general partnership whose chief executive office is in Pennsylvania. Lender perfects a security interest in Debtor's equipment by filing in Pennsylvania. On April 1, 2002, Debtor moves its chief executive office to New Jersey. Ordinarily, Lender's security interest remains perfected for four months after the move. See subsection (a)(2). However, if the financing statement was filed on May 15, 1997, and its effectiveness lapses under Pennsylvania law in May, 2002, then Lender's security interest becomes unperfected upon lapse. See subsection (a)(1).

Example 2: Under the facts of Example 1, Lender files a financing statement in New Jersey before the effectiveness of the Pennsylvania financing statement lapses. Under subsection (b), Lender's security interest is continuously perfected beyond May, 2002.

Subsections (a)(3) and (a)(4) allow a one-year period in which to reperfect. The longer period is necessary because even with the exercise of due diligence, the secured party may be unable to discover the occurrence of the events to which those subsections refer.

Example 3: Debtor is a Pennsylvania corporation. Lender perfects a security interest in Debtor's equipment by filing in Pennsylvania. Debtor's shareholders decide to reincorporate in Delaware. They form a Delaware corporation (Newcorp) into which they merge Debtor. The merger effectuates a transfer of the collateral from Debtor to Newcorp, a debtor located in another jurisdiction. Under subsection (a)(3), the security interest remains perfected for one year after the merger. If a financing statement is filed against Newcorp within the year following the merger, then the security interest remains perfected thereafter.

3. **Retroactive Unperfection.** Subsection (b) sets forth the consequences of the failure to reperfect before perfection ceases under subsection (a): the security interest becomes unperfected prospectively and, as against purchasers for value but not as against donees or lien creditors, retroactively. The rule applies to agricultural liens, as well. See also Section 9-516 (taking the same approach with respect to lapse). Although this approach creates the potential for circular priorities, the alternative–retroactive unperfection against lien creditors–would create substantial and unjustifiable preference risks.

Example 4: Under the facts of Example 3, six months after the merger, Buyer bought from Newcorp some equipment formerly owned by Debtor. At the time of the purchase, Buyer took subject to Lender's perfected security interest, of which Buyer was unaware. See Section 9-315(a)(1). However, subsection (b) provides that if Lender fails to reperfect in Delaware within a year after the merger, its security interest becomes unperfected and is deemed never to have been perfected against Buyer. Under Section 9-317(b), having given value and received delivery of the equipment without knowledge of the security interest and before it was perfected, Buyer would take free of the security interest.

Example 5: Under the facts of Example 3, one month before the merger, Debtor created a security interest in a piece of equipment in favor of Financer, who perfected by filing in Pennsylvania. At that time, Financer's security interest is subordinate to Lender's. See Section 9-322(a)(1). Financer reperfects by filing in Delaware within a year after the merger, but Lender fails to do so. Under subsection (b), Lender's security interest is deemed never to have been perfected against Financer, a purchaser for value. Consequently, under Section 9-322(a)(2), Financer's security interest is senior.

4. **Goods Covered by a Certificate of Title.** Subsections (d) and (e) address continued perfection of a security interest in goods covered by a certificate of title.

Example 6: Debtor's automobile is covered by a certificate of title issued by Illinois. Lender perfects a security interest in the automobile by complying with Illinois' certificate-of-title statute. Thereafter, Debtor applies for a certificate of title in Indiana. Six months thereafter, Creditor acquires a judicial lien on the automobile. Under Section 9-303(b), Illinois law ceases to govern perfection; rather, Indiana law governs. Nevertheless, under Indiana's Section 9-316(d), Lender's security interest remains perfected until it would become unperfected under Illinois law had no certificate of title been issued by Indiana. Thus, unless Illinois law provides that Lender's security interest would have become unperfected regardless of the issuance of the Indiana certificate of title, Lender's security interest is senior to Creditor's judicial lien.

Example 7: Under the facts in Example 6, five months after Debtor applies for an Indiana certificate of title, Debtor sells the automobile to Buyer. Under subsection (e)(2), because Lender did not reperfect within the four months after the goods became covered by the Indiana certificate of title, Lender's security interest is deemed never to have been perfected against Buyer. Under Section 9-317(b), Buyer is likely to take free of the security interest. Lender could have protected itself by perfecting its security interest either under Indiana's certificate-of-title statute, see Section 9-311, or by taking possession of the automobile, if it had a right to do so. See Section 9-313(b).

5. **Deposit Accounts, Letter-of-Credit Rights, and Investment Property.** Subsections (f) and (g) address changes in the jurisdiction of a bank, issuer of or nominated person with respect to a letter of credit, securities intermediary, and commodity intermediary. The provisions are analogous to those of subsections (a) and (b).

6. **Agricultural Liens.** This section does not apply to agricultural liens.

Example 8: Supplier holds an agricultural lien on corn. The lien arises under an Iowa statute. Supplier perfects by filing a financing statement in Iowa, where the corn is located. See Section 9-302. Debtor stores the corn in Missouri. Assume the Iowa agricultural lien survives or an agricultural lien arises under Missouri law (matters that this Article does not govern). Once the corn is located in Missouri, Missouri becomes the jurisdiction whose law governs perfection. See Section 9-302. Thus, the agricultural lien will not be perfected unless Supplier files a financing statement in Missouri.

[9-317]

Reporters' Comments

1. **Source.** Former Section 9-301.

2. **Filed but Unattached Security Interests.** Under former Section 9-301(1)(b), a lien creditor's rights have priority over an unperfected security interest. Perfection requires attachment (former Section 9-303) and attachment requires the giving of value (former Section 9-203). It follows that, if a secured party has filed a financing statement but has not yet given value, an intervening lien creditor whose lien arises after filing but before attachment of the security interest acquires rights that are senior to those of the secured party that later gives value. This result comports with the *nemo dat* concept: When the security interest attaches, the collateral is already subject to the judicial lien.

On the other hand, this result treats the first secured advance differently from all other advances. The special rule for future advances in Section 9-323(b) (former Section 9-301(d)) affords priority to a discretionary advance made by a secured party within 45 days after the lien creditor's rights arise as long as the secured party is "perfected when the lien creditor's lien arises–i.e., so long as the advance is not the first one and an earlier advance has been made.

Subsection (a)(2) revises former Section 9-301(1)(b) and treats the first advance the same as subsequent advances. That is, a judicial lien that arises after a financing statement is filed and before the security interest attaches and becomes perfected is subordinate to all advances secured by the security interest.

3. **Security Interests of Consignors and Receivables Buyers.** “Security interest is defined in Section 1-201(37) to include the interest of a true consignor and the interest of a buyer of certain receivables (accounts, chattel paper, payment intangibles, and promissory notes). A consignee or a seller of accounts or chattel paper each has rights in the collateral that a lien creditor may reach, as long as the competing security interest of the consignor or buyer is unperfected. This is so even though the debtor-consignee or debtor-seller may not have any rights in the collateral as between it and the consignor or buyer. See Sections 9-318 (seller); 9-319 (consignee). (Security interests arising from sales of payment intangibles and promissory notes are automatically perfected. See Section 9-309. Accordingly, a lien creditor cannot take priority over the rights of the buyer.)

4. **Receivables Buyers That Are Not Secured Parties.** A buyer of accounts, chattel paper, payment intangibles, or promissory notes can be a person “which is not a secured party under subsection (b) or (d) only in a transaction that is excluded from Article 9 by Section 9-109.

5. **Agricultural Liens.** Subsections (a), (b), and (c) subordinate unperfected agricultural liens in the same fashion that they subordinate unperfected security interests.

6. **Purchase-money Security Interests.** Subsection (e) derives from former Section 9-301(2). It provides that, if a purchase-money security interest is perfected by filing no later than 20 days after the debtor receives delivery of the collateral, the security interest takes priority over the rights of buyers, lessees, or lien creditors which arise between the time the security interest attaches and the time of filing. Subsection (e) differs from former Section 9-301(2) in two significant respects. First, subsection (e) protects a purchase-money security interest against all buyers and lessees, not just against transferees in bulk. Second, subsection (e) conditions this protection on filing within 20, as opposed to ten, days after delivery.

7. **“Receives Delivery.”** The Official Comments should clarify when a debtor “receives delivery of collateral for purposes of subsections (b), (c), and (e).

[9-318]

Reporters’ Comments

1. **Source.** New.

2. **Buyers of Accounts and Chattel Paper.** Section 1-201(37) defines “security interest to include the interest of a buyer of accounts or chattel paper. This section provides that if the buyer’s security interest is unperfected, then for purposes of determining the rights of third parties, the seller (debtor) has all rights

and title that the seller sold. The seller has these rights even though, as between the parties, it has sold all its rights to the buyer. As a consequence of this section, the seller can transfer and the creditors of the seller can reach the account or chattel paper as if it had not been sold.

> **Example:** D sells accounts or chattel paper to B-1 and retains no interest in them as against B-1. B-1 does not file a financing statement. D then sells the same receivables to B-2. B-2 files a proper financing statement. Having sold the receivables to B-1, D would not appear to have any rights in the collateral so as to permit B-2's security (ownership) interest to attach. Nevertheless, under this section, for purposes of determining the rights of D's creditors, D has the rights that D sold. Accordingly, B-2's security interest attaches, is perfected by the filing, and is senior to B-1's interest.

3. **Effect of Perfection.** If the security interest of a buyer of accounts or chattel paper is perfected, the seller normally would not retain any property rights in the accounts or chattel paper.

[9-319]

Reporters' Comments

1. **Source.** New.

2. **Consignments.** This section takes an approach to consignments similar to that taken by Section 9-318 with respect to buyers of accounts and chattel paper. Revised Section 1-201(37), reproduced in Appendix I, defines "security interest to include the interest of a consignor of goods under many true consignments. Section 9-319(a) provides that, for purposes of determining the rights of third parties, the consignee acquires all rights and title that the consignor had, if the consignor's security interest is unperfected. The consignee acquires these rights even though, as between the parties, it purchases a limited interest in the goods (as would be the case, e.g., in a true consignment, under which the consignee acquires only the interest of a bailee). As a consequence of this section, creditors of the consignee can acquire judicial liens and security interests in the goods. Former Section 9-114 contained priority rules applicable to security interests in consigned goods. Under this Article, the priority rules for purchase-money security interests in inventory apply to consignments. See Section 9-103(d). Accordingly, a special section containing priority rules for consignments no longer is needed. Section 9-317 determines whether the rights of a judicial lien creditor are senior to the interest of the consignor, Sections 9-322 and 9-324 govern competing security interests in consigned goods, and Sections 9-317, 9-315, and 9-320 determine whether a buyer takes free of the consignor's interest.

Example 1: SP-1 delivers goods to D in a transaction that constitutes a “consignment as defined in Section 9-102. SP-1 does not file a financing statement. D then grants a security interest in the goods to SP-2. SP-2 files a proper financing statement. Assuming D is a mere bailee, as in a “true consignment, D would not appear to have any rights in the collateral (beyond those of a bailee) so as to permit SP-2’s security interest to attach to the greater rights. Nevertheless, under this section, for purposes of determining the rights of D’s creditors, D acquires SP-1's rights. Accordingly, SP-2’s security interest attaches, is perfected by the filing, and is senior to SP-1’s interest.

Insofar as creditors of the consignee are concerned, this Article to a considerable extent reformulates the former law, which appears in former Sections 2-326 and 9-114, without changing the results. However, neither Article 2 nor former Article 9 specifically addresses the rights of non-ordinary course buyers from the consignee.

3. **Effect of Perfection.** Subsection (b) contains a special rule with respect to consignments that are perfected. If application of this Article would result in the consignor having priority over a competing creditor, then other law determines the rights and title of the consignee.

Example 2: SP-1 delivers goods to D in a transaction that constitutes a “consignment as defined in Section 9-102. SP-1 files a proper financing statement. D then grants a security interest in the goods to SP-2. Under the priority rules of this part, SP-1's security interest would be senior to SP-2's. Subsection (b) indicates that, for purposes of determining SP-2's rights, other law determines the rights and title of the consignee. If, for example, a consignee obtains only the special property of a bailee, then SP-2's security interest would attach only to that special property.

Example 3: SP-1 obtains a security interest in all D’s existing and after-acquired inventory. SP-1 perfects its security interest with a proper filing. Then SP-2 delivers goods to D in a transaction that constitutes a “consignment as defined in Section 9-102. SP-2 files a proper financing statement but does not send notification to SP-1 under Section 9-324(a). Accordingly, SP-2's security interest is junior to SP-1's under Sections 9-322(a). Under Section 9-319(b), D has the consignor’s rights and title, so that SP-1's security interest attaches to SP-2's ownership interest in the goods. Thereafter, D grants a security interest in the goods to SP-3, and SP-3 perfects. Because SP-2's perfected security interest is senior to SP-3's under Section 9-322(a), subsection (b) applies. Other law determines D’s rights and title to the goods insofar as SP-3 is concerned, and SP-3's security interest attaches to those rights.

[9-320]

Reporters’ Comments

1. **Source.** Former Section 9-307.

2. **Possessory Security Interests.** Subsection (e) is new. It rejects the holding of *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 350 N.E.2d 590 (N.Y. 1976) and, together with Section 9-317(b), prevents a buyer of collateral from taking free of a security interest if the collateral is in the possession of the secured party. “The secured party referred in subsection (e) is the holder of the security interest referred to in subsection (a) or (b). Section 9-313 determines whether a secured party is in possession for purposes of this section. Under some circumstances, Section 9-313 provides that a secured party is in possession of collateral even if the collateral is in the physical possession of a third party.

3. **Oil, Gas, and Other Minerals.** Under subsection (d), a buyer in ordinary course of business of minerals at the wellhead or minehead or after extraction takes free of a security interest created by the seller. This subsection generally follows the recommendation of the ABA Oil and Gas Task Force by expanding the protection afforded these buyers. See Alvin C. Harrell & Owen L. Anderson, *Report of the ABA UCC Committee Task Force on Oil and Gas Finance*, 26 Texas Tech. L. Rev. 805, 813-14 (1994). Specifically, it provides that the buyers take free not only of Article 9 security interests but also of interests “arising out of an encumbrance. As defined in Section 9-102, the term “encumbrance means “a right, other than an ownership interest, in real property. Thus, to the extent that a real property mortgage encumbers minerals not only before but also after extraction, subsection (d) enables a buyer in ordinary course of the minerals to take free of the mortgage. This subsection does not, however, follow the Task Force’s recommendation that these buyers should also take free of interests arising out of ownership interests in the real property. This issue is significant only in a minority of states. Several of them have adopted special statutes and nonuniform amendments to Article 9 to provide special protections to mineral owners, whose interests often are highly fractionalized in the case of oil and gas. See Terry I. Cross, *Oil and Gas Product Liens--Statutory Security Interests for Producers and Royalty Owners Under the Statutes of Kansas, New Mexico, Oklahoma, Texas and Wyoming*, 50 Consumer Fin. L. Q. Rep. 418 (1996). Inasmuch as a complete resolution of the issue is likely to require the addition of complex provisions to this Article, and there are good reasons to believe that a uniform solution would not be feasible, this Article leaves its resolution to other legislation.

[9-321]

Reporters’ Comments

1. **Source.** Derived from Sections 2A-103(1)(o) and 2A-307(3).

2. **Lessee in Ordinary Course.** Subsection (a) contains the rule formerly found in Section 2A-307(3).

3. **Licensee in Ordinary Course.** Subsection (c) is new. Like the analogous rules in subsection (a) with respect to lessees in ordinary course and Section 9-320(a) with respect to buyers in ordinary course, the rule in subsection (c) reflects the expectations of the parties. The definition of “licensee in ordinary course of business is modeled upon that of “buyer in ordinary course of business.

[9-322]

Reporters’ Comments

1. **Source.** Former Section 9-312(5), (6).

2. **General Rules: Perfected Security Interests.** Subsection (a)(1) contains the basic, first-in-time rule governing conflicting perfected security interests: The first security interest that is filed or perfected takes priority. The rule applies to security interests that are perfected upon attachment (e.g., those arising from the sale of a payment intangible or promissory note), even though there may be no notice to creditors or subsequent purchasers and notwithstanding any common-law rule to the contrary. This rule is subject to the other rules contained in Part 3 of this Article, including cases of purchase-money security interests, security interests in deposit accounts, and security interests in letter-of-credit rights which qualify for the special priorities in Sections 9-324, 9-327, and 9-329. This subsection also is subject to Sections 4-210 and 5-118. The latter is new. It affords a security interest in letter of credit documents to an issuer or nominated person and appears in Appendix I. Inasmuch as Section 9-103(d) treats the interest of a consignor to be a purchase-money security interest in inventory, the reference to former Section 9-114 has been deleted.

Subsection (a)(2) is new. It makes explicit the rule that a perfected security interest has priority over an unperfected security interest.

3. **Priority in Proceeds: General.** Subsection (b)(1) follows former Section 9-312(6). It provides that the baseline rules of subsection (a) apply generally to priority conflicts in proceeds except where otherwise provided. Subsections (c), (d), and (e) provide additional priority rules for proceeds of collateral in situations where the temporal rules of subsection (a)(1) not appropriate. These new provisions distinguish what we refer to in these comments as “non-filing collateral from what we call “filing collateral. As used in these comments, non-filing collateral is collateral of a type for which perfection may be achieved by a method other than filing (possession or control, mainly) and for which secured parties who so perfect generally do not expect or need to conduct a filing search, from other collateral. Non-filing collateral consists of chattel paper, negotiable

documents, deposit accounts, instruments, investment property, letter-of-credit rights. We refer to the other collateral–accounts, commercial tort claims, general intangibles, goods, non-negotiable documents, and payment intangibles–as "filing collateral.

4. **Proceeds of Non-filing Collateral: Non-temporal Priority.** Subsection (c)(2) provides a baseline priority rule for proceeds of non-filing collateral that applies if the secured party has taken the steps required for non-temporal priority over a conflicting security interest in non-filing collateral (e.g., control, in the case of deposit accounts, letter-of-credit rights, and investment property). (This rule applies whether or not there exists an actual conflicting security interest in the original non-filing collateral.) Under subsection (c)(2), the priority in the original collateral continues in proceeds if the security interest in proceeds is perfected and the proceeds are cash proceeds or non-filing proceeds of the same type (e.g., instruments, investment property) as the original collateral. The Official Comments will explain that "type means a type of collateral defined in the UCC and should be read broadly. For example, a security is of the same type as a security entitlement (i.e., investment property), and a promissory note is of the same type as a draft (i.e., an instrument).

> **Example 1.** SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security. The debtor receives cash proceeds of the security (e.g., dividends deposited into the debtor's deposit account). If the first-to-file-or-perfect rule were applied, SP-1's security interest in the cash proceeds would be senior, although SP-2's security interest is perfected under Section 9-315. This is the result under former Article 9. Under subsection (c), however, SP-2's security interest is senior.

Note that under Section 9-327 a different result would obtain in Example 1 (i.e., SP-1's security interest would be senior) if SP-1 were to obtain control of the deposit-account proceeds. This is so because subsection (c) is subject to subsection (f), which in turn provides that the priority rules under subsections (a) through (e) are "subject to the other provisions of this part.

> **Example 2.** SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security. The debtor receives proceeds of the security consisting of a new certificated security issued as a stock dividend on the original collateral. Although the new security is of the same type as the original collateral (i.e., investment property), once the 20-day period of automatic perfection expires (see Section 9-315(e)), SP-2's security interest is unperfected. (SP-2 has not filed or taken possession or control, and no temporary-perfection rule applies.) Consequently, subsection (c) does not confer priority, and, under the first-to-file-or-perfect rule, SP-1's security interest in the security is senior. This is the result under former Article 9.

Example 3. SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security and also by filing against investment property. The debtor receives proceeds of the security consisting of a new certificated security issued as a stock dividend of the collateral. Because the new security is of the same type as the original collateral (i.e., investment property) and, unlike Example 2, SP-2's security interest is perfected by filing, SP-2's security interest is senior under subsection (c). If the new security were redeemed by the issuer upon surrender and yet another security were received by the debtor, SP-2's security interest would continue to enjoy priority under subsection (c). The new security would be proceeds of proceeds.

Example 4. SP-1 perfects its security interest in instruments by filing. SP-2 subsequently perfects its security interest in investment property by taking control of a certificated security and also by filing against investment property. The debtor receives proceeds of the security consisting of a dividend check that it deposits to a deposit account. Because the check and the deposit account are cash proceeds, SP-1's and SP-2's security interests in the cash proceeds are perfected under Section 9-315. However, SP-2's security interest is senior under subsection (c).

Example 5. SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security and also by filing against investment property. The debtor receives an instrument as proceeds of the security. (Assume that the instrument is not cash proceeds.) Because the instrument is not of the same type as the original collateral (i.e., investment property), SP-2's security interest, although perfected by filing, does not achieve priority under subsection (c). Under the first-to-file-or-perfect rule, SP-1's security interest in the proceeds is senior.

5**. Proceeds of Filing Collateral.** Under subsections (d) and (e), if a security interest in non-filing collateral is perfected by a means other than filing (e.g., control or possession), it does not retain its priority over a conflicting security interest in proceeds that are filing collateral. Moreover, it is not entitled to priority in proceeds under the first-to file-or-perfect rule of subsections (a) and (b). Instead, under subsection (d), priority is determined on a new first-to-file rule.

Example 6. SP-1 perfects its security interest in the debtor's deposit account by obtaining control. Thereafter, SP-2 files against equipment, (presumably) searches, finds no conflicting security interest, and advances against the debtor's equipment. SP-1 then files against the debtor's equipment. The debtor uses funds from the deposit account to purchase equipment, which SP-1 can trace as proceeds of its security interest in the debtor's deposit account. If the first-to-file-or-perfect rule were applied, SP-1's security interest would be senior under subsections (a) and (b) because it was the first to perfect in the original collateral. Under subsection (d), however, SP-2's security interest would be senior under the first-to-file rule. This corresponds with the likely expectations of the parties.

Example 7. SP-1 perfects its security interest in the debtor's deposit account by obtaining control. Thereafter, SP-2 files against inventory, (presumably) searches, finds no conflicting security interest, and advances against the debtor's inventory. Inventory is sold and the proceeds deposited into the deposit account. The debtor uses funds from the deposit account to purchase additional inventory, which SP-1 can trace as proceeds of its security interest in the debtor's deposit account. The new inventory is sold and the proceeds deposited into *another* deposit account. Although the new deposit account is cash proceeds and is also the same type of collateral as the original collateral, SP-1 does not obtain priority. SP-1's security interest in the new deposit account does not satisfy subsection (c)(3) because the deposit account is proceeds of proceeds (the new inventory) other than cash proceeds[, chattel paper, deposit accounts, negotiable documents, instruments, investment property, or letter-of-credit rights]. Stated otherwise, once [proceeds other than cash proceeds or proceeds of the same type as the original collateral intervene] [filing collateral intervenes] in the chain of proceeds, priority under subsection (c) is thereafter unavailable.

Note that under subsection (e), the first-to-file rule of subsection (e) applies only if the proceeds in question are filing collateral and are not non-filing collateral. If the proceeds are non-filing collateral, either the first-to-file-or-perfect rule under subsections (a) and (b) or the priority rule in subsection (c) would apply.

6. **Priority in Supporting Obligations.** Under subsections (b)(2) and (c)(1), a security interest having priority in collateral also has priority in a supporting obligation for that collateral. However, the rules in these subsections are subject to the special rule in Section 9-329 governing the priority of security interests in a letter-of-credit right. See subsection (g). Under Section 9-329, a secured party's failure to obtain control (Section 9-107) of a letter-of-credit right supporting collateral may leave its security interest exposed to a priming interest of a party who does take control.

7. **Agricultural Liens.** Statutes other than this Article may purport to grant priority to an agricultural lien as against a conflicting security interest or agricultural lien. Under subsection (g), if another statute grants priority to an agricultural lien, the agricultural lien has priority only if the same statute creates the agricultural lien and the agricultural lien is perfected. Otherwise, subsection (a) applies the same the same priority rules to an agricultural lien as to a security interest, regardless of whether the agricultural lien conflicts with another agricultural lien or with a security interest. Inasmuch as no agricultural lien on

proceeds arises under this Article, subsections (b) through (e) do not apply to proceeds of agricultural liens.

[9-323]

Reporters’ Comments

1. **Source.** Former Sections 9-312(7), 9-301(4), 9-307(3), 2A-307(4).

2. **Competing Security Interests.** This section collects all of the special rules dealing with “future advances. Subsection (a) replaces and clarifies former Section 9-312(7). No substantive change is intended. Former subsection (7) was added by the 1972 Revisions to Article 9 in order to override some decisions that subordinated future advances to intervening interests. Under a proper reading of the first-to-file-or perfect rule of Section 9-322(a) (and former Section 9-312(5)), it is abundantly clear that the time when an advance is made plays no role in determining priorities among conflicting security interests except when a financing statement was not filed and the advance is the giving of value as the last step for attachment and perfection. Subsection (a) of this section states the only other instance when the time of an advance figures in the priority scheme: when the security interest is perfected only automatically under Section 9-309 or temporarily under Section 9-312(e), (f), or (g) and is not made pursuant to a commitment entered into while the security interest was perfected by another method.

The new formulation in subsection (a) clarifies the result when the initial advance is paid and a new (“future) advance is made subsequently. Under former Section 9-312(7), the priority of the new advance turned on whether it was “made while a security interest is perfected. This section resolves any ambiguity by omitting the quoted phrase.

3. **Competing Lien Creditors.** Subsection (b) replaces former Section 9-301(4). It addresses the problem considered by PEB Commentary No. 2 and removes the ambiguity that necessitated the commentary. Former subsection (4) appears to state a general rule that a lien creditor has priority over a perfected security interest and is “subject to the security interest “only in specified circumstances. Because subsection (4) speaks to the making of an “advance, it arguably implies that to the extent a security interest secures non-advances (expenses, interest, etc.), it is junior to the lien creditor’s interest. Subsection (b) solves the problem by providing that a security interest is subordinate only to the extent that the specified circumstances occur, thereby eliminating the erroneous implication. As under former Section 9-301(4), a secured party’s knowledge does not cut short the 45-day period during which future advances can achieve priority over an intervening lien creditor’s interest.

4. **Sales of Receivables; Consignments.** Subsections (a) and (b) do not apply to outright sales of accounts, chattel paper, payment intangibles, or promissory notes, nor do they apply to consignments.

5. **Competing Buyers and Lessees.** Subsections (d) and (e) replace former Section 9-307(3), and subsections (f) and (g) replace former Section 2A-307(4). No change in meaning is intended.

[9-324]

Reporters' Comments

1. **Source.** Former Section 9-312(3), (4).

2. **Purchase-money Security Interests in Inventory.** Subsections (a) and (b), which afford a special priority to certain purchase-money security interests in inventory, derive from former Section 9-312(3).

3. **Notification to Conflicting Inventory Secured Party: Timing.** Under subsection (a)(3), the purchase-money security interest achieves priority over a conflicting security interest only if the holder of the conflicting security interest receives a notification within five years before the debtor receives possession of the purchase-money collateral. If the debtor never receives possession, the purchase-money security interest has priority, even if notification is not given.

Some courts have mistakenly read former Section 9-312(3)(b) to require, as a condition of purchase-money priority in inventory, that the purchase-money secured party give the notification before it files a financing statement. Read correctly, the "before clauses compare (i) the time when the holder of the conflicting security interest filed a financing statement with (ii) the time when the purchase-money security interest becomes perfected by filing or automatically perfected temporarily. Only if (i) occurs before (ii) must notification be given to the holder of the conflicting security interest. Subsection (b) has been rewritten in an effort to clarify this point.

4. **Notification to Conflicting Inventory Secured Party: Address.** Inasmuch as the address provided as that of the secured party on a filed financing statement is an "address that is reasonable under the circumstances, the holder of a purchase-money security interest may satisfy the requirement to "send notification to the holder of a conflicting security interest in inventory by sending a notification to that address, even if the address is or becomes incorrect. See Section 9-102 (definition of "send). Similarly, because the address is "held out by [the holder of the conflicting security interest] as the place for receipt of such communications [i.e., communications relating to security interests], the holder is deemed to have "received a notification delivered to that address. See Section 1-201(26).

5. **Consignments.** Subsections (a) and (b) also determine the priority of a consignor’s interest in consigned goods as against a security interest in the goods created by the consignee. Inasmuch as a consignment subject to this Article is defined to be a purchase-money security interest, see Section 9-103(d), no inference concerning the nature of the transaction should be drawn from the fact that a consignor uses the term “security interest in its notice under subsection (a)(4). Similarly, a notice stating that the consignor has delivered or expects to deliver goods, properly described, “on consignment meets the requirements of subsection (a)(4), even if it does not contain the term “security interest, and even if the transaction subsequently is determined to be a security interest. Cf. Section 9-505 (use of “consignor and “consignee in financing statement).

6. **Priority in Proceeds.** Under subsection (a), the purchase-money priority carries over not only into certain identifiable cash proceeds of the inventory but also, to the extent provided in Section 9-330, into proceeds consisting of chattel paper, instruments, and their proceeds. Under section 9-330(e), the holder of a purchase-money security interest in inventory is deemed to give new value for chattel paper proceeds. This subsection thereby enables such a secured party to obtain priority in chattel paper proceeds, even if the secured party does not actually give new value for the chattel paper.

Subsections (c), (e), and (f) provide that the purchase-money priority carries over into proceeds of the collateral only if the security interest in the proceeds is perfected. Although this qualification did not appear in former Section 9-312(4), we believe that it was implicit in that provision.

7. **Purchase-money Security Interests in Livestock.** New subsections (c) and (e) provide a purchase-money priority rule for farm-products livestock. They are patterned on the purchase-money priority rule for inventory found in subsections (a) and (b) and include a requirement that the purchase-money secured party notify earlier-filed parties. Two differences between subsections (a) and (c) are noteworthy. First, unlike the purchase-money inventory lender, the purchase-money livestock lender enjoys priority in *all* proceeds of the collateral. Thus, under subsection (c), the purchase-money secured party takes priority in accounts over an earlier-filed accounts financer. Second, subsection (c) affords priority in certain products of the collateral as well as proceeds. Former Article 9 does not deal with products in any meaningful way.

8. **Purchase-money Security Interests in Aquatic Farm Products.** Aquatic goods produced in aquacultural operations (e.g., catfish raised on a catfish farm) are farm products. See Section 9-102 (definition of “farm products). The definition does not indicate whether aquatic goods are “crops, as to which the model production money security interest priority in Section 9-324A applies, or “livestock, as to which the purchase-money priority in subsection (c) of this section applies. This Article leaves courts free to determine the classification of

particular goods on a case-by-case basis, applying whichever priority rule makes more sense in the overall context of the debtor’s business.

9. **Purchase-money Priority in Goods Other than Inventory and Livestock.** Subsection (e) extends from 10 days to 20 days the “grace period for achieving purchase-money priority in non-inventory collateral found in former Section 9-312(4). It applies only to purchase-money security interests in goods.

Several reported cases arising under former Section 9-312(4) address the question of when the “debtor receives “possession of collateral for purposes of that section. Among other issues, these cases concern collateral that is delivered in stages and goods that were held in a person’s possession for a period of time (e.g., under a lease) before the person created a security interest in them. The Official Comments should address this question and the analogous question under Section 9-317(e).

Subsection (f) of this section governs the priority of purchase-money security interests in software. A purchase-money security interest in software has the same priority as the purchase-money security interest in the goods in which the software was acquired for use. This priority is determined under subsections (a) and (b) (for inventory) or (e) (for other goods).

10. **Multiple Purchase-money Security Interests.** New subsection (g) governs priority among multiple purchase-money security interests in the same collateral. It grants priority to purchase-money security interests securing the price of collateral (i.e., created in favor of the seller) over purchase-money security interests that secure enabling loans. Section 7.2(c) of the Restatement of the Law of Property (Mortgages), Tentative Draft No. 4 (February 28, 1995), approves this rule with respect to real property mortgages, on the ground that:

> the equities favor the vendor. Not only does the vendor part with specific real estate rather than money, but the vendor would never relinquish it at all except on the understanding that the vendor will be able to use it to satisfy the obligation to pay the price. This is the case even though the vendor may know that the mortgagor is going to finance the transaction in part by borrowing from a third party and giving a mortgage to secure that obligation. In the final analysis, the law is more sympathetic to the vendor’s hazard of losing real estate previously owned than to the third party lender’s risk of being unable to collect from an interest in real estate that never previously belonged to it.

The first-to-file-or-perfect rule of Section 9-322 applies to multiple purchase-money security interests securing enabling loans.

Subsection (g) makes no reference to proceeds. The Official Comments can explain how the proceeds rules would be applied in these unusual cases.

[9-325]

Reporters' Comments

1. **Source.** New.

2. **"Double Debtor" Problem.** This section addresses the "double debtor problem, which arises when a debtor acquires property that is subject to a security interest created by another debtor.

3. **Taking Subject to Perfected Security Interest.** Consider the following scenario:

> **Example 1:** A owns an item of equipment subject to a perfected security interest in favor of SP-A. A sells the equipment to B, not in the ordinary course of business. B acquires its interest subject to SP-A's security interest. See Sections 9-201; 9-315(a).

Under this section, if B creates a security interest in the equipment in favor of SP-B, SP-B's interest is subordinate to SP-A's interest, even if SP-B filed against B before SP-A filed against A, and even if SP-B took a purchase-money security interest. Normally, SP-B could have investigated the source of the equipment and discovered SP-A's filing before making an advance against the equipment, whereas SP-A had no reason to search the filings against someone other than its debtor, A.

4. **Taking Subject to Unperfected Security Interest.** This section applies only if the security interest in the transferred collateral was perfected when the transferee acquired the collateral. See paragraph (2). If this condition is not met, then the normal priority rules apply.

> **Example 2:** A owns an item of equipment subject to an unperfected security interest in favor of SP-A. A sells the equipment to B, who gives value and takes delivery of the equipment without knowledge of the security interest. B takes free of the security interest. See Section 9-315(a). If B then creates a security interest in favor of SP-B, no priority issue arises; SP-B has the only security interest in the equipment.

> **Example 3:** The facts are as in Example 2, except that B knows of SP-A's security interest and therefore takes the equipment subject to it. If B creates a security interest in the equipment in favor of SP-B, this section does not determine the relative priority of the security interests. Rather, the normal priority rules govern. If SP-B perfects its security interest, then, under

Section 9-322(a)(2), SP-A's unperfected security interest will be junior to SP-B's perfected security interest. The award of priority to SP-B is premised on the belief that SP-A's failure to file could have misled SP-B.

5. **Taking Subject to Perfected Security Interest that Becomes Unperfected.** This section applies only if the security interest in the transferred collateral did not become unperfected at any time after the transferee acquired the collateral. See paragraph (3). If this condition is not met, then the normal priority rules apply.

Example 4: As in Example 1, A owns an item of equipment subject to a perfected security interest in favor of SP-A. A sells the equipment to B, not in the ordinary course of business. B acquires its interest subject to SP-A's security interest. See Sections 9-201; 9-315(a). B creates a security interest in favor of SP-B, and SP-B perfects its security interest. This section provides that SP-A's security interest is senior to SP-B's. However, if SP-A's financing statement lapses while SP-B's security interest is perfected, then the normal priority rules would apply, and SP-B's security interest would become senior to SP-A's security interest. See Sections 9-319(a)(2); 9-515(c).

6. **Unusual Situations.** The appropriateness of the rule of subsection (a) is most apparent when it works to subordinate security interests having priority under the basic priority rules of Section 9-322(a) or the purchase-money priority rules of Section 9-324. The rule also works properly when applied to the security interest of a buyer under Section 2-711(3) or a lessee under Section 2A-508(5). However, subsection (a) may provide an inappropriate resolution of the "double debtor problem in some of the wide variety of other contexts in which the "double debtor issue may arise. Although subsection (b) limits the application of subsection (a) to only those in cases in which subordination is known to be appropriate, courts should apply the rule in other settings, if necessary to promote the underlying purposes and policies of the Uniform Commercial Code. See Section 1-102(1).

[9-326]

Reporters' Comments

1. **Source.** New.

2. **Collateral of New Debtors.** This section addresses the priority contests that may arise when a new debtor becomes bound by the security agreement of an original debtor and each has a secured creditor.

Subsection (a) subordinates the original debtor's secured party's security interest perfected under Section 9-508 to security interests in the same collateral perfected in another manner, e.g., by filing against the new debtor.

> **Example 1:** SP-X holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory, and SP-Z holds a perfected-by-filing security interest in Z Corp's existing and after-acquired inventory. Z Corp becomes bound as debtor by X Corp's security agreement (e.g., Z Corp buys X Corp's assets and assumes its security agreement). See Section 9-203(d). Under Section 9-508, SP-X's financing statement is effective to perfect a security interest in inventory acquired by Z Corp after it becomes bound. Subsection (a) provides that SP-X's security interest is subordinate to SP-Z's, regardless of which financing statement was filed first.

Subsection (b) addresses the priority among security interests created by the original debtor (X Corp). By invoking the other priority rules of this subpart, as applicable, subsection (b) preserves the relative priority of security interests created by the original debtor.

> **Example 2:** Under the facts of Example 1, SP-Y also holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory. SP-Y filed after SP-X. Inasmuch as both SP-X's and SP-Y's security interests in inventory acquired by Z Corp are perfected solely under Section 9-508, the normal priority rules apply. Under the "first-to-file-or-perfect rule of Section 9-322(a)(1), SP-X has priority over SP-Y.

[9-327]

Reporters' Comments

1. **Source.** New; derived from former Section 9-115(5).

2. **Deposit Accounts.** This section does not apply to accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are not "deposit accounts.

3. **Control**. Under subsection (1), security interests perfected by control (Sections 9-314; 9-104) take priority over those perfected otherwise, e.g., as identifiable cash proceeds under Section 9-315. Secured parties for whom the deposit account is an integral part of the credit decision will, at a minimum, insist upon the right to immediate access to the deposit account upon the debtor's default (i.e., control). Those secured parties for whom the deposit account is less essential will not take control, thereby running the risk that the debtor will dispose of funds on deposit (either outright or for collateral purposes) after default but before the account can be frozen by court order or the secured party can obtain control.

Subsection (2) governs the case (expected to be very rare) in which a bank enters into a Section 9-104(a)(2) control agreement with more than one secured party. Subsection (a)(2) provides that the security interests rank according to time of obtaining control. If the bank is solvent and the control agreements are well-drafted, the bank will be liable to each secured party, and there will be no need for a priority rule.

4. **Priority of Bank.** Under subsection (3), the security interest of the bank with which the deposit account is maintained normally takes priority over all other conflicting security interests in the deposit account, regardless of whether the deposit account constitutes the competing secured party's original collateral or its proceeds. A rule of this kind enables banks to extend credit to their depositors without the need to examine either the public record or their own records to determine whether another party might have a security interest in the deposit account.

A secured party who takes a security interest in the deposit account as original collateral can protect itself against the results of this rule in one of two ways. It can take control of the deposit account by becoming the bank's customer (i.e., by having the account in its name). Under subsection (4), this arrangement operates to subordinate the bank's security interest. Alternatively, the secured party can obtain an express subordination agreement from the bank. See Section 9-339. Additional clarification may be needed in the Official Comments to cover cases in which both the debtor and the secured party are indebted to the bank.

A secured party who claims the deposit account as proceeds of other collateral can reduce the risk of becoming junior by obtaining the debtor's agreement to deposit proceeds into a specific cash collateral account and obtaining the agreement of that bank to subordinate all its claims to those of the secured party. But if the debtor violates its agreement and deposits funds into a deposit account other than the cash collateral account, the secured party risks being subordinated.

5. **Priority in Proceeds of and Funds Transferred from Deposit Account.** The priority afforded by this section does not extend to proceeds of a deposit account. Rather, Section 9-322(c) through (f) governs priorities in proceeds of a deposit account. Section 9-315(d) addresses continuation of perfection in proceeds of deposit accounts. As to funds transferred from a deposit account that serves as collateral, see Section 9-332.

[9-328]

Reporters' Comments

1. **Source.** Former Section 9-115(5).

2. **Priority in Investment Property.** The 1994 revisions to Articles 8 and 9 marked the first time that Article 9 permitted perfection of security interests in securities by filing. See former Section 9-115. This Article carries forward that approach. See Section 9-312(a). The 1994 revisions recognize that, in order to avoid disruption of existing practices in the securities markets, it is necessary to give perfection by filing a different and more limited effect for securities than for other forms of collateral. In particular, the necessity of conducting a search in order to ensure priority of a security interest would be enormously disruptive and detrimental. Consequently, the 1994 revisions provide that, generally speaking, the priority rules operate without regard to whether a financing statement was filed with respect to one or more conflicting security interests.

3. **Certificated Securities.** A long-standing practice has developed whereby secured parties whose collateral consists of a security evidenced by a security certificate take possession of the security certificate. If the security certificate is in registered form, the secured party will not achieve control over the security unless the security certificate contains an appropriate indorsement or is (re)registered in the secured party's name. See Section 8-106(b). However, the secured party's acquisition of possession constitutes "delivery of the security certificate under Section 8-301 and serves to perfect the security interest under Section 9-313(a). A security interest perfected by this method has priority over a security interest perfected other than by control (e.g., by filing). See paragraph (2).

The priority rule stated in paragraph (2) may seem anomalous, in that it can afford less favorable treatment to purchasers who buy collateral outright that to those who take a security interest in it. For example, a buyer of a security certificate would cut off a security interest perfected by filing only if the buyer achieves the status of a protected purchaser under Section 8-303. The buyer would not be a protected purchaser, for example, if it does not obtain "control under Section 8-106 (e.g., if it fails to obtain a proper indorsement of the certificate) or if it had notice of an adverse claim under Section 8-105. As Official Comment 5 to former Section 9-115 suggests, however, the priority rule is best understood not as one intended to protect careless or guilty parties, but one that eliminates the need to conduct a search of the public records only insofar as necessary to serve the needs of the securities markets.

4. **Conflicting Security Interests Perfected by Control.** Former Section 9-115, added recently in conjunction with Revised Article 8, introduced into Article 9 the concept of security interests that rank equally. Some observers have questioned the wisdom of ranking equally the security interests of parties holding adverse interests in the same collateral. Paragraph (3) of this section replaces the equal priority rule for conflicting security interests in investment property with a temporal rule. For securities, both certificated and uncertificated, under paragraph (3)(A) priority is based on the time that control is obtained. For security entitlements carried in securities accounts, the treatment is more complex. Paragraph (3)(B) bases priority on the timing of the steps taken to achieve control.

For example, assume a secured party achieves control under Section 8-106(d)(2) by obtaining the securities intermediary's agreement to act on the secured party's entitlement orders with respect to all present and future security entitlements in a designated account. Under paragraph (3)(B)(ii), the priority of the security interest dates from the time of the agreement. This priority applies equally to security entitlements to financial assets credited to the account after the agreement was entered into. This priority rule is analogous to "first-to-file priority under Section 9-322 with respect to after-acquired collateral. Paragraphs (3)(B)(i) and (3)(B)(iii) provide similar rules security entitlements as to which control is obtained by other methods, and paragraph (3)(C) provides a similar rule for commodity contracts carried in a commodity account. Section 8-510 also has been revised to provide a temporal priority conforming to paragraph (3)(B).

[9-329]

Reporters' Comments

1. **Source.** New; loosely modeled after former Section 9-115(5).

2. **General Rule.** Paragraph (1)(A) awards priority to a secured party that perfects its security interest directly in letter-of-credit rights (i.e., one that takes an assignment of proceeds and obtains consent of the issuer or any nominated person under Section 5-114(c)) over another conflicting security interest (i.e., one that is perfected automatically in the letter-of-credit rights under Section 9-308(d)). This is consistent with international letter-of-credit practice and provides finality to payments made to recognized assignees of letter-of-credit proceeds. If an issuer or nominated person recognizes multiple security interests in a letter-of-credit right, resulting in multiple parties having control (Section 9-107), under paragraph (1)(B) the security interests rank according to the time of obtaining control.

3. **Transferee Beneficiaries.** Paragraph (2) confirms that a transferee beneficiary's rights are paramount under Section 5-114(e), which provides that the "[r]ights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds. Arguably, paragraph (2) is unnecessary and the same result would obtain under Article 5, inasmuch as there is in effect a novation upon the transfer with the issuer becoming bound on a new, independent obligation to the transferee. In the interest of clarity, however, subsection (2) makes the priority explicit in Article 9.

Under this approach, the rights of nominated persons and transferee beneficiaries under a letter of credit include the right to demand payment from the issuer. Under Section 5-114(e), their rights to payment are independent of their obligations to the beneficiary (or original beneficiary) and superior to the rights of assignees of letter of credit proceeds (Section 5-114(c)) and others claiming a security interest in the beneficiary's (or original beneficiary's) letter of credit rights.

A transfer of drawing rights under a transferable letter of credit establishes independent Article 5 rights in the transferee and does not create or perfect an Article 9 security interest in the transferred drawing rights. The definition of "letter-of-credit right in Section 9-102 excludes a beneficiary's drawing rights. The exercise of drawing rights by a transferee beneficiary may breach a contractual obligation of the transferee to the original beneficiary concerning when and how much the transferee may draw or how it may use the funds received under the letter of credit. If, for example, drawing rights are transferred to support a sale or loan from the transferee to the original beneficiary, then the transferee would be obligated to the original beneficiary under the sale or loan agreement to account for any drawing and for the use of any funds received. The transferee's obligation would be governed by the applicable law of contracts or restitution.

4. **Secured Party-Transferee Beneficiaries.** As described in Comment 3, drawing rights under letters of credit are transferred in many commercial contexts in which the transferee is not a secured party claiming a security interest in an underlying receivable supported by the letter of credit. Consequently, a transfer of a letter credit is not a means of "perfection of a security interest. The transferee's independent right to draw under the letter of credit and to receive and retain the value thereunder (in effect, priority) is not based on Article 9 but on letter-of-credit law and the terms of the letter of credit. Assume, however, that a secured party does hold a security interest in a receivable that is owned by a beneficiary-debtor and supported by a transferable letter of credit. Assume further that the beneficiary-debtor causes the letter of credit to be transferred to the secured party, the secured party draws under the letter of credit, and, upon the issuer's payment to the secured party-transferee, the underlying account debtor's obligation to the original beneficiary-debtor is satisfied. In this situation, the payment to the secured party-transferee is proceeds of the receivable collected by the secured party-transferee. Consequently, the secured party-transferee would have certain duties to the debtor and third parties under Article 9. For example, it would be obliged to collect under the letter of credit in a commercially reasonable manner and to remit any surplus pursuant to Sections 9-607 and 9-608.

This scenario is problematic under letter-of-credit law and practice, inasmuch as a transferee beneficiary collects in its own right arising from its own performance. Accordingly, under Section 5-114, the independent and superior rights of a transferee control over any inconsistent duties under Article 9. A transferee beneficiary may take a transfer of drawing rights to avoid reliance on the original beneficiary's credit and collateral, and it may consider any Article 9 rights superseded by its Article 5 rights. Moreover, it will not always be clear (i) whether a transferee beneficiary has a security interest in the underlying collateral, (ii) whether any security interest is senior to the rights of others, or (iii) whether the transferee beneficiary is aware that it holds a security interest. There will be clear cases in which the role of a transferee beneficiary as such is merely incidental to a conventional secured financing. There also will be cases in which the existence of a security interest may have little to do with the position of a transferee beneficiary as such. In dealing with these cases and less clear cases involving the possible application of Article 9 to a nominated person or a transferee beneficiary, the right to demand payment under a letter of credit should be distinguished from letter-of-credit rights. The courts also should give appropriate consideration to the policies and provisions of Article 5 and letter-of-credit practice as well as Article 9.

[9-330]

Reporters’ Comments

1. **Source.** Former Section 9-308.

2. **Chattel Paper.** This section enables purchasers of chattel paper, including secured parties, to obtain priority over earlier-perfected security interests in the chattel paper. It applies to both tangible and electronic chattel paper.

This section follows former Section 9-308 in distinguishing between earlier-perfected security interests in chattel paper that is claimed merely as proceeds of inventory subject to a security interest and chattel paper that is claimed other than merely as proceeds. Like former Section 9-308, this section does not elaborate upon the phrase “merely as proceeds. For an elaboration, see PEB Commentary No. 8.

This section makes explicit the “good faith requirement and retains the requirements of “the ordinary course of the purchaser’s business and the giving of “new value as a conditions for priority. Concerning the last, the Article deletes former Section 9-108 and adds to Section 9-102 a completely different definition of the term “new value. Under subsection (e), the holder of a purchase-money security interest in inventory is deemed to give “new value for chattel paper constituting the proceeds of the inventory.

If a possessory security interest in tangible chattel paper or a perfected-by-control security interest in electronic chattel paper does not qualify for priority under this section, it may be subordinate to a perfected-by-filing security interest under Section 9-322(a).

3. **Possession.** The priority afforded by this section turns in part on whether a purchaser “takes possession of tangible chattel paper. Similarly, the governing law provisions in Section 9-301 address both “possessory and “nonpossessory security interests. Two common practices have raised particular concerns. First, in some cases the parties create more than one copy or counterpart of chattel paper evidencing a single secured obligation or lease. This practice raises

questions as to which counterpart is the “original and whether it is necessary for a purchaser to take possession of all counterparts in order to “take possession of the chattel paper. Second, parties sometimes enter into a single “master agreement. The master agreement contemplates that the parties will enter into separate “schedules from time to time, each evidencing chattel paper. Must a purchaser of an obligation or lease evidenced by a single schedule also take possession of the master agreement as well as the schedule in order to “take possession of the chattel paper?

The problem raised by the first practice is easily solved. The parties may in the terms of their agreement and by designation on the chattel paper identify only one counterpart as the original chattel paper for purposes of taking possession of the chattel paper. Concerns about the second practice also are easily solved by careful drafting. Each schedule should provide that it incorporates the terms of the master agreement, not the other way around. This will make it clear that each schedule is a “stand alone document.

4. **Chattel Paper Claimed Merely as Proceeds.** Subsection (a) revises the rule in former Section 9-308(b) to eliminate reference to what the purchaser knows. Instead, a purchaser who meets the possession or control, ordinary course, and new value requirements takes priority over a competing security interest unless the chattel paper itself indicates that it has been assigned to an identified assignee other than the purchaser. Thus subsection (a) recognizes the common practice of placing a “legend on chattel paper to indicate that it has been assigned. This approach, under which the chattel paper purchaser who gives new value in ordinary course can rely on possession of unlegended, tangible chattel paper without any concern for other facts that it may know, comports with the expectations of both inventory and chattel paper financers.

5. **Chattel Paper Claimed Other Than Merely as Proceeds.** Subsection (b) eliminates the requirement that the purchaser take without knowledge that the “specific paper is subject to the security interest and substitutes for it the requirement that the purchaser take “without knowledge that the purchase violates the rights of the secured party. This standard derives from the definition of “buyer in ordinary course of business in Section 1-201(9). The source of the purchaser’s knowledge is irrelevant. Note, however, that “knowledge means “actual knowledge. Section 1-201(25).

In contrast to a junior secured party in accounts, who may be required in some special circumstances to undertake a search under the “good faith requirement, see Comment 5 to Section 9-328, a purchaser of chattel paper under this section is not required as a matter of good faith to make a search in order to determine the existence of prior security interests. There may be circumstances where the purchaser undertakes a search nevertheless, either on its own volition or because other considerations make it advisable to do so, e.g., the purchaser also is purchasing accounts. Without more, a purchaser of chattel paper who has seen a financing statement covering the chattel paper or who knows that the chattel paper is encumbered with a security interest, does not have knowledge that its purchase violates the secured party's rights. However, if a purchaser sees a statement in a financing statement to the effect that a purchase of chattel paper from the debtor would violate the rights of the filed secured party, the purchaser would have such knowledge. Likewise, under new subsection (f), if the chattel paper itself indicates that it had been assigned to an identified secured party other than the purchaser, the purchaser to have wrongful knowledge for purposes of subsection (b), thereby preventing the purchaser from qualifying for priority under that subsection, even if the purchaser did not have actual knowledge. In the case of tangible chattel paper, the indication normally would consist of a written legend on the chattel paper. In the case of intangible chattel paper, this Article leaves to developing market and technological practices the manner in which the chattel paper would indicate an assignment.

6. **Instruments.** Subsection (d) contains a special priority rule for instruments. Under this subsection, a purchaser of an instrument has priority over a security interest perfected by a method other than possession (e.g., by filing, temporarily under Section 9-312(e) or (g), as proceeds under Section 9-315(d), or automatically upon attachment under Section 9-309(4) if the security interest arises out of a sale of the instrument) if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party. To the extent subsection (d) conflicts with Section 3-306, subsection (d) governs. See Section 3-102(b).

The rule in subsection (c) is similar to the rules in subsections (a) and (b), which govern priority in chattel paper. The observations in Comment 5 concerning the requirement of good faith and the phrase "without knowledge that the purchase violates the rights of the secured party apply equally to purchasers of instruments. However, unlike a purchaser of chattel paper, to qualify for priority under this section a purchaser of an instrument need only give value as defined in Section 1-201; it need not give "new value. Also, the purchaser need not purchase the instrument in the ordinary course of its business.

7. **Priority in Proceeds of Chattel Paper.** Subsection (c) sets forth the two circumstances under which the priority afforded to a purchaser of chattel paper under subsection (a) or (b) extends also to proceeds of the chattel paper. The first is if the purchaser would have priority under the normal priority rules applicable to proceeds. The second, which the following Comments discuss in greater detail, is if the proceeds consist of the specific goods covered by the chattel paper. Former Article 9 is silent as to the priority of a security interest in proceeds when a purchaser qualifies for priority under Section 9-308.

8. **Priority in Returned and Repossessed Goods.** Returned and repossessed goods may constitute proceeds of chattel paper. The following Comments explain the treatment of returned and repossessed goods as proceeds of

chattel paper. The analysis is consistent with that of PEB Commentary No. 5, which these Comments replace, and is based upon the following example:

> **Example:** Secured Party 1 (SP-1) has a security interest in all the inventory of a dealer in goods (Dealer); SP-1’s security interest is perfected by filing. Dealer sells some of its inventory to a buyer in the ordinary course of business (BIOCOB) pursuant to a conditional sales contract (chattel paper) that does not indicate that it has been assigned to SP-1. Secured Party 2 (SP-2) purchases the chattel paper from Dealer and takes possession of the paper in good faith, in the ordinary course of business, and without knowledge that the purchase violates the rights of SP-1. Subsequently, BIOCOB returns the goods to Dealer because they are defective. Alternatively, Dealer acquires possession of the goods following BIOCOB’s default.

9. **Assignment of Non-Lease Chattel Paper.**

a. **Loan by SP-2 to Dealer Secured by Chattel Paper (or Functional Equivalent Pursuant to Recourse Arrangement).**

(1) **Returned Goods.** If BIOCOB returns the goods to Dealer for repairs, Dealer is merely a bailee and acquires thereby no meaningful rights in the goods to which SP-1’s security interest could attach. (Although SP-1’s security interest could attach to Dealer’s interest as a bailee, that interest is not likely to be of any particular value to SP-1.) Dealer is the owner of the *chattel paper* (i.e., the owner of a right to payment secured by a security interest in the goods); SP-2 has a security interest in the chattel paper, as does SP-1 (as proceeds of the goods under Section 9-315). Under Section 9-330, SP-2’s security interest in the chattel paper is senior to that of SP-1. SP-2 enjoys this priority regardless of whether, or when, SP-2 filed a financing statement covering the chattel paper. Because chattel paper and goods represent different types of collateral, Dealer does not have any meaningful interest in *goods* to which either SP-1’s or SP-2’s security interest could attach in order to secure Dealer’s obligations to either creditor. See Section 9-102 (defining “chattel paper and “goods).

Now assume that BIOCOB returns the goods to Dealer under circumstances whereby Dealer once again becomes the owner of the goods. This would be the case, for example, if the goods were defective and BIOCOB was entitled to reject or revoke acceptance of the goods. See Sections 2-602 (rejection); 2-608 (revocation of acceptance). Unless BIOCOB has waived its defenses as against assignees of the chattel paper, SP-1’s and SP-2’s rights against BIOCOB would be subject to BIOCOB’s claims and defenses. See Sections 9-403; 9-404. SP-1’s security interest would attach again because the returned goods would be proceeds of the chattel paper. Dealer’s acquisition of the goods easily can be characterized as “proceeds consisting of an “in kind collection on or distribution on account of the chattel paper. See Section 9-102 (definition of “proceeds). Assuming that SP-1’s security interest is perfected by filing against the goods and that the filing is made in the same office where a filing would be made against the chattel paper, SP-1's security interest in the goods would remain perfected beyond the 20-day period of automatic perfection. See Section 9-315(e).

Because Dealer's newly reacquired interest in the goods is proceeds of the chattel paper, SP-2's security interest also would attach in the goods as proceeds. If SP-2 had perfected its security interest in the chattel paper by filing (again, assuming that filing against the chattel paper was made in the same office where a filing would be made against the goods), SP-2's security interest in the reacquired goods would be perfected beyond 20 days. See Section 9-315(e). However, if SP-2 had relied only on its possession of the chattel paper for perfection and had not filed against the chattel paper or the goods, SP-2's security interest would be unperfected after the 20-day period. See Section 9-315(e). Nevertheless, SP-2's unperfected security interest in the goods would be senior to SP-1's security interest under Section 9-330(c). The result in this priority contest is not affected by SP-2's acquiescence or non-acquiescence in the return of the goods to Dealer.

(2) **Repossessed Goods.** As explained above, Dealer owns the chattel paper covering the goods, subject to security interests in favor of SP-1 and SP-2. In Article 9 parlance, Dealer has an interest in chattel paper, not goods. If Dealer, SP-1, or SP-2 repossesses the goods upon BIOCOB's default, whether the repossession is rightful or wrongful as among Dealer, SP-1, or SP-2, Dealer's interest will not change. The location of goods and the party who possesses them does not affect the fact that Dealer's interest is in chattel paper, not goods. The goods continue to be owned by BIOCOB. SP-1's security interest in the goods does not attach until such time as Dealer reacquires an interest (other than a bare possessory interest) in the goods. For example, Dealer might buy the goods at a foreclosure sale from SP-2 (whose security interest in the chattel paper is senior to that of SP-1); that disposition would cut off BIOCOB's rights in the goods. Section 9-617.

In many cases the matter would end upon sale of the goods to Dealer at a foreclosure sale and there would be no priority contest between SP-1 and SP-2; Dealer would be unlikely to buy the goods under circumstances whereby SP-2 would retain its security interest. There can be exceptions, however. For example, Dealer may be obliged to purchase the goods from SP-2, SP-2 may convey the goods to Dealer, and Dealer may fail to pay SP-2. Or, one could imagine that SP-2, like SP-1, has a general security interest in the inventory of Dealer. In the latter case, SP-2 should not receive the benefit of any special priority rule, since its interest in no way derives from priority under Section 9-330. In the former case, SP-2's security interest in the goods reacquired by Dealer is senior to SP-1's security interest under Section 9-330.

b. **Dealer's Outright Sale of Chattel Paper to SP-2.** Article 9 also applies to a transaction whereby SP-2 buys the chattel paper in an outright sale transaction without recourse against Dealer. Sections 1-201(37); 9-109(a). Although Dealer does not, in such a transaction, retain any residual ownership interest in the chattel paper, the chattel paper constitutes proceeds of the goods to which SP-1's security interest will attach and continue following the sale of the goods. Section 9-315(a). Even though Dealer has not retained any interest in the chattel paper, as discussed above BIOCOB subsequently may return the goods to Dealer under circumstances whereby Dealer reacquires an interest in the goods. The priority contest between SP-1 and SP-2 will be resolved as discussed above; Section 9-330 makes no distinction among purchasers of chattel paper on the basis of whether the purchaser is an outright buyer of chattel paper or one whose security interest secures an obligation of Dealer.

10. **Assignment of Lease Chattel Paper.** As defined in Section 9-102, "chattel paper includes not only writings that evidence security interests in specific goods but also those that evidence true leases of goods.

The analysis with respect to lease chattel paper is similar to that set forth above with respect to non-lease chattel paper. It is complicated, however, by the fact that, unlike the case of chattel paper arising out of a sale, Dealer retains a residual interest in the *goods*. See Section 2A-103(1)(q) (defining "lessor's residual interest); *In re Leasing Consultants, Inc.*, 486 F.2d 367 (2d Cir. 1973) (lessor's residual interest under true lease is an interest in goods and is a separate type of collateral from lessor's interest in the lease). If Dealer leases goods to a "lessee in ordinary course of business (LIOCOB), then LIOCOB takes its interest under the lease (i.e., its "leasehold interest) free of the security interest of SP-1. See Sections 2A-307(3); 2A-103(1)(m) (defining "leasehold interest), (1)(o) (defining "lessee in ordinary course of business). SP-1 would, however, retain its security interest in the residual interest. In addition, SP-1 would acquire an interest in the lease chattel paper as proceeds. If Dealer then assigns the lease chattel paper to SP-2, Section 9-330 gives SP-2 priority over SP-1 with respect to the chattel paper, *but not* with respect to the residual interest in the *goods*. Consequently, assignees of lease chattel paper typically take a security interest in and file against the lessor's residual interest in goods, expecting their priority in the goods to be governed by the first-to-file-or-perfect rule of Section 9-322.

If the goods are returned to Dealer, other than upon expiration of the lease term, then the security interests of both SP-1 and SP-2 normally would attach to the goods as proceeds of the chattel paper. (If the goods are returned to Dealer at the expiration of the lease term and the lessee has made all payments due under the lease, however, then Dealer no longer has any rights under the chattel paper. Dealer's interest in the goods consists solely of its residual interest, as to which SP-2 has no claim.) This would be the case, for example, when the lessee rescinds the lease or when the lessor recovers possession in the exercise of its remedies under Article 2A. See, e.g., Section 2A-525. If SP-2 enjoyed priority in the chattel paper under Section 9-330, then SP-2 likewise would enjoy priority in the returned goods as proceeds. This does not mean that SP-2 necessarily is entitled to the entire value of the returned goods. The value of the goods represents the sum of the present value of (i) the value of their use for the term of the lease and (ii) the value of the residual interest. SP-2 has priority in the former, but SP-1 ordinarily would have priority in the latter. Thus, an allocation of a portion of the value of the goods to each component may be necessary.

[9-331]

Reporters' Comments

1. **Source.** Former Section 9-309.

2. **"Priority."** In some provisions, this Article distinguishes between claimants that take collateral free of a security interest (in the sense that the security interest no longer encumbers the collateral) and those that take an interest in the collateral that is senior to a surviving security interest. See, e.g., Section 9-317. Whether a holder or purchaser referred to in this section takes free or is senior to a security interest depends on the whether the purchaser is a buyer of the collateral or takes a security interest in it. The term "priority is meant to encompass both scenarios, as it does in Section 9-330.

3. **Rights Acquired by Purchasers.** The holders and purchasers referred to in this section do not always take priority over a security interest. See, e.g., Section 7-503 (affording paramount rights to certain owners and secured parties as against holder to whom a negotiable document of title has been duly negotiated). Accordingly, this section adds the clause, "to the extent provided in Articles 3, 7, and 8 to former Section 9-309.

4. **Financial Assets and Security Entitlements.** New subsection (b) provides explicit protection for those who deal with financial assets and security entitlements and who are immunized from liability under Article 8. See, e.g., Sections 8-502; 8-503(e); 8-510; 8-511. The new subsection makes explicit in Article 9 what is already implicit in Article 9 and explicit in several provisions of Article 8. It does not change current law.

5. **Collections by Junior Secured Party.** Under this section, a junior secured party in accounts may, under some circumstances collect and retain the proceeds of those accounts, free of the claim of a senior secured party to those same accounts. In order to qualify as a holder in due course, however, the junior must satisfy the requirements of Section 3-302, which include taking in "good faith . This means that the junior not only must act "honestly , but also must observe "reasonable commercial standards of fair dealing under the particular circumstances. See Section 9-102(a). Although "good faith does not impose a general duty of inquiry, e.g., a search of the records in filing offices, there may be

circumstances in which “reasonable commercial standards of fair dealing would require such a search.

Consider, for example, a junior secured party in the business of financing or buying accounts who fails to undertake a search to determine the existence of prior security interests. Because a search, under the usages of trade of that business, would enable it to know or learn upon reasonable inquiry that collecting the accounts violated the rights of a senior secured party, the junior may fail to meet the good-faith standard. See Utility Contractors Financial Services, Inc. v. Amsouth Bank, NA, 985 F.2d 1554 (11th Cir. 1993). Likewise, a junior secured party who collects accounts when it knows or should know under the particular circumstances that doing so would violate the rights of a senior secured party, because the debtor had agreed not to grant a junior security interest in, or sell, the accounts, may not meet the good-faith test. Thus, if a junior secured party conducted or should have conducted a search and a financing statement filed on behalf of the senior secured party states such a restriction, the junior’s collection would not meet the good-faith standard. On the other hand, if there was a course of performance between the senior secured party and the debtor which placed no such restrictions on the debtor and allowed the debtor to collect and use the proceeds without any restrictions, the junior secured party may then satisfy the requirements for being a holder in due course. This would be more likely in those circumstances where the junior secured party was providing additional financing to the debtor on an on-going basis by lending against or buying the accounts and had no notice of any restrictions against doing so. Generally, the senior secured party would not be prejudiced because the practical effect of such payment to the junior secured party is little different than if the debtor itself had made the collections and subsequently paid the secured party from the debtor’s general funds. Absent collusion, the junior secured party would take the funds free of the senior security interests. See Section 9-332. In contrast, the senior secured party is likely to be prejudiced if, as a part of a liquidation process, the junior secured party collects the accounts by notifying the account debtors to make payments directly to the junior. Those collections may not be consistent with “reasonable commercial standards of fair dealing.

Whether the junior secured party qualifies as a holder in due course is fact-sensitive and should be decided on a case-by-case basis in the light of those circumstances. Decisions such as Financial Management Services Inc. v. Familian, 905 P.2d 506 (Ariz. App. Div. 1995) (finding holder in due course status) could be determined differently under this application of the good-faith requirement.

[9-332]

Reporters’ Comments

1. **Source.** New.

2. **Scope.** This section affords broad protection to transferees who take funds from a deposit account and to those who take money. The term "transferee is not defined; however, the debtor itself is not a transferee. Thus this section does not cover the case in which a debtor withdraws money (currency) from its deposit account or the case in which a bank debits an encumbered account and credits another account it maintains for the debtor.

A transfer of funds from a deposit account, to which subsection (b) applies, normally will be made by check, by funds transfer, or by debiting the debtor's deposit account and crediting another depositor's account.

> **Example 1:** Debtor maintains a deposit account with Bank A. The deposit account is subject to a security interest in favor of Lender. At Bank B's suggestion, Debtor moves the funds from the account at Bank A to Debtor's deposit account with Bank B. Unless Bank B acted in collusion with Debtor in violating Lender's rights (an unlikely scenario, where, as here, Lender allowed Debtor access to an account sufficient to transfer funds), Bank B takes the funds (the credits running in favor of Bank B) free from Lender's security interest. See subsection (b). However, inasmuch as the deposit account maintained with Bank B constitutes the proceeds of the deposit account at Bank A, Lender's security interest would attach to that account as proceeds. See Section 9-315.

Subsection (b) also would apply if, in the example, Bank A debited Debtor's deposit account in exchange for the issuance of Bank A's cashier's check. Lender's security interest would attach to the cashier's check as proceeds of the deposit account, and the rules applicable to instruments would govern any competing claims to the cashier's check. See Sections 3-306; 9-330; 9-331.

If Debtor withdraws money (currency) from an encumbered deposit account and transfers the money to a third party, then subsection (a), to the extent not displaced by federal law relating to money, applies. It contains the same rule as subsection (b).

Subsection (b) applies to *transfers of funds from* a deposit account; it does not apply to *transfers of the deposit account* itself or of an interest therein. For example, this section does not apply to the creation of a security interest in a deposit account. Competing claims to the deposit account itself are dealt with by other Article 9 priority rules. See Sections 9-317(a); 9-327; 9-340; 9-341. Similarly, a corporate merger normally would not result in a transfer of funds from a deposit account. Rather, it might result in a transfer of the deposit account itself. If so, the normal rules applicable to transferred collateral would apply; this section would not.

3. **Policy.** Broad protection for transferees helps to ensure that security interests in deposit accounts do not impair the free flow of funds. It also minimizes

the likelihood that a secured party will enjoy a claim to whatever the transferee purchases with the funds. Rules concerning recovery of payments traditionally have placed a high value on finality. The opportunity to upset a completed transaction, or even to place a completed transaction in jeopardy by bringing suit against the transferee of funds, should be severely limited. Although the giving of value usually is a prerequisite for receiving the ability to take free from third-party claims, where payments are concerned the law is even more protective. Thus, Section 3-418(c) provides that, even where the law of restitution otherwise would permit recovery of funds paid by mistake, no recovery may be had from a person "who in good faith changed position in reliance on the payment. Rather than adopt this standard, this section eliminates all reliance requirements whatsoever. Payments made by mistake are relatively rare, but payments of funds from encumbered deposit accounts (e.g., deposit accounts containing collections from accounts receivable) occur with great regularity. In the mine run of cases, unlike payment by mistake, no one would object to these payments. In the vast proportion of cases, the transferee probably would be able to show a change of position in reliance on the payment. This section does not put the transferee to the burden of having to make this proof.

4. **"Bad Actors."** To deal with the question of the "bad actor, this section borrows "collusion language from Article 8. See, e.g., Sections 8-115, 8-503(e). This is the most protective (i.e., least stringent) of the various standards now found in the UCC. Compare, e.g., Section 1-201(9) ("without knowledge that the sale . . . is in violation of the . . . security interest); Section 1-201(19) ("honesty in fact in the conduct or transaction concerned); Section 3-302(a)(2)(v) ("without notice of any claim).

5. **Transferee Who Does Not Take Free.** This section sets forth the circumstances under which certain transferees of money or funds take free of security interests. It does not determine the rights of a transferee who does not take free of a security interest.

> **Example 2:** The facts are as in Example 1, but, in wrongfully moving the funds from the deposit account at Bank A to Debtor's deposit account with Bank B, Debtor acts in collusion with Bank B. Bank B does not take the funds free of Lender's security interest under this section. If Debtor grants a security interest to Bank B, Section 9-327 governs the relative priorities of Lender and Bank B. Under Section 9-327(3), Bank B's security interest in the Bank B deposit account is senior to Lender's security interest in the deposit account as proceeds. However, Bank B's senior security interest does not protect Bank B against any liability to Lender that might arise from Bank B's wrongful conduct. As noted in Example 1, the potential for collusion in violating a secured party's rights under these circumstances seems more theoretical than real.

[9-333]

Reporters' Comments

1. **Source.** Former Section 9-310.

2. **"Possessory Liens."** This section governs the relative priority of security interests arising under this Article and "possessory liens, i.e., common-law and statutory liens whose effectiveness depends on the lienor's possession of goods with respect to which the lienor provided services or furnished materials in the ordinary course of its business. As under former Section 9-310, the possessory lien has priority over a security interest unless the possessory lien is created by a statute that expressly provides otherwise.

[9-334]

Reporters' Comments

1. **Source.** Former Section 9-313.

2. **Fixtures.** This provisions of section with respect to fixtures follow those of former Section 9-313. However, they have been rewritten to conform to Section 2A-309 and to prevailing style conventions. Also, like other 10-day periods, the 10-day period in this section has been changed to 20 days.

3. **Priority in Manufactured Homes.** A manufactured home may become a fixture. New subsection (e)(4) contains a special rule granting priority to certain security interests created in a "manufactured home as part of a "manufactured-home transaction (also as defined in Section 9-102). Under this rule, a security interest in a manufactured home that becomes a fixture has priority over a conflicting interest of an encumbrancer or owner of the real property if the security interest is perfected under a certificate of title law (see Section 9-311). Subsection (e)(4) is only one of the priority rules applicable to security interests in a manufactured home that becomes a fixture. Thus, a security interest in a manufactured home which does not qualify for priority under this subsection may qualify under another. Priority contests with other Article 9 security interests would be governed by the usual priority rules.

4. **Crops.** Growing crops are "goods in which a security interest may be created and perfected under this Article. In some jurisdictions, a mortgage of real property may cover crops, as well. In the event that crops are encumbered by both a mortgage and an Article 9 security interest, subsection (i) provides that the security interest has priority. States whose real-property law provides otherwise should either amend that law directly or override it by enacting subsection (j).

[9-335]

Reporters' Comments

1. **Source.** New. This section replaces former Section 9-314.

2. **"Accession."** This section applies to an "accession, as defined in Section 9-102, regardless of the cost or difficulty of removing the accession from the other goods, and regardless of whether the original goods have come to form an integral part of the other goods. This section does not apply to goods whose identity has been lost. Goods of that kind are "commingled goods governed by Section 9-336. Neither this section nor the following one addresses case of collateral that changes form without the addition of other goods.

3. **"Accession" versus "Other Goods."** This section distinguishes among the "accession, the "other goods, and the "whole. The last term refers to the combination of the "accession and the "other goods. If one person's collateral becomes physically united with another person's collateral, each is an "accession.

> **Example 1:** SP-1 holds a security interest in the debtor's tractors (which are not subject to a certificate-of-title law), and SP-2 holds a security interest in a particular tractor engine. The engine is installed in a tractor. From the perspective of SP-1, the tractor becomes an "accession and the engine is the "other goods. From the perspective of SP-2, the engine is the "accession and the tractor is the "other goods. The completed tractor–tractor cum engine–constitutes the "whole.

4. **Scope.** This section governs only a few issues concerning accessions. Subsection (a) contains rules governing continuation of a security interest in an accession. Subsection (b) contains a rule governing continued perfection of a security interest in goods that become an accession. Subsection (d) contains a special priority rule governing accessions that become part of a whole covered by a certificate of title. Subsections (e) and (f) govern enforcement of a security interest in an accession.

5. **Matters Left to Other Provisions of This Article: Attachment and Perfection.** Other provisions of this Article often govern accession-related issues. For example, this section does not address whether a secured party acquires a security interest in the whole if its collateral becomes an accession. Normally this will turn on the description of the collateral in the security agreement.

> **Example 2:** Debtor owns a computer subject to a perfected security interest in favor of SP-1. Debtor acquires memory and installs it in the computer. Whether SP-1's security interest attaches to the memory depends on whether the security agreement covers it.

Similarly, this section does not determine whether perfection against collateral that becomes an accession is effective to perfect a security interest in the whole. Other provisions of this article, including the requirements for indicating the collateral covered by a financing statement, resolve that question.

6. **Matters Left to Other Provisions of This Article: Priority.** With one exception, concerning goods covered by a certificate of title (see subsection (d)), the other provisions of this part, including the rules governing purchase-money security interests, determine the priority of most security interests in an accession, including the relative priority of a security interest in an accession and a security interest in the whole. See subsection (c).

> **Example 3:** Debtor owns an office computer subject to a security interest in favor of SP-1. Debtor acquires memory and grants a perfected security interest in the memory to SP-2. Debtor installs the memory in the computer, at which time (we assume) SP-1's security interest attaches to the memory. The first-to-file-or-perfect rule of Section 9-322 governs priority in the memory. If, however, SP-2's security interest is a purchase-money security interest, Section 9-324(e) would afford priority in the memory to SP-2, regardless of which security interest was perfected first.

7. **Goods Covered by a Certificate of Title.** This section does govern the priority of a security interest in an accession that is or becomes part of a whole that is subject to a security interest perfected by compliance with a certificate-of-title statute. Subsection (d) provides that a security interest in the whole, perfected by compliance with a certificate-of-title statute, takes priority over a security interest in the accession. It enables a secured party to rely upon a certificate of title without having to check the UCC files to determine whether any components of the collateral may be encumbered. The subsection imposes a corresponding risk upon those who finance goods that may become part of goods covered by a certificate of title. In doing so, it reverses the priority that appeared reasonable to most pre-UCC courts.

> **Example 4:** Debtor owns an automobile subject to a security interest in favor of SP-1. The security interest is perfected by notation on the certificate of title. Debtor buys tires subject to a perfected-by-filing purchase-money security interest in favor of SP-2 and mounts the tires on the automobile's wheels. If the security interest in the automobile attaches to the tires, then SP-1 acquires priority over SP-2. The same result would obtain if SP-1's security interest attached to the automobile and was perfected after the tires had been mounted on the wheels.

[9-336]

Reporters' Comments

1. **Source.** New. This section replaces former Section 9-315.

2. **"Commingled Goods."** Subsection (a) defines "commingled goods. It is meant to include not only goods whose identity is lost through manufacturing or production (e.g., flour that has become part of baked goods) but also goods whose identity is lost by commingling with other goods from which they cannot be distinguished (e.g., ball bearings).

3. **Consequences of Becoming "Commingled Goods."** By definition, the identity of the original collateral cannot be determined once the original collateral becomes commingled goods. Consequently, the security interest in the specific original collateral alone is lost once the collateral becomes commingled goods, and no security interest in the original collateral can be created thereafter except as a part of the resulting product or mass. See subsection (b).

Once collateral becomes commingled goods, the secured party's security interest is transferred from the original collateral to the product or mass. See subsection (c). If the security interest in the original collateral was perfected, the security interest in the product or mass is a perfected security interest. See subsection (d). This perfection continues until lapse.

4. **Priority of Perfected Security Interests That Attach under this Section.** This section governs the priority of competing security interests in a product or mass only when both security interests arise under this section. In that case, if both security interests are perfected by operation of this section (see subsections (c) and (d)), then the security interests rank equally, in proportion to the value of the collateral at the time it became commingled goods. See subsection (f)(2).

> **Example 1:** SP-1 has a perfected security interest in Debtor's eggs, which have a value of \$ 300 and secure a debt of \$ 400, and SP-2 has a perfected security interest in Debtor's flour, which has a value of \$ 500 and secures a debt of \$ 600. Debtor uses the flour and eggs to make cakes, which have a value of \$ 1000. The two security interests rank equally and share in the ratio of 3:5. Applying this ratio to the entire value of the product, SP-1 would be entitled to \$ 375 (i.e., 3/8 x \$ 1000), and SP-2 would be entitled to \$ 625 (i.e., 5/8 x \$ 1000).

> **Example 2:** Assume the facts of Example 1, except that SP-1's collateral, worth \$ 300, secures a debt of \$ 200. Recall that, if the cake is worth \$ 1000, then applying the ratio of 3:5 would entitle SP-1 to \$ 375 and SP-2 to \$ 625. However, SP-1 is not entitled to collect from the product more than it is owed. Accordingly, SP-1's share would be only \$ 200, SP-2 would receive the remaining value, up to the amount it is owed (\$ 600).

Example 3: Assume that the cakes in the previous examples have a value of only $ 600. Again, the parties share in the ratio of 3:5. If, as in Example 1, SP-1 is owed $ 400, then SP-1 is entitled to $ 225 (i.e., 3/8 x $ 600), and SP-2 is entitled to $ 375 (i.e., 5/8 x $ 600). Debtor receives nothing. If, however, as in Example 2, SP-1 is owed only $ 200, then SP-2 receives $ 400.

The results in the foregoing examples remain the same, regardless of whether SP-1 or SP-2 (or each) has a purchase-money security interest.

5. **Perfection: Unperfected Security Interests.** The rule explained in the preceding Comment applies only when both security interests in original collateral are perfected when the goods become commingled goods. If a security interest in original collateral is unperfected at the time the collateral becomes commingled goods, subsection (f)(1) applies.

Example 4: SP-1 has a perfected security interest in the debtor's eggs, and SP-2 has an unperfected security interest in the debtor's flour. Debtor uses the flour and eggs to make cakes. Under subsection (c), both security interests attach to the cakes. But since SP-1's security interest was perfected at the time of commingling and SP-2's was not, only SP-1's security interest in the cakes is perfected. See subsection (d). Under subsection (f)(1) and Section 9-322(a)(2), SP-1's perfected security interest has priority over SP-2's unperfected security interest.

If both security interests are unperfected, the rule of Section 9-322(a)(3) would apply.

6. **Multiple Security Interests.** On occasion, a single input may be encumbered by more than one security interest. In those cases, the multiple secured parties should be treated like a single secured party for purposes of determining their collective share under subsection (f)(2). The normal priority rules would determine how that share would be allocated between them. Consider the following example, which is a variation on Example 1 above:

Example 5: SP-1A has a perfected, first-priority security interest in Debtor's eggs. SP-1B has a perfected, second-priority security interest in the same collateral. The eggs have a value of $ 300. Debtor owes $ 200 to SP-1A and $ 200 to SP-1B. SP-2 has a perfected security interest in Debtor's flour, which has a value of $ 500 and secures a debt of $ 600. Debtor uses the flour and eggs to make cakes, which have a value of $ 1000.

For purposes of subsection (f)(2), SP-1A and SP-1B should be treated like a single secured party. The collective security interest would rank equally with that of SP-2. Thus, the secured parties would share in the ratio of 3 (for SP-1A and SP-1B combined) to 5 (for SP-2). Applying this ratio to the entire value of the product, SP-1A and SP-1B in the aggregate would be entitled to $ 375 (i.e., 3/8 x $ 1000), and SP-2 would be entitled to $ 625 (i.e., 5/8 x $ 1000).

SP-1A and SP-1B would share the $ 300 in accordance with their priority, as established under other rules. Inasmuch as SP-1A has first priority, it would receive $ 200, and SP-1B would receive $ 100.

7. **Priority of Security Interests That Attach Other than by Operation of this Section.** Under subsection (e), the normal priority rules determine the priority of a security interest that attaches to the product or mass other than by operation of this section. For example, assume that SP-1 has a perfected security interest in Debtor's existing and after-acquired baked goods, and SP-2 has a perfected security interest in Debtor's flour. When the flour is processed into cakes, subsections (c) and (d) provide that SP-2 acquires a perfected security interest in the cakes. If SP-1 filed against the baked goods before SP-2 filed against the flour, then SP-1 will enjoy priority in the cakes. See Section 9-322 (first-to-file-or perfect). But if SP-2 filed against the flour before SP-1 filed against the baked goods, then SP-2 will enjoy priority in the cakes to the extent of its security interest.

[9-337]

Reporters' Comments

1. **Source.** Derived from former Section 9-103(2)(d).

2. **Protection for Buyers and Secured Parties.** This section affords protection to certain good-faith purchasers for value who are likely to have relied on a "clean certificate of title, i.e., one that neither shows that the goods are subject to a particular security interest nor contains a statement that they may be subject to security interests not shown on the certificate. Under this section, a buyer can take free of, and the holder of a conflicting security interest can acquire priority over, a security interest that is perfected by any method under the law of another jurisdiction. The fact that the security interest has been reperfected by possession under Section 9-313 does not of itself disqualify the holder of a conflicting security interest from protection under subsection (b).

[9-338]

Reporters' Comments

1. **Source.** New.

2. **Effect of Incorrect Information in Financing Statement.** Section 9-520(a) requires the filing office to reject financing statements that do not contain information concerning the debtor as specified in Section 9-516(b)(5). A error in

this information does not render the financing statement ineffective. On rare occasions, a subsequent purchaser of the collateral (i.e., a buyer or secured party) may rely on the misinformation to its detriment. This section subordinates a security interest or agricultural lien perfected by an effective, but flawed, financing statement to the rights of a buyer or holder of a perfected security interest to the extent the purchaser gives value in reasonable reliance on the incorrect information. A purchaser 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.

3. **Relationship to Section 9-507.** This section applies to financing statements that contain information that is incorrect at the time of filing and imposes a small risk of subordination on the filer. In contrast, Section 9-507 deals with financing statements containing information that is correct at the time of filing but which becomes incorrect later. Except as provided in Section 9-507 with respect to changes in the debtor’s name, an otherwise effective financing statement does not become ineffective if the information contained in it becomes inaccurate.

[9-339]

Reporters’ Comments

1. **Source.** Former Section 9-316.

[9-340]

Reporters’ Comments

1. **Source.** New. Subsection (b) is based on a nonuniform Illinois amendment.

2. **Set-off versus Security Interest.** This section resolves the conflict between a security interest in a deposit account and the bank’s rights of recoupment and set-off. It is an exception to the general exclusion of the right of set-off from Article 9. See Section 9-109(d). The issue has been the subject of much dispute under former Article 9.

Subsection (a) states the general rule and provides that the bank may effectively exercise rights of recoupment and set-off against the secured party. Subsection (c) contains an exception: if the secured party has control under Section 9-104(a)(3) (i.e., if it has become the bank’s customer), then any setoff exercised by the bank against a debt owed by the debtor (as opposed to a debt owed to the bank by the secured party) is ineffective. The bank may, however, exercise its recoupment rights effectively. This result is consistent with the priority rule in

Section 9-327(4), under which the security interest of a bank in a deposit account is subordinate to that of a secured party that has control under Section 9-104(a)(3).

This section deals with rights of set-off and recoupment that a bank may have under other law. It does not create a right of set-off or recoupment, nor is it intended to override any limitations or restrictions that other law imposes on the exercise of those rights.

3. **Preservation of Set-off Right.** Subsection (b) makes clear that a bank may hold both a right of set-off against, and an Article 9 security interest in, the same deposit account. The subsection does not pertain to accounts evidenced by an instrument (e.g., certain certificates of deposit), which are excluded from the definition of "deposit accounts.

[9-341]

Reporters' Comments

1. **Source.** New.

2. **Free Flow of Funds.** This section is designed to prevent security interests in deposit accounts from impeding the free flow of funds through the payment system. Subject to two exceptions, it leaves the bank's rights and duties with respect to the deposit account and the funds on deposit unaffected by the creation or perfection of a security interest or by the bank's knowledge of the security interest. In addition, the section permits the bank to ignore the instructions of the secured party unless it had agreed to honor them or unless other law provides to the contrary. A secured party who wishes to deprive the debtor of access to funds on deposit or to appropriate those funds for itself needs to obtain the agreement of the bank, utilize the judicial process, or comply with procedures set forth in other law. Section 4-303(a), concerning the effect of notice on a bank's right and duty to pay items, is not to the contrary. That section addresses only whether an otherwise effective notice comes too late; it does not determine whether a timely notice is otherwise effective.

3. **Operation of Rule.** The general rule of this section is subject to Section 9-340(c), under which a bank's right of set-off may not be exercised against a deposit account in the secured party's name if the right is based on a claim against the debtor. This result reflects current law in many jurisdictions and does not appear to have unduly disrupted banking practices or the payments system. The more important function of this section, which is not impaired by Section 9-340, is the bank's right to follow the debtor's (customer's) instructions (e.g., by honoring checks, permitting withdrawals, etc.) until such time as the depository institution is served with judicial process or receives instructions with respect to the funds on deposit from a secured party that has control over the deposit account.

4. **Liability of Bank.** This Article does not determine whether a bank that pays out funds from an encumbered deposit is liable to the holder of a security interest. Although the fact that a secured party has control over the deposit account and the manner by which control was achieved may be relevant to the imposition of liability, whatever rule applies generally when a bank pays out funds in which a third party has an interest would determine liability to a secured party. Often, this rule is found in a non-UCC adverse claim statute.

5. **Certificates of Deposit.** This section does not address the obligations of banks that issue instruments evidencing deposits (e.g., certain certificates of deposit).

[9-342]

Reporters' Comments

1. **Source.** New. Derived from Section 8-106(g).

2. **Protection for Bank.** This section protects banks from the need to enter into agreements against their will and from the need to respond to inquiries from persons other than their customers.

[Part 4]

Reporters' Prefatory Comment

Part 3, Subpart 3, deals with priorities. This part deals with several other issues affecting third parties (i.e., parties other than the debtor and the secured party). Under current law, there is some uncertainty as to which jurisdiction's law (usually, which jurisdiction's version of Article 9) applies to the matters that this Part addresses. Part 3, Subpart 1, does not determine the law governing these matters, since the matters do not relate to perfection, the effect of perfection or nonperfection, or priority.

It would be odd if a designation of applicable law by a debtor and secured party were to control some of these matters. Consider an example that may arise under current law. Former Section 9-318(4) makes ineffective terms in certain contracts that restrict assignment of the right to payment under the contracts. Under California's nonuniform version of Article 9, security interests in most insurance policies are within the scope of the Article. Under New York's (and most States') version, security interests in insurance policies are excluded. If an insurance policy provides that it is governed by the law of New York, it would seems appropriate for New York's law to determine whether a term restricting assignment of the policy is effective. Since New York's Article 9 does not cover an assignment of the policy, New York's Section 9-318(4) would not appear to render ineffective the restriction on assignment. Now assume that the owner of the policy, a California resident, assigns it as security to a California bank, and the security agreement provides that it is governed by the law of California. Does California's Section 9-318(4) then render the restriction in the policy ineffective? We are inclined to think it should not, but the answer is uncertain.

To the extent that jurisdictions adopt identical versions of this Part and the courts interpret it consistently, the inability to identify the applicable law may be inconsequential. To the extent that nonuniform amendments and inconsistent interpretations occur, however, determining the applicable law may be significant. We think it plausible to assume that some nonuniformity in the rules and applicability of Part 4 will persist as revised Article 9 is submitted to and adopted by the States.

Nevertheless, after considering the issue, the Drafting Committee decided not to attempt to fashion choice-of-law rules for the matters covered by this Part. It opted instead to leave courts free to determine the applicable law on a case-by-case basis in accordance with Section 1-105 and non-UCC principles.

[9-401]

Reporters' Comments

1. **Source.** Former Section 9-311.

2. **Inalienability Under Other Law.** Subsection (a) is new. It addresses the question whether property necessarily is transferable by virtue of its inclusion (i.e., its eligibility as collateral) within the scope of Article 9. Subsection (a) gives a negative answer, subject to the identified exceptions. We believe that subsection (a) is implicit in current law.

3. **Negative Pledge Covenant.** Subsection (b) is an exception to the general rule in subsection (a). It is best explained with an example. A debtor grants a security interest to secure a debt in excess of the value of the collateral and agrees not to create subsequent security interests in the collateral. Subsequently, in violation of its agreement with the secured party, the debtor purports to grant a security interest in the same collateral to another secured party. Subsection (b) validates the creation of the subsequent (prohibited) security interest, which might even achieve priority over the earlier security interest. See Comment 4. However, unlike some other provisions of this Part, such as Section 9-406, subsection (b) does not provide that the agreement itself is "ineffective. Consequently, the debtor's breach may create a default.

4. **Sale of Receivables.** If a debtor sells an account, chattel paper, payment intangible, or promissory note outright, as against the buyer the debtor may have no remaining rights to transfer. If, however, the buyer fails to perfect its interest, then insofar as the rights of third parties are concerned, the debtor retains its rights and title. See Section 9-318. The debtor has the power to convey these rights to a subsequent purchaser. If the subsequent purchaser (buyer or secured lender) perfects, it will achieve priority over the earlier, unperfected purchaser. Section 9-322.

[9-402]

Reporters' Comments

1. **Source.** Former Section 9-317.

2. **Agricultural Liens.** This section expands former Section 9-317 to cover agricultural liens.

[9-403]

Reporters' Comments

1. **Source.** Former Section 9-206.

2. **Scope.** This section expands former Section 9-206 to apply to all account debtors. It is not limited to account debtors that have bought goods.

3. **Relationship to Article 3.** Former Section 9-206(1) was designed to treat certain assignees of receivables like holders in due course of negotiable instruments. It left open certain issues, e.g., whether the section incorporates the special Article 3 definition of “value in Section 3-303 or the generally applicable definition in Section 1-201(44). In 1990, the definition of “holder in due course (Section 3-302) and the articulation of the rights of a holder in due course (Sections 3-305 and 3-306) were revised substantially. This section has been reformulated to track more closely the rules of Sections 3-302, 3-305, and 3-306.

This section applies only to the obligations of an “account debtor, as defined in Section 9-102. Thus, it does not determine the circumstances under which and the extent to which a person who is obligated on a negotiable instrument is disabled from asserting claims and defenses. Rather, Article 3 must be consulted. See, e.g., Sections 3-305; 3-306. Article 3 governs even when the negotiable instrument constitutes part of chattel paper. See Section 9-102 (an obligor on a negotiable instrument constituting part of chattel paper is not an “account debtor).

4. **Relationship to Terms of Assigned Property.** Former Section 9-206(2), concerning warranties accompanying the sale of goods, has been deleted as unnecessary. This Article does not regulate the terms of the account, chattel paper, or general intangible that is assigned, except insofar as the account, chattel paper, or general intangible itself creates a security interest (as often is the case with chattel paper). Thus, Article 2, and not this Article, determines whether a seller of goods makes or effectively disclaims warranties, even if the sale is secured. Similarly, other law, and not this Article, determines the effectiveness of an account debtor’s undertaking to pay notwithstanding, and not to asset, any defenses or claims against an assign*or*–e.g., a “hell or high water provision in the underlying agreement that is assigned. If other law gives effect to this undertaking, then, under principles of *nemo dat,* it would be enforceable by the assignee (secured party). If other law prevents the assignor from enforcing the undertaking, this section nevertheless might permit the assignee to do so. The right of the assignee to enforce would depend upon whether, under the particular facts, the account debtor’s undertaking fairly could be construed as an agreement that falls within the scope of this section and whether the assignee meets the requirements of this section.

5. **Relationship to Federal Trade Commission Rule.** Subsection (d) is new. It applies to rights evidenced by a record that is required to contain, but does not contain, the notice set forth in Federal Trade Commission Rule 433 (the “Holder in Due Course Regulations). Under this subsection, an assignee of such a record takes subject to the consumer account debtor’s claims and defenses to the same extent as it would have if the writing had contained the required notice. Thus,

subsection (d) effectively renders waiver-of-defense clauses ineffective in the consumer transactions to which it applies.

6. **Relationship to Other Law.** The reference to “law other than this Article in subsection (e) encompasses administrative rules and regulations; the reference in former Section 9-206(1) that it replaces (“statute or decision) arguably would not.

This section does not displace other law that gives effect to a non-consumer account debtor’s agreement not to assert defenses against an assignee, even if the agreement would not qualify under subsection (b). See subsection (e).

This section also does not displace other law to the extent that the other law permits an assignee, who takes an assignment with notice of a claim of a property or possessory right, a defense, or a claim in recoupment, to enforce an agreement not to assert claims and defenses against the assign*or*. It also does not displace an assignee’s right to assert that an account debtor is estopped from asserting a claim or defense. Nor does this section displace other law with respect to waivers of potential future claims and defenses that are the subject of an agreement between the account debtor and the assign*ee*. Finally, it does not displace Section 1-107, concerning waiver of a breach that allegedly already has occurred.

[9-404]

Reporters’ Comments

1. **Source.** Former Section 9-318(1).

2. **Rights of Assignee.** Under subsection (a), unlike former Section 9-318(1), the waiver-of-defense clauses addressed are not limited to those in sales of goods transactions. Subsection (a) also tracks Section 3-305(a)(3) more closely than its predecessor.

Subsection (b) is new. It limits the claim that the account debtor may assert against an assignee. Borrowing from Section 3-305(a)(3) and cases construing former Section 9-318, subsection (b) generally does not afford the account debtor the right to an affirmative recovery from an assignee.

3. **Consumer Account Debtors; Relationship to Federal Trade Commission Rule.** Subsections (c) and (d) also are new. Subsection (c) makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors. Subsection (d) applies to rights evidenced by a record that is required to contain, but does not contain, the notice set forth in Federal Trade Commission Rule 433 (the “Holder in Due Course Regulations). Under subsection (d), a consumer account debtor has the same right to an

affirmative recovery from an assignee of such a record as the consumer would have had against the assignee had the record contained the required notice.

4. **Application to "Account Debtor."** This section deals only with the rights and duties of "account debtors –and for the most part only with account debtors on accounts, chattel paper, and payment intangibles. Neither this section nor any other provision of this Article, including Sections 9-408 and 9-409, provides analogous regulation of the rights and duties of other obligors on collateral, such as the maker of a negotiable instrument (governed by Article 3), the issuer of or nominated person under a letter of credit (governed by Article 5), or the issuer of a security (governed by Article 8). Article 9 leaves those rights and duties untouched; however, Section 9-409 deals with the special case of letters of credit. When chattel paper is composed in part of a negotiable instrument, the obligor on the instrument is not an "account debtor, and Article 3 governs the rights of the assignee of the chattel paper with respect to the issues this section addresses. See, e.g., Section 3-601 (dealing with discharge of an obligation to pay a negotiable instrument).

References in this section to an "account debtor include account debtors on collateral that is proceeds.

5. **Account Debtors on Health-Care-Insurance Receivables.** Subsection (e) is new. The obligation of an insurer with respect to a health-care-insurance receivable is governed by other law.

[9-405]

Reporters' Comments

1. **Source.** Former Section 9-318(2).

2. **Modification of Assigned Contract.** Subsections (a) and (b) change former Section 9-318(2) by providing that good-faith modifications are binding against an assignee to the extent that (i) the right to payment has not been fully earned or (ii) the right to payment has been earned and notification has not been given to the account debtor.

3. **Consumer Account Debtors.** Subsection (c) is new. It makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors.

4. **Account Debtors on Health-Care-Insurance Receivables.** Subsection (d) also is new. The obligation of an insurer with respect to a health-care-insurance receivable is governed by other law.

[9-406]

Reporters’ Comments

1. **Source.** Former Section 9-318(3), (4).

2. **Account Debtor’s Right to Pay.** Subsection (a) provides the general rule concerning an account debtor’s right to pay the assignor until the account debtor receives appropriate notification. The revision makes clear that once the account debtor receives the notification, the account debtor cannot discharge its obligation by paying the assignor. It also makes explicit that payment to the assignor before notification, or payment to the assignee after notification, discharges the obligation. No change in meaning from former Section 9-318 is intended.

Subsection (a) also has been revised to apply only to account debtors on accounts, chattel paper, and payment intangibles. (The term “account debtor is defined in Section 9-102 to include those obligated on all general intangibles.) Although this revision renders subsection (d) more precise, it probably does not change the law. Former Section 9-318(3) refers to the account debtor’s obligation to “pay, thereby suggesting that the subsection is limited to account debtors on accounts, chattel paper, and other payment obligations.

Nothing in this section conditions the effectiveness of a notification on the identity of the person who gives it. An account debtor that doubts whether the right to payment has been assigned may avail itself of the procedures in subsection (c).

3. **Limitations on Effectiveness of Notification.** This section contains some special rules concerning the effectiveness of a notification under subsection (a).

Subsection (b)(1) tracks former Section 9-318(3) and makes ineffective a notification that does not reasonably identify the rights assigned. A reasonable identification need not identify the account with specificity.

Subsection (b)(2), which is new, applies only to sales of payment intangibles. It makes a notification ineffective to the extent that other law gives effect to an agreement between an account debtor and a seller of a payment intangible that limits the account debtor’s duty to pay a person other than the seller. Payment intangibles are substantially less fungible than accounts and chattel paper. In some (e.g., commercial bank loans), account debtors customarily and legitimately expect that they will not be required to pay any person other than the financial institution that has advanced funds.

It has become common in financing transactions to assign interests in a single obligation to more than one assignee. Requiring an account debtor that owes a single obligation to make multiple payments to multiple assignees would be unnecessarily burdensome. Thus, under subsection (b)(3), an account debtor that is notified to pay an assignee less than the full amount of any installment or other periodic payment has the option to treat the notification as ineffective, ignore the notice, and discharge the assigned obligation by paying the assignor. Some account debtors may not realize that the law affords them the right to ignore certain notices of assignment with impunity. By making the notification ineffective at the account debtor's option, subsection (b)(3) permits an account debtor to pay the assignee in accordance with the notice and thereby to satisfy its obligation *pro tanto*. Under subsection (f), the rights and duties created by subsection (b)(3) cannot be waived or varied.

4. **Proof of Assignment.** Subsection (c) links payment with discharge, as in subsection (a). It follows former Section 9-318(3) in referring to the right of the account debtor to pay the assignor if the requested proof of assignment is not seasonably forthcoming. Arguably, the notification of assignment would remain effective, so that, in the absence of reasonable proof of the assignment, the account debtor could discharge the obligation by paying either the assignee or the assignor. Of course, if no assignment was in fact made, the putative assignee has no right to payment under any circumstances, and the account debtor cannot discharge the obligation by paying the putative assignee. If no assignment was made, the quality of the notice or the "proof of assignment are irrelevant.

An account debtor may face another problem if its obligation becomes due while the account debtor is awaiting reasonable proof of the assignment that it has requested from the assignee. This section does not excuse the account debtor from timely compliance with its obligations. Consequently, an account debtor may discharge its obligation by paying the assignor when payment is due, even if the account debtor has not yet received a response to its request for proof of the assignment. On the other hand, after requesting reasonable proof of the assignment, an account debtor may not discharge its obligation by paying the assignor before payment is due unless the assignee has failed to provide the proof seasonably.

5. **Restrictions on Assignment.** Former Section 9-318(4) renders ineffective an agreement between an account debtor and an assignor which prohibits assignment of an account (whether outright or for collateral purposes) or prohibits a security assignment of a general intangible for the payment of money due or to become due. Subsection (d) essentially follows former Section 9-318(4), but expands the rule of free assignability to chattel paper (subject to Sections 2A-303 and 9-407) and promissory notes and explicitly overrides restrictions on assignability as well as prohibitions.

Former Section 9-318(4) does not apply to sales of payment intangibles but does apply to assignments for security. Subsection (e) continues this approach and also makes subsection (d) inapplicable to sales of promissory notes. Section 9-408 addresses anti-assignment clauses with respect to sales of payment intangibles and promissory notes.

Like former Section 9-318(4), subsection (d) provides that anti-assignment clauses are "ineffective. The quoted term means that the clause is of no effect whatsoever; the clause does not prevent the assignment from taking effect between the parties, nor does the prohibited assignment constitute a default under the agreement between the account debtor and assignor.

6. **Multiple Assignments.** The section remains silent concerning multiple assignments. The Official Comments will refer to applicable non-UCC rules.

7. **Consumer Account Debtors.** Subsection (g) is new. It makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors.

8. **Account Debtors on Health-Care-Insurance Receivables.** Subsection (h) also is new. The obligation of an insurer with respect to a health-care-insurance receivable is governed by other law.

[9-407]

Reporters' Comments

1. **Source.** Section 2A-303. A subsection patterned on Section 2A-303(1), which appeared in earlier drafts, has been deleted as unnecessary.

2. **Conforming Terminology.** This section has been conformed in several respects to analogous provisions in Sections 9-406, 9-408, and 9-409, including the substitution of "ineffective for "not enforceable.

[**9-408]**

Reporters' Comments

1. **Source.** New.

2. **Free Assignability.** This section makes ineffective any attempt to restrict the assignment of a general intangible, health-care-insurance receivable, or promissory note, whether the restriction appears in the terms of a promissory note or the agreement between an account debtor and a debtor (subsection (a)) or in a rule of law, including a statute or governmental rule or regulation (subsection (c)). The principal goal is to protect the creation, attachment, and perfection of a security interest (including a sale of a health-care-insurance receivable (which is an "account), payment intangible, or promissory note) while preventing these events from giving rise to a default or breach by the assignor or from triggering a remedy of the account debtor or person obligated on a promissory note. Achieving this goal

will enhance the ability of certain debtors to obtain credit. On the other hand, subsection (d) protects the other party–the “account debtor on a general intangible or the person obligated on a promissory note–from any adverse effects of the security interest. It leaves the account debtor’s or obligated person’s rights and obligations unaffected in all material respects if a restriction rendered ineffective by subsection (a) or (c) would be effective under law other than Article 9.

3. **Terminology: “Account Debtor”; “Person Obligated on a Promissory Note.”** This section uses the term “account debtor as it is defined in Section 9-102. It refers to the party, other than the debtor, to a general intangible, including a permit, franchise, or the like, and the person obligated on a health-care-insurance receivable, which is a type of account. The definition of “account debtor does not limit the term to persons who are obligated to *pay* under a general intangible. Rather, the term includes all persons who are obligated on a general intangible, including those who are obligated to render performance in exchange for payment. In many cases, e.g., the creation of a security interest in a franchisee’s rights under a franchise agreement, the principal payment obligation under a general intangible may be a obligation to pay *by* the debtor (franchisee) *to* the account debtor (franchisor). This section also refers to a “person obligated on a promissory note, inasmuch as those persons do not fall within the definition of “account debtor.

4. **Scope: Sales of Payment Intangibles and Other General Intangibles.** This section applies to a security interest in payment intangibles only if the security interest arises out of sale of the payment intangibles. Security interests in payment intangibles that secure an obligation are subject to the even broader anti-assignment rule in Section 9-406(d).

This section does not render ineffective any term that restricts outright sales of general intangibles other than payment intangibles. It deals only with restrictions on security interests. The only sales of general intangibles that create security interests are sales of payment intangibles. This section also deals with sales of promissory notes, which also create security interests. See Section 9-109.

5. **Effects on Account Debtors and Persons Obligated on Promissory Notes.** Subsections (a) and (c) affect two classes of persons. These subsections affect account debtors on general intangibles and health-care-insurance receivables and persons obligated on promissory notes. Subsection (c) also affects governmental entities that enact or determine rules of law. *However, subsection (d) ensures that these affected persons cannot possibly be affected adversely*. That provision removes any burdens or adverse effects on these persons for which any rational basis could exist to restrict the effectiveness of an assignment or to exercise any default remedies. For this reason, the effects of subsections (a) and (c) are wholly immaterial for those persons.

Some concerns have been expressed about the perceived breadth of this section. In particular, some have read subsection (a) to override various covenants that do not directly prohibit, restrict, or require consent to an assignment but which might, nonetheless, present a practical impairment of the assignment. Properly read, however, this section reaches only covenants that prohibit, restrict, or require consents to assignments; it does not override all terms that might “impair an assignment in fact.

6. **Effect in Assignor’s Bankruptcy.** This section could have a substantial effect if the assignor enters bankruptcy. Roughly speaking, Bankruptcy Code Section 552 invalidates security interests in property acquired after a bankruptcy petition is filed, except to the extent that the post-petition property constitutes proceeds of pre-petition collateral. Consider the owner of a cable television franchise that, under applicable law, cannot be assigned without the consent of the municipal franchisor. A lender wishes to extend credit to the franchisee, secured by the debtor’s “going business value. To secure the loan, the debtor grants a security interest in all its existing and after-acquired property. The franchise represents the principal value of the business. The municipality refuses to consent to any assignment for collateral purposes. As a consequence, by virtue of other law, the security interest in the franchise does not attach. If the debtor enters bankruptcy and sells the business, the secured party will receive but a fraction of the business’s value. Under this section, however, the security interest would attach to the franchise. As a result, the security interest would attach to the proceeds of any sale of the franchise during bankruptcy. This section would protect the interests of the municipality by preventing the secured party from enforcing its security interest to the detriment of the municipality.

7. **Effect Outside of Bankruptcy.** The principal effects of this section will take place outside of bankruptcy. Compared to the relatively few debtors that enter bankruptcy, there are many more that do not. By making available previously unavailable property as collateral, this section should enable debtors to obtain additional credit.

8. **Contrary Federal Law.** This section does not override federal law to the contrary. However, it does reflect an important policy judgment that we hope will provide a template for future federal law reforms.

[9-409]

Reporters’ Comments

1. **Source.** New.

2. **Purpose and Relevance.** This section, patterned on Section 9-408, limits the effectiveness of any attempt to restrict the creation, attachment, or

perfection of a security interest in letter-of-credit rights, whether the restriction appears in the letter of credit or a rule of law, custom, or practice applicable to the letter of credit.

The principal goal of subsection (a) is to protect the creation, attachment, and perfection of a security interest while preventing these events from giving rise to a default or breach by the assignor or from triggering a remedy or defense of the issuer or other person obligated on a letter of credit. Subsection (b) protects the issuer and other parties from any adverse effects of the security interest. It explicitly preserves the “independence principle of letter-of-credit law by leaving unaffected the rights and obligations of issuers, nominated persons, and transferee beneficiaries if a restriction rendered ineffective by subsection (a) would be effective under other law.

Letter-of-credit rights are a type of supporting obligation. See Section 9-102. Under Sections 9-203 and 9-308, a security interest in a supporting obligation attaches and is perfected automatically if the security interest in the supported obligation attaches and is perfected. See Section 9-107, Comment 5. It would be anomalous, or at least misleading, to provide for automatic attachment and perfection in Article 9 if, under other law (e.g., Article 5), a restriction on transfer or assignment is effective to block attachment. This section makes it clear that restrictions on an assignment of a letter of credit are ineffective to prevent attachment and perfection, but preserves letter-of-credit law and practice limiting the right of a beneficiary to transfer its right to draw or otherwise demand performance (Section 5-112) and limiting the obligation of an issuer or nominated person to recognize a beneficiary’s assignment of letter-of-credit proceeds (Section 5-114). Thus, this section’s treatment of letter-of-credit rights differs from that of instruments and investment property.

[Part 5]

[9-501]

Reporters' Comments

1. **Source.** Derived from former Section 9-401.

2. **Where to File.** Subsection (a) indicates where in a given State a financing statement is to be filed. Former Article 9 affords each State three alternative approaches, depending on the extent to which the State desires central filing (usually with the Secretary of State), local filing (usually with a county office), or both. Local filing increases the net costs of secured transactions by increasing uncertainty and the number of required filings. Any benefit that local filing may have had in the 1950's (e.g., ease of access to local creditors) 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.

3. **Minerals and Timber.** Under subsection (a)(1), a filing in the office where a mortgage on the related real property would be filed will perfect a security interest in as-extracted collateral. Inasmuch as the security interest does not attach until extraction, the filing continues to be effective after extraction. A different result occurs with respect to timber to be cut, however. Unlike as-extracted collateral, standing timber may be goods before it is cut. See Section 9-102 (defining "goods). Once cut, however, it is no longer timber *to be* cut, and the filing in the real property mortgage office ceases to be effective. The timber then becomes ordinary goods, and filing in the office specified in subsection (a)(2) is necessary for perfection. Note also that after the timber is cut the law of the debtor's location, not the location of the timber, governs perfection under Section 9-301.

4. **Fixtures.** There are two ways in which a secured party may file a financing statement to perfect a security interest in goods that are or are to become fixtures. It may file in the Article 9 records, as with most other goods. See subsection (a)(2). Or it may file the financing statement as a "fixture filing, defined in Section 9-102, in the office in which a mortgage on the related real property would be filed. See subsection(a)(1)(B).

[9-502]

Reporters' Comments

1. **Source.** Former Section 9-402(1), (5), (6).

2. **Debtor's Signature; Required Authorization.** Subsection (a) sets forth the requirements for an effective financing statement. It derives from former Section 9-402(1), but omits several requirements.

First, subsection (a) omits the requirement that the debtor sign a financing statement. As PEB Commentary No. 15 indicates, a paperless financing statement may be filed electronically under existing law. Nevertheless, the elimination of the signature requirement facilitates paperless filing. Elimination of the debtor's signature requirement makes the exceptions provided by former Section 9-402(2) unnecessary.

The fact that this Article does not require that an authenticating symbol be contained in the public record does not mean that all filings are authorized. To the contrary, this Article contains several provisions designed to ensure that only authorized records are filed. Section 9-509(a) entitles a person to file an initial financing statement or an amendment that adds collateral only if the debtor authorizes the filing, and Section 9-625(e) provides a remedy for unauthorized filings. Of course, a filing has legal effect only to the extent it is authorized. See Section 9-510.

Making an unauthorized filing may give rise to civil or criminal liability under other law. In addition, this Article contains provisions that assist in the discovery of unauthorized filings and the amelioration of their practical effect. For example, Section 9-518 provides a procedure whereby a person may add to the public record a statement to the effect that a financing statement indexed under the person's name was wrongfully filed, and Section 9-509(c) entitles any person to file a termination statement if the secured party of record fails to comply with its obligation to file or send one to the debtor.

3. **Certain Other Requirements.** Subsection (a) deletes other formerly required information because it seems unwise (real property description for financing statements covering crops), unnecessary (adequacy of copies of financing statements), or both (copy of security agreement as financing statement). In addition, a financing statement lacking certain other information that formerly was required as a condition of perfection (e.g., an address for the debtor or secured party) must be rejected by the filing office to reject a financing statement. See Sections 9-516(b); 9-520(a). However, if the filing office accepts the record, it is effective nevertheless. See Section 9-520(b).

4. **Real-property-related Filings.** Subsection (b) contains the requirements for fixture filings and financing statements covering timber to be cut or minerals and minerals-related accounts constituting as-extracted collateral. Subsection (c) explains when a real property mortgage is effective as a financing statement filed as a fixture filing or to cover timber to be cut or as-extracted collateral. The changes relating to minerals and accounts primarily respond to recommendations of the ABA Oil and Gas Task Force.

In some cases it may be difficult to determine whether goods are or will become fixtures. Nothing in this part prohibits the filing of a “precautionary fixture filing, which would provide protection in the event goods are determined to be fixtures. The fact of filing should not be a factor in the determining whether goods are fixtures. Cf. Section 9-505(b).

5. **“Pre-filed” Financing Statement.** Subsection (d), which is taken from former Section 9-402(1), may be unnecessary. Nevertheless, a majority of the Drafting Committee believe that the provision has proven useful. See also Section 9-308(a) (contemplating situations in which a financing statement is filed before a security interest attaches).

[9-503]

Reporters’ Comments

1. **Source.** Subsection (a)(4)(A) derives from former Section 9-402(7); otherwise, new.

2. **Debtor’s Name.** The requirement that a financing statement provide the debtor’s name is particularly important. Financing statements are indexed under the name of the debtor, and people who wish to find financing statements search for them under the debtor’s name. Subsection (a) explains what the debtor’s name is for purposes of a financing statement. If the debtor is a “registered organization (defined in Section 9-102 so as to ordinarily include corporations, limited partnerships, and limited liability companies), then the debtor’s name is the name shown on the public records of the debtor’s “jurisdiction of organization (also as defined in Section 9-102). Subsections (a)(2) and (a)(3) contain special rules for decedent’s estates and trusts, as to which current law is now silent.

Subsection (a)(4)(A) essentially follows the first sentence of former Section 9-402(7). Section 1-201(28) defines the term “organization, which appears in subsection (a)(4), very broadly, to include all legal and commercial entities as well as associations that lack the status of a legal entity. If the organization has a name, that name is the correct name to put on a financing statement. If the organization does not have a name, then the financing statement should name the individuals or other entities who comprise the organization.

Together with subsections (b) and (c), subsection (a) reflects the prevailing view that the actual individual or organizational name of the debtor on a financing statement is both necessary and sufficient, whether or not the financing statement provides trade or other names of the debtor and, if the debtor has a name, whether or not the financing statement provides the names of the partners, members, or associates who comprise the debtor.

3. **Secured Party's Name.** New subsection (d) makes clear that when the secured party is a representative, the financing statement is sufficient if it names the secured party, whether or not it indicates any representative capacity. Similarly, a financing statement that names a representative of the secured party need not indicate the representative capacity.

> **Example:** Debtor creates a security interest in favor of a group of secured parties, but not to their representative, the collateral agent. The collateral agent is not itself a secured party. See Section 9-102. Under Sections 9-502(a) and 9-503(d), however, a financing statement is effective if it names as secured party the collateral agent and not the actual secured parties, even if it omits the collateral agent's representative capacity.

4. **Multiple Names.** Subsection (e) makes explicit what is implicit in current law, that a financing statement may provide the name of more than one debtor and secured party. See Section 1-102(5)(a) (words in the singular include the plural).

[9-504]

Reporters' Comments

1. **Source.** Former Section 9-402(1).

2. **Indication of Collateral.** This section expands the class of sufficient collateral references to embrace "an indication that the financing statement covers all assets or all personal property. If the property in question belongs to the debtor and is personal property, any searcher will know that the property is covered by the financing statement. A broad statement of this kind would not be a sufficient description for purposes of a security agreement. See Section 9-108. It follows that a somewhat narrower description than "all assets, e.g., "all assets other than automobiles, is sufficient for purposes of this section even if it does not suffice for purposes of a security agreement.

[9-505]

Reporters' Comments

1. **Source.** Former Section 9-408, expanded.

2. **Goods Covered by a Certificate of Title.** This section provides the same benefits for compliance with a statute or treaty described in Section 9-311(a) that former Section 9-408 provides for filing, in connection with the use of terms such as "lessor, consignor, etc. It also expands the rule to embrace more generally other bailments and transactions. The references to "owner and

“registered owner are intended to address, for example, the situation where a putative lessor is the registered owner of an automobile covered by a certificate of title and the transaction is determined to create a security interest. Although this section provides that the security interest is perfected, it may be advisable or necessary to amend the relevant certificate-of-title act in order to ensure that this result will be achieved. The references to “buyer and “seller encompass sales transactions, primarily sales of payment intangibles and promissory notes.

3. **“Intended as Security.”** Former Article 9 and Section 1-201 refer to transactions, including leases and consignments, “intended as security. This misleading phrase creates the erroneous impression that the parties to a transaction can dictate how the law will classify it (e.g., as a bailment or as a security interest) and thus affect the rights of third parties. The phrase has been deleted wherever it appears. The last two sentences of this section substitute the concept of whether collateral secures an obligation for the existing “intention standard.

4. **Consignments.** Although a “true consignment is a bailment, the filing and priority provisions of former Article 9 apply to it; a consignment “intended as security creates a security interest that is in all respects subject to former Article 9. This Article subsumes many true consignments under the rubric of “security interest. Nevertheless, it maintains the distinction between a (true) “consignment, as to which only certain aspects of Article 9 apply, and a would-be consignment that actually “secures an obligation, to which Article 9 applies in full. The revisions to this section reflect the change in terminology.

[9-506]

Reporters’ Comments

1. **Source.** Former Section 9-402(8), as expanded.

2. **Errors.** This section adds to former Section 9-402(8) two new rules concerning the effectiveness of financing statements in which the debtor’s name is incorrect. Subsection (b) contains the general rule: a financing statement that fails sufficiently to provide the debtor’s name in accordance with Section 9-503(a) is seriously misleading as a matter of law. Subsection (c) provides an exception: If the financing statement nevertheless would be discovered in a search under the debtor’s correct name, using the filing office’s standard search logic, if any, then as a matter of law the incorrect name does not make the financing statement seriously misleading. A financing statement that is seriously misleading under this section 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 data base other than that of the filing office.

3. **New Debtors.** Subsection (d) provides that, in determining the extent to which a financing statement naming an original debtor is effective against a new debtor, the sufficiency of financing statement should be tested against the name of the new debtor.

[9-507]

Reporters' Comments

1. **Source.** Former Section 9-402(7).

2. **Scope of Section.** This section deals with situations in which the information in a proper financing statement becomes inaccurate after the financing statement is filed. Section 9-338 deals with situations in which the financing statement contains a particular kind of information (i.e., the information described in Section 9-516(b)(5)) that is incorrect at the time it is filed.

3. **Post-filing Disposition of Collateral.** Under subsection (a), a financing statement remains effective even if the collateral is sold or otherwise disposed of. This subsection clarifies the third sentence of former Section 9-402(7) by providing that a financing statement remains effective following the disposition of collateral only when the security interest or agricultural lien continues in that collateral. This result is consistent with the conclusion of PEB Commentary No. 3. Normally, a security interest does continue after disposition of the collateral. See Section 9-315(a). Law other than this Article determines whether an agricultural lien survives disposition of the collateral.

As a consequence of the disposition, the collateral may be owned by a person other than the debtor against whom the financing statement was filed. Under subsection (a), the secured party remains perfected even if it does not correct the public record. Subsection (a) addresses only the sufficiency of the information contained in the financing statement. A disposition of collateral may result in loss of perfection for other reasons. See Section 9-316.

> **Example:** Dee Corp. is an Illinois corporation. It creates a security interest in its equipment in favor of Secured Party. Secured Party files a proper financing statement in Illinois. Dee Corp. sells an item of equipment to Bee Corp., a Pennsylvania corporation, subject to the security interest. The security interest continues, see Section 9-315(a), and remains perfected, see Section 9-507(a), notwithstanding that the financing statement is filed under "D (for Dee Corp.) and not under "B. However, because Bee Corp. is located in Pennsylvania and not Illinois, see Section 9-307, Secured Party must perfect under Pennsylvania law within one year after the transfer. If Secured Party fails to do so, its security interest will become unperfected and will be deemed to have been unperfected against purchasers of the collateral. See Section 9-316.

4. **Other Post-filing Changes.** Subsection (b) provides that, as a general matter, post-filing changes that render a financing statement inaccurate and seriously misleading have no effect on a financing statement. The financing statement remains effective. It is subject to two exceptions: Section 9-508 and Section 9-507(c). Section 9-508 addresses the effectiveness of a financing statement filed against an original debtor when a new debtor becomes bound by the original debtor's security agreement It is discussed in the Reporters' Comments to that section. Section 9-507(c) addresses a "pure change of the debtor's name, i.e., a change that does not implicate a new debtor. It clarifies former Section 9-402(7) regarding the effectiveness of a seriously misleading financing statement for the four months following a name change and provides that the record can be corrected by an amendment to the financing statement that specifies the debtor's new correct name or otherwise renders the financing statement not seriously misleading.

[9-508]

Reporters' Comments

1. **Source.** New.

2. **The Problem.** Section 9-203(d) and (e) and this section deal with situations where one party (the "new debtor) becomes bound as debtor by a security agreement entered into by another person (the "original debtor). These situations often arise as a consequence of changes in business structure. For example, the original debtor may be an individual debtor who operates a business as a sole proprietorship and then incorporates it. Or, the original debtor may be a corporation that is merged into another corporation. Under both former Article 9 and this Article, collateral that is transferred in the course of the incorporation or merger normally would remain subject to a perfected security interest. See Sections 9-315(a); 9-507(a). Former Article 9 is less clear with respect to whether an after-acquired property clause in a security agreement authenticated by the original debtor would be effective to create a security interest in property acquired by the new corporation or the merger survivor and, if so, whether a financing statement filed against the original debtor would be effective to perfect the security interest. This section and Sections 9-203(d) and (e) are an attempt at clarification.

3. **How a New Debtor Becomes Bound.** Normally, a security interest is unenforceable unless the debtor has authenticated a security agreement describing the collateral. See Section 9-203(b). New Section 9-203(e) creates an exception, under which a security agreement entered into by one person is effective with respect to the property of another. This exception comes into play if a "new debtor becomes bound as debtor by a security agreement entered into by another person (the "original debtor). (The quoted terms are defined in new subsections of Section 9-102.) If a new debtor does become bound, then the security agreement entered into by the original debtor satisfies the security-agreement requirement of

Section 9-203(b)(3) as to existing or after-acquired property of the new debtor to the extent the property is described in the agreement. In that case, no other agreement is necessary to make a security interest enforceable in that property. See Section 9-203(e).

Section 9-203(d) explains when a new debtor becomes bound by an original debtor's security agreement. Under Section 9-203(d)(1), a new debtor becomes bound as debtor if, by contract or operation of other law, the security agreement becomes effective to create a security interest in the new debtor's property. For example, if the applicable corporate law of mergers provides that when A Corp merges into B Corp, B Corp becomes a debtor under A Corp's security agreement, then B Corp would become bound as debtor following such a merger. Similarly, B Corp would become bound as debtor if B Corp contractually assumes A's obligations under the security agreement.

Under certain circumstances, a new debtor becomes bound for purposes of Article 9 even though it would not be bound under other law. Under Section 9-203(d)(2), a new debtor becomes bound when it (i) becomes obligated not only for the secured obligation but also generally under applicable law for the obligations of the original debtor and (ii) acquires or succeeds to substantially all the assets of the original debtor. For example, some corporate laws provide that, when two corporations merge, the surviving corporation succeeds to the assets of its merger partner and "has all liabilities of both corporations. In the case where, for example, A Corp merges into B Corp (and A Corp ceases to exist), some people have questioned whether A Corp's grant of a security interest in its existing and after-acquired property becomes a "liability of B Corp, such that B Corp's existing and after-acquired property becomes subject to a security interest in favor of A Corp's lender. Even if corporate law were to give a negative answer, under Section 9-203(d)(2), B Corp would become bound for purposes of Section 9-203(e) and this section. The substantially-all-assets requirement of Section 9-203(d)(2) excludes sureties and other secondary obligors as well as persons who become obligated through veil piercing and other non-successorship doctrines. In many cases, it will exclude successors to the assets and liabilities of a division of a debtor.

4. **When a Financing Statement Is Effective Against a New Debtor.** Subsection (a) provides that a filing against the original debtor is effective to perfect a security interest in collateral that a new debtor has at the time it becomes bound by the original debtor's security agreement and that it acquires before the expiration of four months after the new debtor becomes bound. Under subsection (b), however, if the filing against the original debtor is seriously misleading as to the new debtor's name, the filing is effective as to collateral acquired by the new debtor after the four-month period only if a person files during the four-month period an initial financing statement providing the name of the new debtor. Compare Section 9-507(c) (four-month period of effectiveness with respect to collateral acquired by a debtor after the debtor changes its name).

5. **Transferred Collateral.** This section does not apply to collateral transferred by the original debtor to a new debtor. Under those circumstances, the filing against the original debtor continues to be effective until it lapses. See subsection (c); Section 9-507(a).

6. **Priority.** Section 9-326 governs the priority contest between a secured creditor of the original debtor and a secured creditor of the new debtor.

[9-509]

Reporters' Comments

1. **Source.** New.

2. **Scope and Approach of This Section.** This section collects in one place most of the rules determining whether a record may be filed. Section 9-510 explains the extent to which a filed record is effective. These sections reflect this Article's indifference as to the person who effects a filing. The filing scheme contemplated by this part does not contemplate that the identity of a "filer will be a part of the searchable records. This is consistent with, and a necessary aspect of, eliminating signatures or other evidence of authorization from the system (except to the extent that filing offices may choose to employ authentication procedures in connection with electronic communications). As long as the appropriate person authorizes the filing, or, in the case of a termination statement, the debtor is entitled to the termination, it is largely insignificant whether the secured party or another person files any given record.

3. **Unauthorized Filings.** Records filed in the filing office do not require signatures for their effectiveness. Subsection (a)(1) substitutes for the debtor's signature on a financing statement the requirement that the debtor authorize in an authenticated record the filing of an initial financing statement or an amendment that adds collateral. Also, under subsection (a)(1), if an amendment adds a debtor, that debtor must authorize the amendment. A person who files an unauthorized record in violation of subsection (a)(1) is liable under Section 9-625(e) for a statutory penalty and damages. Of course, a financing statement that is filed without authorization is ineffective to perfect a security interest. See Section 9-510(a).

4. **Authorization in Security Agreement.** Under subsection (b), the authentication of a security agreement *ipso facto* constitutes the debtor's consent to the filing of a financing statement covering the collateral described in the security agreement. The secured party need not obtain a separate authorization. The authorization to file an initial financing statement also constitutes an authorization to file a record covering actual proceeds of the original collateral, even if the security agreement is silent as to proceeds.

Example 1: Debtor authenticates a security agreement creating a security interest in Debtor's inventory in favor of Secured Party. Secured Party files a financing statement covering inventory and accounts. The financing statement is authorized insofar as it covers inventory and unauthorized insofar as it covers accounts. (Note, however, that the financing statement will be effective to perfect a security interest in accounts constituting proceeds of the inventory to the same extent as a financing statement covering only inventory.)

Example 2: Debtor authenticates a security agreement creating a security interest in Debtor's inventory in favor of Secured Party. Secured Party files a financing statement covering inventory. Debtor sells some inventory, deposits the buyer's payment into a deposit account, and withdraws the funds to purchase equipment. As long as the equipment can be traced to the inventory, the security interest continues in the equipment. See Section 9-315(a)(2). However, because the equipment was acquired with cash proceeds, the financing statement becomes ineffective to perfect the security interest in the equipment on the 21st day after the security interest attaches to the equipment unless Secured Party continues perfection beyond the 20-day period by filing a financing statement against the equipment. See Section 9-315(d). Debtor's authentication of the security agreement authorizes the filing of an initial financing statement covering the equipment, which is "property that becomes collateral under Section 9-315(a)(2). See Section 9-509(b)(2).

5. **Agricultural Liens.** Under subsection (a)(2), the holder of an agricultural lien may file a financing statement covering collateral subject to the lien without obtaining the debtor's authorization. Because the lien arises as matter of law, the debtor's consent is not required. A person who files an unauthorized record in violation of this subsection is liable under Section 9-625(e) for a statutory penalty and damages.

6. **Amendments; Termination Statements Authorized by the Debtor.** Most amendments may not be filed unless the secured party of record, as determined under Section 9-511, authorizes the filing. See subsection (c)(1). However, under subsection (c)(2), the secured party of record need not authorize the filing of a termination statement if the secured party of record failed to send or file a termination statement under Section 9-513. However, under Section 9-510(c), the termination statement is effective only if the debtor authorizes it to be filed and the termination statement so indicates.

7. **Multiple Secured Parties of Record.** Subsection (d) deals with multiple secured parties of record. It permits each secured party of record to authorize the filing of amendments. However, Section 9-510(b) protects the rights and powers of one secured party of record from the effects of filings made by another secured party of record.

8. **Successor to Secured Party of Record.** A person may succeed to the powers of the secured party of record by operation of other law, e.g., the law of corporate mergers. If so, the successor has the power to authorize filings within the meaning of this section.

[9-510]

Reporters' Comments

1. **Source.** New.

2. **Ineffectiveness of Unauthorized or Overbroad Filings.** Subsection (a) provides that a filed financing statement is effective only to the extent that a person was entitled to file it.

> **Example 1:** Debtor authorizes the filing of a financing statement covering inventory. Under Section 9-509, the secured party may file a financing statement covering only inventory; it may not file a financing statement covering other collateral. The secured party files a financing statement covering inventory and equipment. This section provides that the financing statement is effective only to the extent the secured party may file it. Thus, the financing statement is effective to perfect a security interest in inventory but ineffective to perfect a security interest in equipment.

3. **Multiple Secured Parties of Record.** Section 9-509(d) permits any secured party of record to authorize the filing of most amendments. Subsection (b) of this section prevents a filing authorized by one secured party of record from affecting the rights and powers of another secured party of record without the latter's consent.

> **Example 2:** Debtor creates a security interest in favor of A and B. The financing statement names A and B as the secured parties. If an amendment deleting some collateral covered by the financing statement is filed pursuant to B's authorization, A's security interest would remain perfected in all the collateral.

> **Example 3:** Debtor creates a security interest in favor of A and B. The financing statement names A and B as the secured parties. If a termination statement is filed pursuant to B's authorization, A's rights would be unaffected. That is, the financing statement would continue to be effective to perfect A's security interest.

4. **Continuation Statements.** A continuation statement may be filed only within the six months immediately before lapse. See Section 9-515(d). The filing office is obligated to reject a continuation statement that is filed outside the six-

month period. See Sections 9-520(a); 9-516(b)(7). Subsection (d) provides that if the filing office fails to reject a continuation statement that is not filed in a timely manner, the continuation statement is ineffective nevertheless.

[9-511]

Reporters' Comments

1. **Source.** New.

2. **"Secured Party of Record."** This new section explains how the secured party of record is to be determined. If SP-1 is named as the secured party in an initial financing statement, it is the secured party of record. Similarly, if an initial financing statement reflects a total assignment from SP-0 to SP-1, then SP-1 is the secured party of record. See subsection (a). If, subsequently, an amendment is filed assigning SP-1's status to SP-2, then SP-2 becomes the secured party of record in place of SP-1. The same result obtains if a subsequent amendment deletes the reference to SP-1 and substitutes therefor a reference to SP-2. If, however, a subsequent amendment adds SP-2 as a secured party but does not purport to remove SP-1 as a secured party, then SP-2 and SP-1 each is a secured party of record. See subsection (b). An amendment purporting to remove the only secured party of record without providing a successor is ineffective. See Section 9-512(e). At any point in time, all effective records that comprise a financing statement must be examined to determine the person or persons that have secured party of record status.

Application of other law may result in a person succeeding to the powers of a secured party of record. For example, if the secured party of record (A) merges into another corporation (B) and the other corporation (B) survives, other law may provide that B has all of A's powers. If so, then B is authorized to take all actions under this part that A would have been authorized to take. Similarly, acts taken by a person who is authorized under generally applicable principles of agency to act on behalf of the secured party of record are effective under this part.

[9-512]

Reporters' Comments

1. **Source.** Former 9-402(4).

2. **Changes to Financing Statements.** This section addresses changes to financing statements, including addition and deletion of collateral. Although termination statements, assignments, and continuation statements are types of amendment, this Article follows former Article 9 and treats these types of amendments separately. See Section 9-513 (termination statements); 9-514

(assignments); 9-515 (continuation statements). One should not infer from this separate treatment that this Article requires a separate amendment to accomplish each change. Rather, a single amendment would be legally sufficient to, e.g., add collateral and continue the effectiveness of the financing statement.

3. **Amendments.** An amendment under this Article may identify only the information contained in a financing statement that is to be changed or, alternatively, it may take the form of an amended and restated financing statement. The latter would state, for example, that the financing statement "is amended and restated to read as follows: . . . References in this Part to an "amended financing statement are to a financing statement as amended by an amendment.

This section revises former Section 9-402(4) to permit secured parties of record to make changes in the public record without the need to obtain the debtor's signature. However, the filing of an amendment that adds collateral must be authorized by the debtor or it will not be effective. See Sections 9-509(a); 9-510(a).

4. **Addition of a Debtor.** An amendment that adds a debtor is effective, provided that the added debtor authorizes the filing. See Section 9-509(a). However, filing an amendment adding a debtor to a previously filed financing statement affords no advantage over filing an initial financing statement against that debtor. With respect to the added debtor, for purposes of determining the priority of the security interest, the time of filing is the time of the filing of the amendment. See subsection (d). Moreover, the effectiveness of the financing statement lapses with respect to added debtor at the time it lapses with respect to the original debtor. See subsection (b).

5. **Deletion of All Debtors or Secured Parties of Record.** Subsection (e) assures that there will be a debtor and secured party of record for every financing statement.

> **Example:** A filed financing statement names A and B as secured parties of record and covers inventory and equipment. An amendment deletes equipment and purports to delete A and B as secured parties of record without adding a substitute secured party. The amendment is ineffective to the extent it purports to delete the secured parties of record but effective with respect to the deletion of collateral. As a consequence, the financing statement, as amended, covers only inventory, but A and B remain as secured parties of record.

[9-513]

Reporters' Comments

1. **Source.** Former Section 9-404.

2. **Duty to File or Send.** This section specifies when a secured party must cause the secured party of record to file or send to the debtor a termination statement for a financing statement. Subsections (a) and (b) apply to a financing statement covering consumer goods. Subsection (c) applies to other financing statements. Subsection (a) and (c) each makes explicit what may have been implicit under former Article 9: If the debtor did not authorize the filing of a financing statement in the first place, the secured party of record should file or send a termination statement. The liability imposed upon a secured party that fails to comply with subsection (a) or (c) is identical to that imposed for the filing of an unauthorized financing statement or amendment. See Section 9-625(e).

3. **“Bogus” Filings.** A secured party’s duty to send a termination statement arises when the secured party “receives an authenticated demand from the debtor. In the case of an unauthorized financing statement, the person named as debtor in the financing statement may have no relationship with the named secured party and no reason to know the secured party’s address. Inasmuch as the address in the financing statement is “held out by [the person named as secured party in the financing statement] as the place for receipt of such communications [i.e., communications relating to security interests], the putative secured party is deemed to have “received a notification delivered to that address. See Section 1-201(26). If a termination statement is not forthcoming, the person named as debtor itself may authorize the filing of a termination statement, which will be effective if it indicates that the person authorized it to be filed. See Sections 9-509(c)(2); 9-510(c).

4. **Buyers of Receivables.** Applied literally, former Section 9-404(1) would require many buyers of receivables to file a termination statement immediately upon filing a financing statement because “there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value. Subsection (c)(1) and (2) remedies this problem.

5. **Effect of Filing.** Subsection (d) states the effect of filing a termination statement. If one of several secured parties of record files a termination statement, subsection (d) applies only with respect to the rights of the person filing the termination statement. See Section 9-510(b). The financing statement remains effective with respect to the rights of the others.

[9-514]

Reporters’ Comments

1. **Source.** Former Section 9-405.

2. **Comparison to Prior Law.** Most of the changes to this section are for clarification or to embrace medium-neutral drafting. As a general matter, this Article preserves the opportunity given by former Section 9-405 to assign a security

interest of record in one of two different ways. Under subsection (a), a secured party may assign all of its power to affect a financing statement by naming an assignee in the initial financing statement. The secured party of record may accomplish the same result under subsection (b) by making a subsequent filing. Subsection (b) also may be used for an assignment of only some of the secured party of record's power to affect a financing statement, e.g., the power to affect the financing statement as it relates to particular items of collateral. An initial financing statement may not be used to change the secured party of record with respect to some, but not all, of the collateral.

[9-515]

Reporters' Comments

1. **Source.** Former Section 9-403(2), (3), (6).

2. **Period of Financing Statement's Effectiveness.** Subsection (a) states the general rule: a financing statement is effective for a five-year period unless its effectiveness is continued under this section or terminated under Section 9-513. Subsection (b) provides that if the financing statement relates to a public-finance transaction or a manufactured-home transaction and so indicates, the financing statement is effective for 30 years. These financings typically extend well beyond the standard, five-year period. Under subsection (f), a financing statement filed against a transmitting utility remains effective indefinitely, until a termination statement is filed. Likewise, under subsection (g), a real property mortgage effective as a fixture filing remains effective until its effectiveness terminates under real-property law.

3. **Lapse.** When the period of effectiveness under subsection (a) or (b) expires, the effectiveness of the financing statement lapses. Under former Section 9-403(2), lapse was tolled if the debtor entered bankruptcy or another insolvency proceeding. A few years ago, Bankruptcy Code Section 362(b)(3) was amended to permit a secured party to continue or maintain the perfected status of its security interest without first obtaining relief from the automatic stay. Accordingly, subsection (c) deletes the former tolling provision. This subsection imposes a new burden on the secured party: to be sure that a financing statement does not lapse during the debtor's bankruptcy. The last sentence of the subsection addresses the effect of lapse. Of course, if the debtor enters bankruptcy before lapse, the provisions of this Article with respect to lapse would be of no effect to the extent that federal bankruptcy law dictates a contrary result.

4. **Continuation Statements.** Subsection (d) explains when a continuation statement may be filed. A continuation statement filed at a time other than that prescribed by subsection (d) is ineffective, and the filing office may not accept it.

See Sections 9-520(a); 9-516(b). Subsection (e) specifies the effect of a continuation statement and provides for successive continuation statements.

[9-516]

Reporters' Comments

1. **Source.** Subsection (a): former Section 9-403(1); the remainder is new.

2. **What Constitutes Filing.** Subsection (a) deals generically with what constitutes filing of a record, including an initial financing statement and amendments of all kind (e.g., assignments, termination statements, and continuation statements). It follows former Section 9-403(1), under which either acceptance of a record by the filing office or presentation of the record and tender of the filing fee constitutes filing.

3. **Effectiveness of Rejected Record.** Subsection (b) provides an exclusive list of grounds upon which the filing office may reject a record. See Section 9-520(a). Although some of these grounds would also be grounds for rendering a filed record ineffective (e.g., an initial financing statement does not provide a name for the debtor), many others would not be (e.g., an initial financing statement does not provide a mailing address for the debtor or secured party of record).

A financing statement or other record that is communicated to the filing office but which the filing office refuses to accept provides no public notice, regardless of the reason for the rejection. However, this section distinguishes between records that the filing office rightfully rejects and those that it wrongfully rejects. A filer is able to prevent a rightful rejection by complying with the requirements of subsection (b). No purpose is served by giving effect to records that justifiably never find their way into the system, and subsection (b) so provides.

Subsection (d) deals with the filing office's unjustified refusal to accept a record. Here, the filer is in no position to prevent the rejection and, many believe, as a general matter should not be prejudiced by it. Although wrongfully rejected records generally are effective, subsection (d) contains a special rule to protect a third party purchaser of the collateral (e.g., a buyer or competing secured party) who gives value in reliance upon the apparent absence of the record from the files. As against a person who searches the public record and reasonably relies on what the public record shows, subsection (d) imposes upon the filer the risk that a record failed to make its way into the filing system. This risk is likely to be small, particularly when a record is presented electronically, and the filer can guard against this risk by conducting a post-filing search of the records. Moreover, Section 9-520(b) requires the filing office to give prompt notice of its refusal to accept a record for filing.

4. **Method or Medium of Communication.** Rejection pursuant to subsection (b)(1) for failure to communicate a record properly should be understood to mean noncompliance with procedures relating to security, authentication, or other communication-related requirements that the filing office may impose.

5. **Address for Secured Party of Record.** Under subsection (b)(4) and Section 9-520(a), the lack of a mailing address for the secured party of record requires the filing office to reject an initial financing statement. The failure to include an address for the secured party of record no longer renders a financing statement ineffective. See Section 9-502(a). The function of the address is not to identify the secured party of record but rather to provide an address to which others can send required notifications, e.g., of a purchase-money security interest in inventory or of the disposition of collateral. Inasmuch as the address shown on a filed financing statement is an “address that is reasonable under the circumstances, a person required to send a notification to the secured party may satisfy the requirement by sending a notification to that address, even if the address is or becomes incorrect. See Section 9-102 (definition of “send). Similarly, because the address is “held out by [the secured party] as the place for receipt of such communications [i.e., communications relating to security interests], the secured party is deemed to have received a notification delivered to that address. See Section 1-201(26).

6. **Uncertainty Concerning Individual Debtor’s Last Name.** Subsection (b)(3)(C) requires the filing office to reject an initial financing statement or amendment adding an individual debtor if the office cannot index the record because it does not identify the debtor’s last name (e.g., it is unclear whether the debtor’s name is Elton John or John Elton).

7. **Inability of Filing Office to Read or Decipher Information.** Under subsection (c)(1), if the filing office cannot read or decipher information, the information is not provided by a record for purposes of subsection (b).

8. **Classification of Records.** For purposes of subsection (b), a record that does not indicate it is an amendment or identify an initial financing statement to which it relates is deemed to be an initial financing statement. See subsection (c)(2).

9. **Effectiveness of Rejectable But Unrejected Record.** Section 9-520(a) requires the filing office to refuse to accept an initial financing statement for a reason set forth in subsection (b). However, if the filing office accepts such a financing statement nevertheless, the financing statement generally is effective if it complies with the requirements of Section 9-502(a) and (b). See Section 9-520(c). Similarly, an otherwise effective financing statement generally remains so even though the information in the financing statement becomes incorrect. See Section 9-507(b).

[9-517]

Reporters' Comments

1. **Source.** New.

2. **Effectiveness of Mis-indexed Records.** This section provides that the filing office's error in mis-indexing a record does not render ineffective an otherwise effective record. Like former Section 9-401, it imposes the risk of filing-office error on those who search the files rather than on those who file.

[9-518]

Reporters' Comments

1. **Source.** New.

2. **Correction Statements.** Existing law affords no nonjudicial means for a debtor to correct a financing statement or other record that is inaccurate or wrongfully filed. Subsection (a) affords the debtor the right to file a correction statement. The statement must give the basis for the debtor's belief that the public record should be corrected. See subsection (b). The statement becomes part of the "financing statement, as defined in Section 9-102; however, subsection (c) provides that the filing does not affect the effectiveness of the initial financing statement or any other filed record. These provisions resemble the analogous remedy in the Fair Credit Reporting Act.

This section does not displace other provisions of this Article that impose liability for making unauthorized filings or failing to file or send a termination statement. See Section 9-625(e). Nor does it displace any available judicial remedies.

3. **Resort to Other Law.** After having considered a variety of approaches to this problem, the Drafting Committee concluded that Article 9 is unlikely to provide a satisfactory or complete solution to problems caused by misuse of the public records. The problem of "bogus filings is not limited to the UCC filing system but extends to the real property records, as well. A summary judicial procedure for correcting the public record and criminal penalties for those who misuse the filing and recording systems are likely to be more effective and put less strain on the filing system than provisions requiring action by the filing office.

[9-519]

Reporters' Comments

1. **Source.** Former Sections 9-403(4), (7); 9-405(2).

2. **Filing Office's Duties.** Subsections (a) through (e) set forth the duties of the filing office with respect to filed records. Subsection (f) requires the filing office to maintain appropriate storage and retrieval facilities.

3. **File Number.** Subsection (a)(1) requires the filing office to assign a unique number to each filed record. That number is the "file number only if the record is an initial financing statement. See Section 9-102.

4. **Time of Filing.** Subsection (a)(2) and § 9-523 refer to the "date and time of filing. The statutory text does not contain any instructions to a filing office as to how the time of filing is to be determined. The method of determining or assigning a time of filing is an appropriate matter for filling-office rules to address.

5. **Related Records.** Subsections (c) and (e) are designed to ensure that an initial financing statement and all filed records relating to it are associated with one another, indexed under the name of the debtor, and retrieved together. To comply with subsection (e), a filing office must be capable of retrieving records in each of two ways: by the name of the debtor and by the file number of the initial financing statement to which the record relates.

6. **Prohibition on Deleting Names from Index.** This article contemplates that the filing office not deletes the name of a debtor from the index until at least one year passes after the effectiveness of the financing statement lapses as to all secured parties of record. See subsection (g). This rule applies even to if the filing office accepts an amendment purporting to delete or modify the name of a debtor or terminate the effectiveness of the financing statement. If an amendment provides a modified name for a debtor, the amended name should be added to the index, see subsection (c)(2), but the pre-amendment name should remain. The same principles apply with respect to names of secured parties.

7. **Standard of Performance.** Subsection (h) is new. It imposes a minimum standard of performance. Prompt indexing is crucial to the effectiveness of any filing system. An accepted but un-indexed record affords no public notice.

[9-520]

Reporters' Comments

1. **Source.** New.

2. **Refusal to Accept a Record for Filing.** In some States, filing offices have considered themselves obligated to review the form and content of a financing statement and to refuse to accept those that they determine are legally insufficient.

Some filing offices impose requirements for or conditions to filing that do not appear in the statute. Under this section, the filing office would not be expected to make legal judgments and would not be permitted to impose additional conditions or requirements.

Subsection (a) both prescribes and limits the bases upon which the filing office must and may reject records by reference to the reasons set forth in Section 9-516(b). For the most part, the bases for rejection are limited to those that prevent the filing office from dealing with a record that it receives–because some the requisite information (e.g., the debtor's name) is missing or cannot be deciphered, because the record is not communicated by a method or medium that the filing office accepts (e.g., it is MIME-, rather than UU-encoded), or because the filer fails to tender an amount equal to or greater than the filing fee.

3. **Consequences of Accepting a Rejectable Record.** Section 9-515(b) includes among the reasons for rejecting an initial financing statement the failure to give certain information that is not required as a condition of effectiveness. In conjunction with Section 9-516(b)(5), this section requires the filing office to refuse to accept an otherwise legally sufficient financing statement that does not contain a mailing address for the debtor, does not disclose whether the debtor is an individual or an organization (e.g., a partnership or corporation) or, if the debtor is an organization, does not give specific information concerning the organization. The information required by Section 9-516(b)(5) assists searchers in weeding out "false positives, i.e., records that a search reveals but which do not pertain to the debtor in question. It assists filers by helping to ensure that the debtor's name is correct and that the financing statement is filed in the proper jurisdiction.

If the filing office accepts a financing statement that does not give this information at all, the filing is fully effective. Section 9-520(c). The financing statement generally is effective if the information is incorrect; however, the security interest is subordinate to the rights of a buyer or holder of a perfected security interest who gives value in reasonable reliance upon the incorrect information. Section 9-338.

4. **Filing Office's Duties with Respect to Rejected Record.** Subsection (b) requires the filing office to communicate the fact of rejection and the reason therefor within a fixed period of time. Inasmuch as a rightfully rejected record is ineffective and a wrongfully rejected record is not fully effective, prompt communication concerning any rejection is important.

5. **Partial Effectiveness of Record.** Under subsection (d), the provisions of this Part apply to each debtor separately. Thus, a filing office may reject an initial financing statement or other record as to one named debtor but accept it as to the other.

Example: An initial financing statement is communicated to the filing office. The financing statement names two debtors, John Smith and Jane Smith. It contains all of the information described in Section 9-516(b)(5) with respect to John but lacks some of the information with respect to Jane. The filing office must accept the financing statement with respect to John, reject it with respect to Jane, and notify the filer of the rejection.

[9-521]

Reporters' Comments

1. **Source.** New.

2. **"Safe Harbor" Written Forms.** Although Section 9-520 limits the bases upon which the filing office can refuse to accept records, this section provide sample written forms that must be accepted in every filing office in the country. By completing one of the forms in this section, a secured party can be certain that the filing office is obligated to accept it, as long as the filing office's rules permit it to accept written communications.

The forms in this section are based upon national financing statement forms that already are in use. Those forms were developed over an extended period and reflect the comments and suggestions of filing officers, secured parties and their counsel (both directly and through organizations such as the American Bar Association), service companies, and the Drafting Committee. They are widely available from printers and search companies, and filing offices in a majority of States have undertaken to accept them, in most cases without any extra or non-standard filing fee. The formatting of those forms and of the ones in this section has been designed to reduce error by both filers and filing offices.

The multi-purpose form in subsection (b) covers changes with respect to the debtor, the secured party, the collateral, and the status of the financing statement (termination and continuation). A single form may be used for several different types of amendments at once (e.g., both to change a debtor's name and continue the effectiveness of the financing statement).

[9-522]

Reporters' Comments

1. **Source.** Former Section 9-403(3), revised substantially.

2. **Maintenance of Records.** Section 9-523 requires the filing office to provide information concerning certain lapsed financing statements. Accordingly,

subsection (a) requires the filing office to maintain a record of the information in a financing statement for at least one year after lapse.

The filing office may maintain this information in any medium. Subsection (b) permits the filing office immediately to destroy written records evidencing a financing statement, provided that the filing office maintains another record of the information contained in the financing statement as required by subsection (a).

[9-523]

Reporters' Comments

1. **Source.** Former Section 9-407; subsections (d) and (e) are new.

2. **Filing Office's Duty to Provide Information.** Former Section 9-407, dealing with obtaining information from the filing office, was bracketed to suggest to legislatures that its enactment was optional. Experience has shown that the method by which interested persons can obtain information concerning the public records should be uniform. Accordingly, the analogous provisions of this Article are not in brackets.

Most of the other changes from former Section 9-407 are for clarification, to embrace medium-neutral drafting, or to impose standards of performance on the filing office.

3. **Acknowledgments of Filing.** Subsections (a) and (b) requires the filing office to acknowledge the filing of a record. Under subsection (a), the filing office is required to acknowledge the filing of a written record only upon request of the filer. Subsection (b) requires the filing office to acknowledge the filing of a non-written record even in the absence of a request from the filer.

4. **Response to Search Request.** Subsection (c)(3) requires the filing office to provide "the information contained in each financing statement to a person who requests it. This requirement can be satisfied by providing copies, images, or reports. The requirement does not in any manner inhibit the filing office from offering to provide less than all of the information (presumably for a lower fee) to a person who asks for less. Thus, subsection (c) accommodates the current practice of providing only the type of record (e.g., initial financing statement, continuation statement), number assigned to the record, date and time of filing, and names and addresses of the debtor and secured party when a requesting person asks for no more (i.e., when the person does not ask for copies of financing statements). In contrast, the filing office's obligation under subsection (b) to provide an acknowledgment containing "the information contained in the record is not defined by a customer's request. Thus unless the filer stipulates otherwise, to comply with

subsection (b) the filing office’s acknowledgment must contain all of the information in a record.

5. **Lapsed and Terminated Financing Statements.** This section reflects the policy that terminated financing statements will remain part of the filing office’s data base. The filing office may remove from the data base only lapsed financing statements, and then only when at least a year has passed after lapse. Subsection (c)(1)(C) requires a filing office to conduct a search and report as to lapsed financing statements that have not been removed from the data base, when requested.

6. **Search by Debtor’s Address.** Subsection (c)(1)(A) contemplates that, by making a single request, a searcher will receive the results of a search of the entire public record maintained by any given filing office. Under current practice, some filing offices routinely limit their searches (and reports of search results) to financing statements showing a particular address for the debtor. The bracketed language in subsection (b)(1)(A) would permit a limited search report of this kind, but only if the search request is so limited. With or without the bracketed language, this subsection does not permit the filing office to compel a searcher to limit a request by address.

7. **Medium of Communication; Certificates.** The former statute provides that the filing office respond to a request for information by providing a certificate. The principle of medium-neutrality would suggest that the statute not require a written certificate. Subsection (d) follows this principle by permitting the filing office to respond by communicating “in any medium. By permitting communication “in any medium, subsection (d) is not inconsistent with a system (e.g., as in New Mexico) in which persons other than filing office staff conduct searches of the filing office’s (computer) records.

Some searchers find it necessary to introduce the results of their search into evidence. Because official written certificates might be introduced into evidence more easily than official communications in another medium, subsection (d) affords States the option of requiring the filing office to issue written certificates upon request. The alternative bracketed language in subsection (d) recognizes that some States may prefer to permit the filing office to respond in another medium, as long as the response can be admitted into evidence in the courts of that State without extrinsic evidence of its authenticity.

8. **Performance Standard.** In some States, filing offices take weeks to respond to requests for information. In some States, requests are filled using information that is weeks old. The utility of the filing system depends on the ability of searchers to get current information quickly. Accordingly, subsection (e) requires that the filing office respond to a request for information no later than two business days after it receives the request. The information contained in the response must be current as of a date no earlier than three business days before the

filing office receives the request. See subsection (c)(1). The failure of the filing office to comply with performance standards, such as subsection (e), has no effect on the private rights of persons affected by the filing of records.

9. **Sales of Records in Bulk.** Subsection (f), which is new, mandates that the appropriate official or the filing office sell or license the filing records to the public in bulk, on a nonexclusive basis, in every medium available to the filing office. The details of implementation are left to filing-office rules.

[9-524]

Reporters' Comment

1. **Source.** New; derived from Section 4-109.

[9-525]

Reporters' Comments

1. **Source.** Various sections of former Part 4.

2. **Fees.** This section contains all fee requirements for filing, indexing, and responding to requests for information. It reflects the view that this Article (1) should mandate a lower fee for as an incentive to file electronically, (2) should mandate a higher fee for longer written records than for shorter ones, (3) should impose an additional charge for multiple debtors to more than more than two debtors, rather than more than one, and (4) should impose the additional charge for multiple debtors only with respect to written records.

[9-526]

Reporters' Comments

1. **Source.** New. Subsection (b) derives in part from the Uniform Consumer Credit Code (1974).

2. **Rules Required.** Operating a filing office is a complicated business, requiring many more rules and procedures than this Article usefully can provide. Subsection (a) requires the adoption of rules to carry out the provisions of Article 9. The filing-office rules must be consistent with the provisions of the statute and adopted in accordance with local procedures.

3. **Importance of Uniformity.** In today's national economy, uniformity of the policies, practices, and technology of the filing offices will reduce the costs of secured transactions substantially. The International Association of Corporate

Administrators (IACA), referred to in subsection (b), is an organization whose membership includes filing officers from every State. These individuals are responsible for the proper functioning of the Article 9 filing system. IACA has been working with liaisons from the Drafting Committee to develop workable statutory provisions as well as model filing-office rules, all with a view toward efficiency and uniformity.

[9-527]

Reporters' Comments

1. **Source.** New; derived in part from the Uniform Consumer Credit Code (1974).

2. **Duty to Report.** This section is designed to promote compliance with the standards of performance imposed upon the filing office and with the requirement that the filing office's policies, practices, and technology be consistent and compatible with the policies, practices, and technology of other filing offices.

[Part 6]

[9-601]

Reporters' Comments

1. **Source.** Former Section 9-501(1), (2), (5).

2. **When Remedies Arise.** Under subsection (a) the secured party's remedies arise "[a]fter default. Like former Section 9-501, this Article leaves the agreement of the parties to define the circumstances giving rise to a default. This Article does not determine whether a secured party's post-default conduct can constitute a waiver of default in the face of an agreement stating that such conduct shall not constitute a waiver. Rather, it continues to leave to the parties' agreement, as supplemented by law other than this Article, the determination whether a default has occurred. See Section 1-103.

3. **Section 9-207.** Subsection (b) has been conformed to Section 9-207, which now applies to secured parties having control of collateral.

4. **Cumulative Remedies.** Former Section 9-501(1) provides that the secured party's remedies are cumulative but does not explicitly provide whether the remedies may be exercised simultaneously. Subsection (c) permits the simultaneous exercise of remedies if the secured party acts in good faith. The liability scheme of Subpart 2 affords redress to an aggrieved debtor or obligor. Moreover, subsection (c) does not override non-UCC law, including the law of tort and statutes regulating collection of debts, which would render a creditor liable for abusive behavior or harassment.

5. **Judicial Enforcement.** Subsection (e) generally follows former Section 9-501(5). The principal change provides that a levy relates back to the earlier of the date of filing or the date of perfection. This provides a secured party that enforces its security interest by levy with the benefit of the "first-to-file-or-perfect priority rule of Section 9-322(a)(1).

6. **Agricultural Liens.** Part 6 provides parallel treatment for the enforcement of agricultural liens and security interests. Because agricultural liens are statutory rather than consensual, this Article does draw a few distinctions between these liens and security interests. Under subsection (e), the statute creating an agricultural lien would govern whether and the date to which an execution lien relates back. Section 9-606 explains when a "default occurs in the agricultural lien context.

7. **Sales of Receivables; Consignments.** Subsection (g) provides that, except as provided in Section 9-607(c), the duties imposed on secured parties do not apply to buyers of accounts, chattel paper, payment intangibles, or promissory notes. Although denominated "secured parties, these buyers normally own the entire interest in the property sold and so may enforce their rights without regard to the seller ("debtor). Likewise, a true consignor may enforce its ownership interest under other law without regard to the duties that this Part imposes on secured parties. Note, however, that Section 9-615 governs cases in which a consignee's secured party (other than a consignor) is enforcing a security interest that is senior to the ownership interest of a true consignor.

[9-602]

Reporters' Comments

1. **Source.** Former Section 9-501(3).

2. **Waiver by Debtors.** This section contains restrictions on waivers by debtors and obligors. In an effort at clarification, this Article uses the term "waive or vary instead of "renounc[e] or modify[] which appears in former Section 9-504(3). It revises former Section 9-501(3) by restricting the ability to waive or modify additional rights and duties: (i) duties under Section 9-207(c)(4)(C), which deals with the use and operation of consumer goods, (ii) the right to a response to a request for an accounting, concerning a list of collateral, or concerning a statement of account (Section 9-210), (iii) the duty to collect collateral in a commercially reasonable manner (Section 9-607), (iv) the implicit duty to refrain from a breach of the peace in taking possession of collateral under Section 9-609, (v) the duty to apply noncash proceeds of collection or disposition in a commercially reasonable manner (Section 9-608 and 9-615), (vi) the right to a special method of calculating a surplus or deficiency in certain dispositions to a secured party, a person related to secured party, or a secondary obligor (Section 9-615), (vii) the duty to give an explanation of the calculation of a surplus or deficiency (Section 9-616), and (viii) the right to limitations on the effectiveness of certain waivers (Section 9-624).

This section provides generally that the specified rights and duties "may not be waived or varied However, it does not restrict the ability of parties to agree to settle or compromise claims for past conduct that may have constituted a violation or breach of those rights and duties, even if the settlement involves an express "waiver.

3. **Waiver by Obligors.** Several earlier drafts permitted waivers by obligors (other than consumer obligors), including secondary obligors such as guarantors. Under those drafts, the restrictions on waiver imposed in subsection (a) related only to waivers by a debtor (defined in Section 9-102 as a person with a property interest, other than a security interest or other lien, in the collateral) and an

obligor (whether or not a debtor) in a consumer-goods transaction. At a recent meeting, the Drafting Committee voted to extend the restrictions to cover all secondary obligors, while retaining a provision to permit waivers by non-consumer primary obligors. However, because the draft contains no provisions granting rights to or imposing duties in favor of those obligors, this draft has deleted that provision. Consequently, the restrictions on waiver now apply to all debtors and obligors.

[9-603]

Reporters' Comments

1. **Source.** Former Section 9-501(3).

2. **Limitation on Ability to Set Standards.** Subsection (a) permits the parties to set standards for compliance with the rights and duties under this part that are not "manifestly unreasonable. Under subsection (b), however, the parties are not permitted to set standards measuring fulfillment of the secured party's duty to take collateral without breaching the peace.

[9-604]

Reporters' Comments

1. **Source.** Former Sections 9-501(4); 9-313(8).

2. **Real-property-related Collateral.** Subsection (a) alters former Section 9-501(4) to make clear that a secured party who exercises rights under Part 6 does not prejudice any rights under real property law.

This Article does not address certain other real-property-related problems. In a number of States, the exercise of remedies by a creditor that is secured by both real property and non-real property collateral is governed by special legal rules. For example, under some anti-deficiency laws, creditors risk loss of rights against personal property collateral if they err in enforcing their rights against the real property. Under a "one-form-of-action rule (or rule against splitting a cause of action), a creditor that judicially enforces a real property mortgage and does not proceed in the same action to enforce a security interest in personalty may (among other consequences) lose the right to proceed against the personalty. Obviously, statutes of this kind create impediments to Article 9 secured parties. Several approaches are available, including: (i) revise Article 9 to override any limitations contained in other law and (ii) continue to submit to other law. The Drafting Committee has opted for the latter approach.

3. **Fixtures.** Subsection (b) is new. It is intended to make clear that a security interest in fixtures may be enforced either under real-property law or under any of the applicable provisions of Part 6, including sale or other disposition either before or after removal of the fixtures (see subsection (c)). Subsection (b) also serves to overrule cases holding that a secured party's only remedy after default is the removal of the fixtures from the real property. See, e.g., *Maplewood Bank & Trust v. Sears, Roebuck & Co.*, 625 A.2d 537 (N.J. Super. Ct. App. Div. 1993).

Former Section 9-313(8) affords to the secured party the right to remove fixtures under certain circumstances. This remedy, with minor modifications, now appears in subsection (c).

[9-605]

Reporters' Comments

1. **Source.** New.

2. **Duties to Unknown Persons.** This section relieves a secured party from duties to a debtor or secondary obligor and to a secured party or lienholder who has filed a financing statement against the debtor, if the secured party does not know about the debtor or secondary obligor. For example, a secured party may be unaware that the original debtor has sold the collateral subject to the security interest and that the new owner has become the debtor. This section should be read in conjunction with the exculpatory provisions in Section 9-628. Note that it relieves a secured party not only from duties arising under this Article but also from duties arising under other law by virtue of the secured party's status as such.

[9-606]

Reporters' Comments

1. **Source.** New.

2. **Time of Default.** Remedies under this part become available upon the debtor's "default. See Section 9-601. This section explains when "default occurs in the agricultural lien context. It requires one to consult the enabling statute to determine when the lienholder is entitled to enforce the lien.

[9-607]

Reporters' Comments

1. **Source.** Former Section 9-502; subsections (b), (d), and (e) are new.

2. **Scope.** As a general matter Part 6 deals with the rights and duties of debtors and secured parties following default. However, this section applies to the collection and enforcement rights of secured parties whether or not a default has occurred. Although seemingly anomalous, in practice it is not unusual for debtors to agree that secured parties are entitled to collect and enforce rights against account debtors prior to default.

This section permits a secured party to collect and enforce obligations included in collateral in its capacity as a secured party. It is not necessary for a secured party first to become the owner of the collateral pursuant to a disposition or acceptance. However, the secured party's rights to collect from and enforce collateral against account debtors and others obligated on collateral under subsection (a) are subject to Sections 9-341, 9-404, 9-407, 9-408, and 9-409 and other applicable law. Neither this Article nor former Section 9-502 should be understood to regulate the duties of an account debtor or other person obligated on collateral. Subsection (e) now makes this explicit. For example, the secured party may be unable to exercise the debtor's rights under an instrument if the debtor is in possession of the instrument, or under a non-transferable letter of credit if the debtor is the beneficiary. Unless a secured party has control over a letter-of-credit right and is entitled to receive payment or performance from the issuer or a nominated person under Article 5, its remedies with respect to the letter- of-credit right may be limited to the recovery of any identifiable proceeds from the debtor. This section establishes only the baseline rights of the secured party *vis-a-vis the debtor*–the secured party is entitled to enforce and collect upon default or earlier if so agreed.

3. **Primary Changes.** The primary substantive changes to this section are: (i) expansion of its application to collection and enforcement against all persons obligated on collateral, not just account debtors; (ii) explicit provision for the secured party's enforcement of the debtor's rights in respect of the account debtor's (and other third parties') obligations; and (iii) provision for the secured party's enforcement of supporting obligations with respect to those obligations (supporting obligations are components of the collateral under Section 9-203(f)).

4. **Rights Against Third Parties.** The rights of a secured party against an account debtor or other third party under subsection (a) include the right to enforce claims that the debtor may enjoy against others. The claims might include a breach of warranty claim arising out of a defect in equipment that is collateral or a secured party's action for an injunction against infringement of a patent that is collateral. Those claims typically would be proceeds of original collateral under Section 9-315.

5. **Deposit Account Collateral.** Subsections (a)(4) and (5) set forth the self-help remedy for a secured party whose collateral is a deposit account.

Subsection (a)(4) addresses the rights of a secured party that is the bank with which the deposit account is maintained. That secured party automatically has control of the deposit account under Section 9-104(a)(1). On default, and otherwise if so agreed, the bank/secured party may apply the funds on deposit to the secured obligation.

If a security interest of a third party is perfected by control (Section 9-104(a)(2) or (a)(3)), then on default, and otherwise if so agreed, the secured party may instruct the bank to pay out the funds in the account. If the third party has control under Section 9-104(a)(3), the depositary institution is obliged to obey the instruction because the secured party is its customer. See Section 4-401. If the third party has control under Section 9-104(a)(2), the control agreement determines the depositary institution's obligation to obey.

If a security interest in a deposit account is unperfected, or is perfected by filing by virtue of the proceeds rules of Section 9-315, the depositary institution ordinarily owes no obligation to obey the secured party's instructions. See Section 9-341. To reach the funds, the secured party must use an available judicial procedure.

6. **Rights Against Mortgagor of Real Property.** Subsection (b) addresses the situation in which the collateral consists of a mortgage note (or other obligation secured by a mortgage on real property). After the debtor's (mortgagee's) default, the secured party (assignee) may wish to proceed with a nonjudicial foreclosure of the real property mortgage securing the note but may be unable to do so because it has not become the assignee of record. The assignee/secured party may not have taken a recordable assignment at the commencement of the transaction; perhaps the mortgage note in question was one of hundreds assigned to the secured party as collateral. Having defaulted, the mortgagee may be unwilling to sign a recordable assignment. This section enables the secured party (assignee) to become the assignee of record by recording the security agreement and an affidavit certifying default in the applicable real-property records. Of course, the secured party's rights derive from those of its debtor. Subsection (b) would not entitle the secured party to proceed with a foreclosure unless the mortgagor also is in default or the debtor (mortgagee) otherwise enjoyed the right to foreclose.

7. **Commercial Reasonableness.** Subsection (c) provides that the secured party's collection and enforcement rights under subsection (a) must be exercised in a commercially reasonable manner. These rights include the right to settle and compromise claims against the account debtor, subject to the standard of commercial reasonableness. The secured party's failure to observe the standard of commercial reasonableness could render it liable to an aggrieved person under Section 9-625, and the secured party's recovery of a deficiency would be subject to Section 9-626. Subsection (c) does not apply if, as is characteristic of most sales of accounts, chattel paper, payment intangibles, and promissory notes, the secured

party (buyer) has no right of recourse against the debtor (seller) or a secondary obligor.

8. **Attorney's Fees and Legal Expenses.** The phrase "reasonable attorney's fees and legal expenses, which appears in subsection (d), includes only those fees and expenses incurred in proceeding against account debtors or other third parties. The secured party's right to recover these expenses arises automatically under this section. The secured party also may incur other attorney's fees and legal expenses in proceeding against the debtor or obligor. Whether the secured party has a right to recover those fees and expenses depends on whether the debtor or obligor has agreed to pay them, as is the case with respect to attorney's fees and legal expenses under Sections 9-608(a)(1)(A) and 9-615(a)(1). The parties also may agree to allocate a portion of the secured party's overhead to collection and enforcement under subsection (d) or Section 9-608(a).

[9-608]

Reporters' Comments

1. **Source.** Subsection (a) is new. Subsection (b) derives from former Section 9-502(2).

2. **Modifications of Prior Law.** Subsections (a) and (b) modifiy former Section 9-502(2) by explicitly providing for the application of proceeds recovered by the secured party in substantially the same manner as provided in Section 9-615(a) and (e) for dispositions of collateral. Also, subsections (a)(4) and (b) omit, as unnecessary, the references, contained in former Section 9-502(2) and in earlier drafts, to agreements varying the baseline rules on deficiencies. The parties are always free to agree that an obligor will not be liable for a deficiency, even if the collateral secures an obligation, and that an obligor is liable for a deficiency, even if the transaction is a sale of receivables. Parallel changes have been made to Section 9-615(d) and (e).

3. **Noncash Proceeds.** Subsection (a)(3) addresses the situation in which an enforcing secured party receives noncash proceeds.

> **Example:** An enforcing secured party receives a promissory note from the account debtor. The secured party may wish to credit the debtor with the principal amount of the note upon receipt of the note or may wish to credit the debtor only as and when the note is paid. Under subsection (a)(3), the secured party is under no duty to apply the note or its value to the outstanding obligation. If the secured party elects to apply the note to the outstanding obligation, however, it must do so in a commercially reasonable manner. The parties may provide for the method of application of noncash

proceeds in the security agreement, if the method is not manifestly unreasonable. See Section 9-603.

Although the secured party is not required to “apply or pay over for application noncash proceeds, the proceeds nonetheless remain collateral subject to this Article. If the secured party were to dispose of them, for example, appropriate notification would be required (see Section 9-611), and the disposition would subject to the standards provided in this part (see Section 9-610). Moreover, a secured party in possession of the noncash proceeds would have the duties specified in Section 9-207.

[9-609]

Reporters’ Comments

1. **Source.** Former Section 9-503.

2. **Multiple Secured Parties.** More than one secured party may be entitled to take possession under this section. Conflicting rights to possession among parties are resolved by the priority rules of this Article or, as applicable, other law. Thus, a senior secured party is entitled to possession as against a junior claimant. Non-UCC law governs whether a junior secured party in possession of collateral is liable to the senior in conversion. Normally, a junior who refuses to relinquish possession of collateral upon the demand of a secured party having a superior possessory right thereto is liable in conversion.

3. **Damages for Breach of Peace.** Concerning damages that may be recovered based on a secured party’s breach of the peace in connection with taking possession of collateral, see Section 9-625, Comment 4.

[**9-610]**

Reporters’ Comments

1. **Source.** Former Section 9-504(1), (3)

2. **Pre-disposition Preparation and Processing.** Former Section 9-504(1) appears to give the secured party the choice of disposing of collateral either “in its then condition or following any commercially reasonable preparation or processing. Some courts have held that the “commercially reasonable standard of former Section 9-504(3) nevertheless may impose an affirmative duty on the secured party to process or prepare the collateral prior to sale. The Drafting Committee was concerned that if the quoted language were added to the second sentence of subsection (b), courts might be unnecessarily quick to impose a duty of

preparation or processing on the secured party. Accordingly, the Drafting Committee chose to retain the language in subsection (a). Subsection (a) does not grant the secured party the right to dispose of the collateral "in its then condition under all circumstances. A secured party may not dispose of collateral "in its then condition when, taking into account the costs and probable benefits of preparation or processing and the fact that the secured party would be advancing the costs at its risk, it would be commercially unreasonable to dispose of the collateral in that condition.

3. **Disposition by Junior Secured Party.** Subsection (a) is not limited to first-priority security interests. Rather, any secured party as to which there has been a default enjoys the right to dispose of collateral under this subsection. The exercise of this right by a secured party whose security interest is subordinate to that of another secured party does not of itself constitute a conversion or otherwise give rise to liability in favor of the holder of the senior security interest. Section 9-615 addresses application of the proceeds of a disposition by a junior secured party. Under Section 9-615(a), a junior secured party owes no obligation to apply the proceeds of disposition to the satisfaction of obligations secured by a senior security interest. Section 9-615(g) builds on this general rule by protecting certain juniors from claims of a senior concerning cash proceeds of the disposition. Even if a senior were to have a non-Article 9 claim to proceeds of a junior's disposition, Section 9-615(g) would protect a junior that acts in good faith and without knowledge that its actions violate the rights of a senior party. Because the disposition by a junior would not cut off a senior's security interest or lien (see Section 9-617), in many (probably most) cases the junior's receipt of the cash proceeds would not violate the rights of the senior.

The holder of a senior security interest is entitled, by virtue of its priority, to take possession of collateral from the junior secured party and conduct its own disposition, provided that the senior enjoys the right to take possession of the collateral from the debtor. See Section 9-609. The holder of a junior security interest normally must notify the senior secured party of an impending disposition. See Section 9-611. Regardless of whether the senior receives a notification from the junior, the junior's disposition does not of itself discharge the senior's security interest. See Section 9-617. Unless the senior secured party has authorized the disposition free and clear of its security interest, the senior's security interest ordinarily will survive the disposition by the junior and continue under Section 9-315(a). If the senior enjoys the right to repossess the collateral from the debtor, the senior likewise may recover the collateral from the transferee.

When a secured party's collateral is encumbered by another security interest or by a lien, one of the claimants may seek to invoke the equitable doctrine of marshaling. As explained by the Supreme Court, that doctrine "rests upon the principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds. *Meyer v. United States*, 375 U.S. 233, 236 (1963), quoting

Sowell v. Federal Reserve Bank, 268 U.S. 449, 456-57 (1925). The purpose of the doctrine is “to prevent the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security. Id. at 237. Because it is an equitable doctrine, marshaling “is applied only when it can be equitably fashioned as to all of the parties having an interest in the property. Id. This Article leaves courts free to determine whether marshaling is appropriate in any given case. See Section 1-103.

4. **Security Interests of Equal Rank.** Sometimes two security interests enjoy the same priority. This situation may arise by contract, e.g., pursuant to “equal and ratable provisions in indentures, or by operation of law. See Section 9-328(6). This Article treats a security interest having equal priority like a senior security interest in many respects. Assume, for example, that SP-X and SP-Y enjoy equal priority, SP-W is senior to them, and SP-Z is junior. If SP-X disposes of the collateral under this section, then (i) SP-W’s and SP-Y’s security interests survive the disposition but SP-Z’s does not, see Section 9-617, and (ii) neither SP-W nor SP-Y is entitled to receive a distribution of proceeds, but SP-Z is. See Section 9-615(a)(3).

When one considers the ability to obtain possession of the collateral, a secured party with equal priority is unlike a senior secured party. As the senior secured party, SP-W should enjoy the right to possession as against SP-X. See Section 9-609, Comments. If SP-W takes possession and disposes of the collateral under this section, it is entitled to apply the proceeds to satisfy its secured claim. SP-Y, however, should not have such a right to take possession from SP-X; otherwise, once SP-Y took possession from SP-X, SP-X would have the right to get possession from SP-Y, which would be obligated to redeliver possession to SP-X, and so on. Resolution of this problem is left to the parties and, if necessary, the courts.

5. **Public vs. Private Dispositions.** This Part maintains three distinctions between “public and other dispositions: (i) the secured party normally may buy at the former, but not at the latter (Section 9-610(c)); (ii) the debtor is entitled to notification of “the time and place of a public sale and notification of “the time after which a private sale or other intended disposition is to be made (Section 9-613(1)(E)); and (iii) transferees in a noncomplying public sale can lose protection more easily than transferees in other noncomplying dispositions (Section 9-617(b)). Although the term in not defined, as used in this Article, a “public sale is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. “Meaningful opportunity is meant to imply that some form of advertisement or public notice must precede the sale and that the public (or the commercially relevant segment of the public) must have access to the sale.

6. **Investment Property.** Dispositions of investment property may be regulated by the federal securities laws. Although the “public sale of securities under this Article may implicate the registration requirements of the Securities Act

of 1933, it need not do so. A disposition that qualifies for deviations from the rules for “private placement exemptions under the Securities Act of 1933 in connection with public advertising nevertheless may constitute a “public sale within the meaning of this section. Moreover, the “commercially reasonable requirements of subsection (b) need not prevent a secured party from conducting a foreclosure sale without first complying with federal registration requirements. To eliminate any doubt, a secured party whose collateral consists of unregistered securities may wish to obtain an undertaking by the debtor to cause the securities to be registered under the 1933 Act upon the secured party’s request. The debtor’s failure to comply with such a requirement should free the secured party (insofar as Article 9 is concerned) to dispose of the unregistered securities in an otherwise commercially reasonable manner. An agreement along these lines would be enforceable as a “standard[] that is not “manifestly unreasonable under Section 9-603.

7. **“Recognized Market.”** A “recognized market, as used in subsection (c) and Section 9-611(d), is one in which the items sold are fungible and prices are not subject to individual negotiation. For example, the Philadelphia Stock Exchange is a recognized market, whereas the markets for used automobiles are not.

8. **Wholesale vs. Retail Dispositions.** A disposition at wholesale is not per se commercially unreasonable. Regarding whether disposition at wholesale is commercially reasonable when retail facilities are readily available, this Article leaves the courts free to resolve each case on its own facts.

9. **Relevance of Price.** A low price may suggest that a court should scrutinize carefully all aspects of a disposition, including the method manner, time, place, and other terms, to ensure that each aspect was commercially reasonable. Note also that even if the disposition is commercially reasonable, Section 9-615(f) provides a special method for calculating a deficiency or surplus if (i) the transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor, and (ii) the amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

10. **Warranties.** Subsection (d) affords the transferee in a disposition under this section the benefit of any title, possession, quiet enjoyment, and similar warranties that would have accompanied the disposition by operation of non-Article 9 law had the disposition been conducted under other circumstances. For example, the Article 2 warranty of title would apply to a sale of goods, the analogous warranties of Article 2A would apply to a lease of goods, and any common law warranties of title would apply to dispositions of other types of collateral. See, e.g., Restatement (2d) Contracts § 333 (warranties of assignor).

Subsection (e) explicitly provides that these warranties can be disclaimed either under other applicable law or by communicating a record containing an express disclaimer. The record need not be written, but an oral communication would not be sufficient. See Section 9-102 (definition of “record). Subsection (f) provides a sample of wording that will effectively exclude the warranties in a disposition under this section, whether or not the exclusion would be effective under non-Article 9 law.

The warranties incorporated by subsection (d) are those relating to “title, possession, quiet enjoyment, and the like. Non-Article 9 law determines whether other statutory or implied warranties, e.g., warranties of quality or fitness for purpose, apply to a disposition under this section. It also determines issues relating to disclaimer of such warranties. For example, a foreclosure sale of a car by a car dealer could give rise to an implied warranty of merchantability (Section 2-314) unless effectively disclaimed or modified (Section 2-316).

This section’s approach to these warranties conflicts with Official Comment 5 to Section 2-312: “Subsection (2) [of Section 2-312] recognizes that sales by . . . foreclosing lienors and person similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller that is purporting to sell only an unknown or limited right. This Article rejects the baseline assumption that commercially reasonable dispositions under this section are “out of the ordinary commercial course or “peculiar. The Official Comment to Section 2-312 will be revised accordingly. See Appendix I.

[9-611]

Reporters’ Comments

1. **Source.** Former Section 9-504(3).

2. **Notification to Debtors and Secondary Obligors.** This section imposes a duty to send notification of a disposition not only to the debtor but also to a secondary obligor. Subsections (b) and (c) resolve an uncertainty under former Article 9 by providing that secondary obligors (sureties) are entitled to receive notification of an intended disposition of collateral, regardless of who created the security interest in the collateral. If the surety created the security interest, it would be the debtor. If it did not, it would be a secondary obligor. (This Article also resolves the question of the secondary obligor’s ability to waive, pre-default, the right to notification–waiver is not permitted. See Section 9-602.) Section 9-605 relieves a secured party from any duty to send notification to a debtor or secondary obligor unknown to the secured party.

Under subsection (b), the principal obligor (borrower) is not always entitled to notification of disposition.

> **Example:** Mooney borrows on an unsecured basis, and Harris grants a security interest in his car to secure the debt. Mooney is a primary obligor, not a secondary obligor. As such, he is not entitled to notification of disposition under this section.

3. **Notification to Other Secured Parties.** Prior to the 1972 amendments to Article 9, former Section 9-504(3) required the enforcing secured party to send reasonable notification of the sale:

> except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or who is known by the secured party to have a security interest in the collateral.

The 1972 amendments eliminated the duty to give notice to secured parties other than those from whom the foreclosing secured party had received written notice of a claim of an interest in the collateral.

Many of the problems arising from dispositions of collateral encumbered by multiple security interests can be ameliorated or solved by informing all secured parties of an intended disposition and affording them the opportunity to work with one another. To this end, subsection (c)(3)(B) expands the duties of the foreclosing secured party to include the duty to notify (and the corresponding burden of searching the files to discover) certain competing secured parties. The subsection imposes a search burden that in some cases may be greater than the pre-1972 burden on foreclosing secured parties but certainly is more modest than that faced by a new lender.

To determine who is entitled to notification, the foreclosing secured party must determine the proper office for filing a financing statement as of a particular date, measured by reference to the “notification date, as defined in subsection (a). This determination requires reference to the choice-of-law provisions of Part 3. The secured party must ascertain whether any financing statements covering the collateral and indexed under the debtor’s name, as the name existed as of that date, in fact were filed in that office. The foreclosing secured party generally need not notify secured parties whose effective financing statements have become more difficult to locate because of changes in the location of the debtor, proceeds rules, or changes in the debtor’s name.

Under subsection (c)(3)(C), the secured party also must notify a secured party that has perfected a security interest by complying with a statute or treaty described in Section 9-311(a), such as a certificate-of-title act.

Subsection (e) provides a “safe harbor that takes into account the inevitable delays attendant to receiving information from the public filing offices. It provides, generally, that the secured party will be deemed to have satisfied its notification duties under subsection (c)(3)(B) if it requests a search from the proper office at least 20 but not more than 30 days before sending notification to the debtor and if it also sends a notification to all secured parties reflected on the search report. The secured party’s duties under subsection (c)(3)(B) also will be satisfied if the secured party requests but does not receive a search report before the notification is sent to the debtor.

In considering the extent, if any, to which expansion of the notification requirement is desirable, one should keep in mind the consequences of failing to send notification to the holder of a competing security interest. In a transaction other than a consumer transaction, the aggrieved secured party has the burden of establishing its loss. See Section 9-626. In a consumer transaction, this Article leaves to other law and the courts the issue of burden of proof. Also relevant are Section 9-615(a), under which junior secured parties are not entitled to receive excess proceeds from the disposing secured party unless they demand them, Section 9-615(g), under which senior secured parties ordinarily are not entitled to share in proceeds of a junior’s disposition, and Section 9-617(a), under which a disposition cuts off junior security interests.

4. **Authentication Requirement.** Subsections (b) and (c) explicitly provide that a notification of disposition must be “authenticated. Some cases read former Section 9-504(3) as validating oral notification.

5. **Second Try.** This Article leaves to judicial resolution, based upon the facts of each case, the question whether the requirement of “reasonable notification requires a “second try, i.e., whether a secured party that sends notification and learns that the debtor did not receive it must attempt to locate the debtor and send another notification.

6. **Recognized Market; Perishable Collateral.** New subsection (d) makes it clear that there is no obligation to give notification of a disposition in the case of perishable collateral or collateral customarily sole on a recognized market (e.g., marketable securities). Former Section 9-504(3) might be read (incorrectly) to relieve the secured party from its duty to notify a debtor but not from its duty to notify other secured parties in connection with dispositions of such collateral.

7. **Failure to Conduct Notified Disposition.** Nothing in this Article prevents a secured party from electing not to conduct a disposition after sending a notification. Nor does it prevent a secured party from electing to send a revised notification if its plans for disposition change. This assumes, however, that the secured party acts in good faith, the revised notification is reasonable, and the revised plan for disposition and any attendant delay are commercially reasonable.

[9-612]

Reporters' Comments

1. **Source.** New.

2. **Reasonable Notification.** Section 9-611(b) requires the secured party to send a "reasonable authenticated notification. Under that section as under former Section 9-504(3), one aspect of a reasonable notification is its timeliness. This generally means that the notification must be sent at a reasonable time in advance of the date of a public disposition or the date after which a private disposition is to be made. A notification that is sent so near to the disposition date that a notified person could not be expected to act on or take account of the notification would be unreasonable.

3. **Timeliness of Notification: Safe Harbor.** The 10-day notice period in subsection (b) is intended to be a "safe harbor and not a minimum requirement. To qualify for the "safe harbor the notification must be sent after default. A notification also must be sent in a commercially reasonable manner. See Section 9-611(b) ("reasonable authenticated notification). Those requirements prevent a secured party from taking advantage of the "safe harbor by, for example, giving the debtor a notification at the time of the original extension of credit or sending the notice by surface mail to a debtor overseas.

4. **No Inference for Consumer Transactions.** The subsection (b) "safe harbor does not apply in consumer transactions. Under subsection (c), the limitation of subsection (b) to transactions other than consumer transactions is intended to leave to the court the determination of the timeliness of notifications in consumer transactions. Subsection (c) also instructs the court not to draw any inference from the limitation as to the proper approach for consumer transactions and leaves the court free to continue to apply established approaches to those transactions.

[9-613]

Reporters' Comments

1. **Source.** New.

2. **Contents of Notification.** To comply with the "reasonable authenticated notification requirement of Section 9-611(b), the contents of a notification must be reasonable. Except in a consumer-goods transaction, the contents of a notification that includes the information set forth in paragraph (1) are sufficient as a matter of law, unless the parties agree otherwise. (The reference to "time of disposition

means here, as it does in former Section 9-504(3), not only the hour of the day but also the date.) Although a secured party may choose to include additional information concerning the transaction or the debtor's rights and obligations, no additional information is required unless the parties agree otherwise. A notification that lacks some of the information set forth in paragraph (1) nevertheless may be sufficient if found to be so by the trier of fact, under paragraph (2). A properly completed sample form of notification in paragraph (5) is one example of a notification that would contain the information set forth in paragraph (1). Under paragraph (4), however, no particular phrasing of the notification is required.

[9-614]

1. **Source.** New.

2. **Notification in Consumer-Goods Transactions.** Subsection (a)(1) sets forth the information required for a reasonable effective notification in a consumer-goods transaction. A notification that lacks any of the information set forth in subsection (a)(1) is insufficient as a matter of law. Compare Section 9-613(2), under which the trier of fact may find a notification to be sufficient even if it lacks some information listed in paragraph (1) of that section.

3. **Safe-Harbor Form of Notification; Errors in Information.** Although Subsection (a)(2) provides that a particular phrasing of a notification is not required, subsection (a)(3) specifies a safe-harbor form that, when properly completed, satisfies subsection (a)(1). Under subsection (a)(4), non-misleading, minor errors in information contained in notification are permitted if the safe-harbor form is used *and if the errors are in information not required under subsection (a)(1)*. However, subsection (b) leaves to the courts the determination of the effects, if any, of errors if another form of notification is used or if the errors relate to information required by subsection (a)(1).

[9-615]

Reporters' Comments

1. **Source.** former Section 9-504(1), (2).

2. **Application of Proceeds.** This section contains the rules governing application of proceeds and the debtor's liability for a deficiency following a disposition of collateral. Subsection (a) sets forth the basic order of application. The proceeds are applied first to the expenses of disposition, second to the obligation secured by the security interest that is being enforced, and third, in the specified circumstances, to interests that are subordinate to that security interest.

Subsections (a) and (d) also address the right of a consignor to receive proceeds of a disposition by a secured party whose interest is senior to that of the consignor. Subsection (a) requires the enforcing secured party to pay excess proceeds first to subordinate secured parties or lienholders whose interests are senior to that of a consignor and, finally, to a consignor. Inasmuch as a consignor is the owner of the collateral, secured parties and lienholders whose interests are junior to the consignor's interest will not be entitled to any proceeds. In like fashion, under revised subsection (d)(1) the debtor is not entitled to a surplus when the enforcing secured party is required to pay over proceeds to a consignor.

3. **Noncash Proceeds.** Subsection (c) addresses the application of noncash proceeds of a disposition, such as a note or lease. The explanation in the Comments to Section 9-608 generally applies to this subsection. Under subsection (c), if a disposition produces noncash proceeds, such as a promissory note, the secured party is under no duty to apply the proceeds or their value to the secured obligation. If a secured party elects to apply the note to the outstanding obligation, however, it must do so in a commercially reasonable manner. One would expect that where noncash proceeds are or may be material, the parties would agree to more specific standards in an agreement entered into before or after default. The parties may agree to the method of application of noncash proceeds if the method is not manifestly unreasonable. See Section 9-603.

4. **Surplus and Deficiency.** Subsection (d) deals with surplus and deficiency. It revises former Section 9-504(2) by imposing an explicit requirement that the secured party “pay the debtor for any surplus, while retaining the secured party's duty to “account. Inasmuch as the debtor may not be an obligor, subsection (d) now provides that the obligor (not the debtor) is liable for the deficiency. The special rule governing surplus and deficiency when receivables have been sold likewise has been revised to take into account the new distinction between debtor and obligor. Subsection (d) also addresses the situation in which a consignor has an interest that is subordinate to the security interest being enforced.

5. **Collateral Under New Ownership.** When the debtor sells collateral subject to a security interest, the original debtor (creator of the security interest) is no longer a debtor inasmuch as it no longer has a property interest in the collateral; the buyer is the debtor. See Section 9-102. As between the debtor (buyer of the collateral) and the original debtor (seller of the collateral), the debtor (buyer) normally would be entitled to the surplus. Subsection (d) therefore requires the secured party to pay the surplus to the debtor (buyer), not to the original debtor (seller) with which it has dealt. But, because this situation arises as a result of the debtor's wrongful act, this Article does not expose the secured party to the risk of determining ownership of the collateral. If the secured party does not know about the new debtor and accordingly pays the surplus to the original debtor, the exculpatory provisions of this Article exonerate the secured party from liability to the new debtor. See Sections 9-605, 9-628(a), (b). If a debtor sells collateral *free*

of a security interest, such as a sale to a buyer in ordinary course of business (see Section 9-320(a)), the property is no longer collateral and the buyer is not a debtor.

6. **"Low Price" Dispositions.** Subsection (f) provides a special method for calculating a deficiency or surplus when the secured party, a person related to the secured party (defined in Section 9-102), or a secondary obligor acquires the collateral at a foreclosure disposition. It recognizes that when the foreclosing secured party or a related party is the transferee of the collateral, the secured party sometimes lacks the incentive to maximize the proceeds of disposition. As a consequence, the disposition may comply with the procedural requirements of this Article (e.g., it is conducted in a commercially reasonable manner following reasonable notice) but nevertheless fetch a low price.

Subsection (f) adjusts for this lack of incentive. If the proceeds of a disposition of collateral to a secured party, a person related to the secured party, or a secondary obligor are "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought, then instead of calculating a deficiency (or surplus) based on the actual net proceeds, the calculation is based upon the amount that would have been received in a commercially reasonable disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor. Subsection (f) thus rejects the view that the secured party's receipt of such a price necessarily constitutes noncompliance with Part 6. However, such a price may suggest the need for greater judicial scrutiny. See Section 9-610, Comment 9.

7. **"Person related to."** Two definitions of "person related to are found in Section 9-102. One applies when the secured party is an individual, and the other applies when the secured party is an organization. The definitions are patterned closely on the corresponding definition in Section 1.301(32) of the Uniform Consumer Credit Code.

[9-616]

Reporters' Comments

1. **Source.** New.

2. **Duty to Send Information Concerning Surplus or Deficiency.** This section reflects the view that, in every consumer-goods transaction, the debtor or obligor is entitled to know the amount of a surplus or deficiency and the basis upon which the surplus or deficiency was calculated. Under subsection (b)(1), a secured party is obligated to provide this information (an "explanation, defined in subsection (a)(1)) no later than the time that it accounts for and pays a surplus or the time of its first written attempt to collect the deficiency. The obligor need not

make a request for an accounting in order to receive an explanation. A secured party that does not account for and pay a surplus or attempt to collect a deficiency in writing has no obligation to send an explanation under subsection (b)(1) and, consequently, cannot be liable for noncompliance.

A debtor or secondary obligor need not wait until the secured party commences written collection efforts in order to receive an explanation of how a deficiency or surplus was calculated. Subsection (b)(2) obliges the secured party to send an explanation within 14 days after it receives a “request (defined in subsection (a)(2)).

3. **Liability for Noncompliance.** A secured party that fails to comply with subsection (b)(2) is liable for any loss caused plus $500. See Section 9-625(b), (c), and (e)(7). A secured party that fails to send an explanation under subsection (b)(1) is liable for any loss caused plus, if the noncompliance was “part of a pattern, or consistent with a practice of noncompliance, $500. See Section 9-625(b), (c), and (e)(6). However, a secured party that fails to comply with this section is not liable for statutory minimum damages under Section 9-625(c)(2). See Section 9-628(d).

[9-617]

Reporters’ Comments

1. **Source.** Former Section 9-504(4).

2. **Title Taken by Qualifying Transferee.** Subsection (a) sets forth the rights acquired by persons that qualify under subsection (b)(1) or (2). Such a person is a “transferee, inasmuch as a buyer at a foreclosure sale does not meet the definition of “purchaser in Section 1-201 (the transfer is not, vis-a-vis the debtor, “voluntary). By virtue of the expanded definition of the term “debtor in Section 9-102, subsection (a) makes clear that the ownership interest of a person that bought the collateral subject to the security interest is terminated. Such a person is a debtor under this Article. Under the former Article, the result arguably is the same, but the statute is not clear. Under subsection (a), a disposition normally discharges the security interest being foreclosed and any subordinate security interests.

3. **Title Taken by Nonqualifying Transferee.** Subsection (c) specifies the consequences for a transferee that does not qualify for protection under subsections (a) and (b) (e.g., a transferee with knowledge of defects in a public sale). The transferee takes subject to the rights of the debtor, the enforcing secured party, and other security interests or liens.

[9-618]

Reporters' Comments

1. **Source.** Former Section 9-504(5).

2. **Scope of This Section.** Under this section, assignments of secured obligations and other transactions (regardless of form) that function like assignments of secured obligations are not dispositions to which Part 6 applies. Rather, they constitute assignments of rights and (occasionally) delegations of duties. Application of this section may require an investigation into the agreement of the parties, which may not be reflected in the words of the repurchase agreement (e.g., when the agreement requires a recourse party to "purchase the collateral but contemplates that the purchaser will then conduct an Article 9 foreclosure sale).

This section, like former Section 9-504(5), does not constitute a general and comprehensive rule for allocating rights and duties upon assignment of a secured obligation. Rather, it applies only in situations involving a secondary obligor described in subsection (a). In other contexts, the agreement of the parties and applicable law other than Article 9 determine whether the assignment imposes upon the assignee any duty to the debtor and whether the assignor retains its duties to the debtor after the assignment.

Subsection (a)(1) applies when there has been an assignment of an obligation that is secured at the time it is assigned. Thus, if a secondary obligor acquires the collateral at a disposition under Section 9-610 and simultaneously or subsequently discharges the unsecured deficiency claim, subsection (a)(1) is not implicated. Similarly, subsection (a)(3) applies only when the secondary obligor is subrogated to the secured party's rights with respect to collateral. Thus, this subsection will not be implicated if a secondary obligor discharges the debtor's unsecured obligation for a post-disposition deficiency. Similarly, if the secured party disposes of some of the collateral and the secondary obligor thereafter discharges the remaining obligation, subsection (a) applies only with respect to rights and duties concerning the remaining collateral and, under subsection (b), the subrogation is not a disposition *of the remaining collateral.*

As discussed more fully in Comment 3, a secondary obligor may receive a transfer of collateral in a disposition made under Section 9-610 in exchange for a payment that is applied against the secured obligation. However, a secondary obligor that pays and receives a transfer of collateral does not necessarily become subrogated to the rights of the secured party as contemplated by subsection (a)(3). Only to the extent the secondary obligor makes a payment in satisfaction of its secondary obligation would it become subrogated. To the extent its payment constitutes the price of the collateral in a Section 9-610 disposition by the secured party, the secondary obligor would not be subrogated. Thus, if the amount paid by the secondary obligor for the collateral in a Section 9-610 disposition is insufficient to discharge the secured obligation and the secondary obligor satisfies the remaining balance, it would be subrogated to the secured party's deficiency claim.

But the duties of the secured party *as such* would have come to an end with respect to that collateral. In some situations the capacity in which the payment is made may be unclear. Accordingly, the parties should in their relationship provide clear evidence of the nature and circumstances of the payment by the secondary obligor.

3. **Transfer of Collateral to Secondary Obligor.** It is possible for a secured party to transfer collateral to a secondary obligor in a transaction that is a disposition under Section 9-610 and that establishes a surplus or deficiency under Section 9-615. Indeed, the draft includes a special rule, in Section 9-615(f), for establishing a deficiency in the case of some dispositions to, *inter alia*, secondary obligors. Some have read former Section 9-504(5) to provide that a transfer of collateral to a recourse party can *never* constitute a disposition of collateral under that section. We doubt that this is a reasonable construction of the statute. It would be odd that a secured party could itself buy collateral at its own public sale while a recourse party would be entirely prohibited from purchasing at the sale.

4. **Timing and Scope of Obligations.** The word “after now replaces the word “if (which appeared in earlier drafts) at the end of the introductory portion of subsection (a). This change is intended to make clear that when a successor assignee, transferee, or subrogee becomes obligated it does not assume any liability for earlier actions or inactions of the secured party that it has succeeded. Once the successor becomes obligated, however, it is responsible for complying with the secured party’s duties thereafter. For example, if the successor is in possession of collateral it has the duties specified in Section 9-207.

[9-619]

Reporters’ Comments

1. **Source.** New.

2. **Transfer of Record or Legal Title.** Potential buyers of collateral that is covered by a certificate of title (e.g., an automobile) or is subject to a registration system (e.g., a copyright) typically require as a condition of their purchase that the certificate or registry reflect their ownership. In many cases, this condition can be met only with the consent of the record owner. If the record owner is the debtor and, as often is the case after the default, the debtor refuses to cooperate, the secured party may have great difficulty disposing of the collateral. Applicable non-UCC law (e.g., a certificate-of-title act, federal registry rules, or the like) may provide a means by which the secured party may obtain or transfer record or legal title for the purpose of a disposition of the property under this Article.

Subsection (b) provides a simple mechanism for obtaining record or legal title, for use primarily when other law does not provide one. Of course, use of this mechanism will not be effective to clear title to the extent that subsection (b) is preempted by federal law. Subsection (b) contemplates a transfer of record or legal title to a third party, following a secured party's exercise of its disposition or acceptance remedies under this Part, as well as a transfer to a secured party prior to its exercise of those remedies. Under subsection (c), a transfer of record or legal title, under subsection (b) or under other law, to a secured party prior to the exercise of those remedies merely puts the secured party in a position to pass legal or record title to a transferee at foreclosure. A secured party that has obtained record or legal title retains its duties with respect to enforcement of its security interest, and the debtor retains its rights as well.

The Official Comments will make clear that the mechanism provided by this section is in addition to any similar title-clearing provision under law other than this article.

[9-620]

Reporters' Comments

1. **Source.** Former Section 9-505.

2. **Overview and Organization.** This section and the two sections following deal with strict foreclosure, 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 Section 9-610. Although these provisions derive from former Section 9-505, they have been entirely reorganized and substantially rewritten. The more straightforward approach taken in this Article eliminates the fiction that the secured party always will present a "proposal for the retention of collateral and the debtor will have a fixed period to respond. By eliminating the need (but preserving the possibility) for proceeding in this fashion, this section eliminates much of the awkwardness of former Section 9-505. It reflects the belief that strict foreclosures should be encouraged and often will produce better results than a disposition for all concerned. This Comment explains how the three sections are organized. The following Comments contain a subsection-by-subsection analysis of the text.

Subsection (a) sets forth the conditions necessary to an effective acceptance (formerly, retention) of collateral in full or partial satisfaction of the secured obligation. The first condition is that the debtor must consent to the acceptance. Subsection (c) provides that this consent must be manifested either by the debtor's post-default, authenticated agreement to the acceptance or, in the case of an acceptance in full satisfaction, by the debtor's 20-day silence after receipt of an authenticated "proposal (defined in Section 9-102). Subsection (b) conditions the effectiveness of an apparent acceptance on the secured party's authenticated acceptance or its sending a proposal; "constructive or "deemed acceptances are not effective.

The second condition necessary to an effective acceptance of collateral is the absence of a timely objection from a person that holds an interest subordinate to the security interest in question. Subsection (d) indicates when an objection is timely. If either of these conditions is not met, any purported or apparent acceptance in satisfaction is ineffective.

The third condition applies only in a consumer-goods transaction: the collateral may not be in the possession of the debtor when the debtor consents to the acceptance.

In addition to the conditions described above, Section 9-621 requires that a secured party that wishes to proceed under this section notify certain other persons that have or claim to have an interest in the collateral. Unlike the failure to meet the conditions in subsection (a), under Section 9-622(b) the failure to comply with the notification requirement of Section 9-621 does not render the acceptance of collateral ineffective. Rather, the acceptance can take effect notwithstanding the secured party’s noncompliance. Section 9-622(b) also indicates that a person to which the required notice was not sent has the right to recover damages under Section 9-625(b). Section 9-622(a) sets forth the effect of an acceptance of collateral.

3. **Proposals.** Section 9-102 defines the term “proposal. It is necessary to send a “proposal to the debtor only if the debtor does not agree to an acceptance in an authenticated record as described in subsection (c)(1) or (c)(2). A proposal need not take any particular form as long as it sets forth the terms under which the secured party is willing to accept collateral in satisfaction. A proposal to accept collateral should specify the amount (or a means of calculating the amount, such as by including a per diem accrual figure) of the secured obligations to be satisfied, state the conditions (if any) under which the proposal may be revoked, and describe any other applicable conditions. Note, however, that a conditional proposal generally requires the debtor’s agreement in order to take effect. See subsection (c), discussed in the following Comment.

4. **Conditions to Effective Acceptance.** Subsection (a) contains the conditions necessary to the effectiveness of an acceptance of collateral. Subsection (a)(1) requires the debtor’s consent. Under subsections (c)(1) and (c)(2), the debtor may consent by agreeing to the acceptance in writing after default. Subsection (c)(2) contains an alternative method by which to satisfy the debtor’s-consent condition in subsection (a)(1). It follows the proposal-and-objection model found in former Section 9-505: The debtor consents if the secured party sends a proposal to the debtor and does not receive an objection within 20 days. Under subsection (c)(1), however, that silence is not deemed to be consent with respect to acceptances in partial satisfaction. Thus, a secured party that wishes to conduct a “partial strict foreclosure must obtain the debtor’s agreement in a record authenticated after default. In all other respects, the conditions necessary to an

effective partial strict foreclosure are the same as those governing acceptance of collateral in full satisfaction.

The time when a debtor consents to a strict foreclosure is significant in several circumstances under this section and the following one. See Sections 9-620(a)(1), (d)(2); 9-621(a)(1), (a)(2), (a)(3). For purposes of determining the time of consent, a debtor's conditional consent constitutes consent.

Subsection (a)(2) contains the second condition to the effectiveness of an acceptance under this section–the absence of an objection from a person holding a junior interest in the collateral or from a secondary obligor. Any junior party–secured party or lienholder–is entitled to lodge an objection to a proposal, even if that person was not entitled to notification under Section 9-621. Subsection (d), discussed below, indicates when an objection is timely.

In a consumer-goods transaction, an acceptance is not effective unless the collateral is not in the possession of the debtor when the debtor consents to the acceptance. Subsection (a)(3).

5. **Secured Party's Agreement; No "Constructive" Strict Foreclosure.** The conditions of subsection (a) relate to actual or implied consent by the debtor and any secondary obligor or holder of a junior security interest or lien. To ensure that the debtor cannot unilaterally cause an acceptance of collateral, subsection (b) provides that compliance with these conditions is necessary but not sufficient to cause an acceptance of collateral. Rather, under subsection (b), acceptance does not occur unless, in addition, the secured party consents to the acceptance in an authenticated record or sends to the debtor a proposal. For this reason, a mere delay in collection or disposition of collateral does not constitute a "constructive strict foreclosure. Instead, a delay that is unreasonable may be a factor relating to whether the secured party acted in a commercially reasonable manner for purposes of Section 9-607 or 9-610. A debtor's voluntary surrender of collateral to a secured party and the secured party's acceptance of possession of the collateral raises no implication whatsoever that the secured party intends or is proposing to accept the collateral in satisfaction of the secured obligation under this section.

6. **When Acceptance Occurs.** This section does not impose any formalities or identify any steps that a secured party must take in order to accept collateral once the conditions of subsections (a) and (b) have been met. Absent facts or circumstances indicating a contrary intention, the fact that the conditions have been met provides a sufficient indication that the secured party has accepted the collateral on the terms to which the debtor has agreed or failed to object. Acceptance of the collateral normally is automatic upon the secured party's becoming bound and the time for objection passing. As a matter of good business practice, an enforcing secured party may wish to memorialize its acceptance, such as by notifying the debtor that the strict foreclosure is effective or by placing a written record to that effect in its files. The secured party's agreement to accept

collateral is self-executing and cannot be breached. The secured party is bound by its agreement to accept collateral and by any proposal to which the debtor consents.

7. **No Possession Requirement.** This section eliminates the former requirement that the secured party be “in possession of collateral. Intangible collateral, which cannot be possessed, may be subject to a strict foreclosure under this section. However, under subsection (a)(3), if the collateral is consumer goods, acceptance does not occur unless the debtor is not in possession.

8. **When Objection Timely.** Subsection (d) explains when an objection is timely and thus prevents an acceptance of collateral from taking effect. An objection by a person to which notification was sent under Section 9-621 is effective if it is received by the secured party within 20 days from the date the notification was sent to that person. Other objecting parties (i.e., third parties that are not entitled to notification) may object at any time within 20 days after the last notification is sent under Section 9-621. If no such notification is sent, third parties must object before the debtor agrees to the acceptance in writing or is deemed to have consented by silence. The former may occur any time after default, and the latter requires a 20-day waiting period. See subsection (c).

9. **Applicability of Other Law.** This section does not purport to regulate all aspects of the transaction by which a secured party may become the owner of collateral previously owned by the debtor. For example, a secured party’s acceptance of a motor vehicle in satisfaction of secured obligations may require compliance with the applicable motor vehicle certificate-of-title law. State legislatures should conform those laws so that they mesh well with this section and Section 9-610, and courts should construe those laws and this section harmoniously. A secured party’s acceptance of collateral in the possession of the debtor also may implicate statutes dealing with a seller’s retention of possession of goods sold. See, e.g., Cal. Civ. Code § 3440.1-.9.

10. **Accounts, Chattel Paper, Payment Intangibles, and Promissory Notes.** If the collateral is accounts, chattel paper, payment intangibles, or promissory notes, then a secured party’s acceptance of the collateral in satisfaction of secured obligations would constitute a sale to the secured party. That sale would give rise to a new security interest (the ownership interest) under Sections 1-201(37) and 9-109. The new security interest would remain perfected by a filing (or, in the case of promissory notes, by possession) that was effective to perfect the secured party’s original security interest. However, the procedures for acceptance of collateral under this section satisfy all necessary formalities and a new security agreement authenticated by the debtor would not be necessary.

11. **Obligation to Dispose of Consumer Goods.** Subsection (e) imposes an obligation on the secured party to dispose of consumer goods under certain circumstances. Subsection (f) explains when a disposition that is required under subsection (e) is timely.

12. **No Acceptance in Partial Satisfaction in Consumer Transaction.** Subsection (g) prohibits the secured party in consumer transactions from accepting collateral in partial satisfaction of the obligation is secures. The Official Comments will explain the consequences of an attempted acceptance in partial satisfaction: The attempted acceptance is void. A secured party that takes possession of the collateral and fails to dispose of it will violate subsection (f), if applicable, and may also violate Section 9-610 or 9-615.

[9-621]

Reporters' Comments

1. **Source.** Former Section 9-505.

2. **Notification.** Subsection (a) specifies three classes of competing claimants to which the secured party must send notification of its proposal: (i) those that notify the secured party that they claim an interest in the collateral, (ii) holders of certain security interests and liens which have filed against the debtor, and (iii) holders of certain security interests and liens which have perfected by compliance with a certificate-of-title or similar statute. With regard to (ii), see the Comment to Section 9-611. Subsection (b) also requires notification to any secondary obligor if the proposal is for acceptance in partial satisfaction.

[9-622]

Reporters' Comments

1. **Source.** New.

2. **Effect of Acceptance.** Subsection (a) specifies the effect of an acceptance of collateral in full or partial satisfaction of the secured obligation. Paragraph (1) expresses the fundamental consequence of accepting collateral in full or partial satisfaction of the secured obligation–the obligation is discharged to the extent consented to by the debtor. Unless otherwise agreed, the obligor remains liable for any deficiency. Paragraphs (2) through (4) indicate the effects of an acceptance on various property rights and interests. Paragraph (2) follows Section 9-617(a) in providing that the secured party acquires "all of a debtor's rights in the collateral. Under paragraph (3), the effect of strict foreclosure on holders of junior security interests and liens is the same regardless of whether the collateral is accepted in full or partial satisfaction of the secured obligation: all junior encumbrances are discharged. Subsection (b) makes clear that this is the effect regardless of whether a proposal was required to be sent or, if required, was sent. Paragraph (4) provides for the termination of other subordinate interests.

[9-623]

Reporters' Comments

1. **Source.** Former Section 9-506.

2. **Redemption.** Subsection (a) follows former Section 9-506 but extends the right of redemption to holders of nonconsensual liens. Most of the other changes are not substantive.

3. **Effect of "Repledging."** Section 9-207 generally permits a secured party having possession or control of collateral to create a security interest in the collateral. As explained in the Comments to that section, the debtor's right (as opposed to its practical ability) to redeem collateral is not affected by, and does not affect, the priority of a security interest created by the debtor's secured party.

[9-624]

Reporters' Comments

1. **Source.** Former Sections 9-504(3); 9-505; 9-506.

2. **Waiver.** This section is a limited exception to Section 9-602, which generally prohibits waiver by debtors and obligors. It makes no provision for waiver of the rule prohibiting a secured party from buying at its own private sale. Transactions of this kind are equivalent to "strict foreclosures and are governed by Sections 9-620, 9-621, and 9-622.

[SUBPART 2. NONCOMPLIANCE WITH ARTICLE.]

[9-625]

Reporters' Comments

1. **Source.** Former Section 9-507.

2. **Scope.** Subsections (a) and (b) are not limited to noncompliance with provisions of this Part of Article 9 as was the case in some earlier drafts and under former Section 9-507; rather they apply to noncompliance with any provision of this Article. The change makes this section applicable to noncompliance with Sections 9-207 (duties of secured party in possession of collateral); 9-208 (duties of secured party having control over deposit account); 9-209 (duties of secured party if account debtor has been notified of an assignment); 9-210 (duty to comply with

request for accounting, etc.); 9-509(a) (duty to refrain from filing unauthorized financing statement); and 9-513(a) or (c) (duty to provide termination statement). Subsections (d), (e), and (f) provide supplemental damages for violation of those sections. Subsection (c)(2), which gives a minimum damage recovery in consumer-goods transactions, applies only to noncompliance with the provisions of this Part.

3. **Injunctions.** Subsection (a) modifies the first sentence of former subsection (1) by adding the references to “collection and “enforcement.

4. **Damages for Noncompliance with this Article.** Subsection (b) sets forth the basic remedy for failure to comply with the requirements of this Article: a damage recovery in the amount of loss caused by the noncompliance. Subsection (c) identifies who may recover from the secured party for its liability under subsection (b). It affords a remedy to any aggrieved person that is a debtor or obligor. However, a principal obligor that is not a debtor may recover damages only for noncompliance with Section 9-616, inasmuch as none of the other rights and duties in this Article run in favor of a principal obligor. Subsection (c) also affords a remedy to an aggrieved person that holds a competing security interest or lien, regardless of whether the aggrieved person is entitled to notification under Part 6. The remedy is available even to holders of senior security interests and liens. The exercise of this remedy is subject to the normal rules of pleading and proof. A person that has delegated the duties of a secured party but that remains obligated to perform them is liable under this subsection. The last sentence of subsection (d) eliminates the possibility of double recovery or other over-compensation arising out of a reduction or elimination of a deficiency under Section 9-626, based on noncompliance with the provisions of this Part relating to collection, enforcement, disposition, or acceptance. Assuming no double recovery, a debtor whose deficiency is eliminated under Section 9-626 may pursue a claim for a surplus. Because Section 9-626 does not apply to consumer transactions, the statute is silent as to whether a double recovery or other over-compensation is possible in a consumer transaction.

Damages for violation of the requirements of this article, including Section 9-609, are those reasonably calculated to put an eligible claimant in the position that it would have occupied had no violation occurred. See Section 1-106. For example, assume that a secured party commits a breach of the peace that enables it to obtain possession of collateral following an actual default. Assume further that in the absence of the breach of the peace, the secured party could have obtained possession through judicial proceedings three weeks later than the time that it actually took possession. Under these circumstances, the debtor should be compensated for the value of the use of the collateral for the three-week period. Assume, alternatively, that the secured party commits a breach of peace while wrongfully taking possession of the collateral (i.e., wrongfully, because no default had occurred). Following its taking possession, the secured party sells the collateral. The collateral now has vanished. These circumstances warrant the debtor’s recovery of the entire value of the collateral. In neither of these cases, however, is the debtor precluded from claiming a different measure of damages in tort. Although subsection (b) supports the recovery of actual damages for committing a breach of the peace in violation of Section 9-609, principles of tort law supplement this Section. See Section 1-103.

5. **Minimum Damages in Consumer-Goods Transactions.** Subsection (c)(2) provides a minimum damage recovery for debtors in a consumer-goods transaction. It is designed to ensure that every noncompliance with the requirements of Part 6 results in liability, regardless of any injury that may have resulted. Under the drafts prior to the March, 1998, draft, if an aggrieved person was entitled to damages under subsection (b) or a reduction of personal liability for a deficiency under Section 9-626, those amounts would have been deducted from the amount available under this subsection. Under this draft, however, the right to minimum statutory damages appears in language that tracks closely the analogous provision in former Section 9-507(1), and Section 9-626 does not apply in consumer transactions. This draft is intended to leave the treatment of statutory damages as it was under former Article 9, with the possible result that statutory damages would not be reduced to take account of actual damages awarded against the secured party or, in jurisdictions in which an absolute bar or rebuttable presumption rule has been judicially adopted, to take account of a loss or reduction of a deficiency.

6. **Supplemental Damages.** Subsection (e) imposes an additional $500 liability upon a person that fails to comply with the provisions specified in that subsection.

7. **Reasonable Excuse.** Under subsection (f), a person that fails to comply with a request for an accounting or a request regarding a list of collateral or statement of account under Section 9-210 has a reasonable excuse for the failure if the person never claimed an interest in the collateral or obligations that were the subject of the request.

8. **Estoppel.** Subsection (g) limits the extent to which a secured party that fails to comply with a request regarding a list of collateral or statement of account may claim a security interest.

[9-626]

Reporters' Comments

1. **Source.** New.

2. **Scope.** The basic damage remedy under Section 9-625(b) is subject to the special rules for transactions other than consumer transactions contained in this section. This section addresses situations in which the amount of a deficiency or surplus is in issue, i.e., situations in which the secured party has collected, enforced,

disposed of, or accepted the collateral. It contains special rules applicable to a determination of the amount of a deficiency or surplus. The rules in this section apply only to noncompliance in connection with the "collection, enforcement, disposition, or acceptance under Part 6. For other types of noncompliance with Part 6, the general liability rule, recovery of actual damages under Section 9-625(b), applies. Consider, for example, a repossession that does not comply with Section 9-609 for want of a default. The debtor's remedy is under Section 9-625(b). In a proper case the secured party also may be liable for conversion under non-UCC law. If the secured party thereafter disposed of the collateral, however, it would violate Section 9-610 at that time, and this section would apply.

3. **Rebuttable Presumption Rule.** Subsection (a) establishes the rebuttable presumption rule for transactions other than consumer transactions. Under paragraph (1), the secured party need not prove compliance with the relevant provisions of this Part as part of its prima facie case. If, however, the debtor or a secondary obligor raises the issue (in accordance with the forum's rules of pleading and practice), then the secured party bears the burden of proving that the collection, enforcement, or disposition complied. In the event the secured party is unable to meet this burden, then paragraph (3) explains how to calculate the deficiency. Under this rebuttable presumption rule, the debtor or obligor is to be credited with the greater of the actual proceeds of the disposition or the proceeds that would have been realized had the secured party complied with the relevant provisions. If a deficiency remains, then the secured party is entitled to recover it. The references to "the secured obligation, expenses, and attorney's fees in paragraphs (3) and (4) embrace the application rules in Sections 9-608(a) and 9-615(a).

Unless the secured party proves that compliance with the relevant provisions would have yielded a smaller amount, under paragraph (4) the amount that a complying collection, enforcement, or disposition would have yielded is deemed to be equal to the amount of the secured obligation, together with expenses and attorney's fees. Thus, the secured party may not recover any deficiency unless it meets this burden.

4. **Consumer Transactions.** Although subsection (a) adopts a version of the rebuttable presumption rule for transactions other than consumer transactions, with certain exceptions Part 6 does not specify the effect of a secured party's noncompliance in consumer transactions. (The exceptions are the provisions for the recovery of damages in Section 9-625.) Subsection (b) provides that the limitation of subsection (a) to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. It also instructs the court not to draw any inference from the limitation as to the proper rules for consumer transactions and leaves the court free to continue to apply established approaches to those transactions.

Courts construing former Section 9-507 have disagreed about the consequences of a secured party's failure to comply with the requirements of former Part 5. Three general approaches have emerged. Some courts have held that a noncomplying secured party may not recover a deficiency (the "absolute bar rule). Other courts have held that the debtor can offset against a claim to a deficiency all damages recoverable under former Section 9-507 resulting from the secured party's noncompliance (the "offset rule). A plurality of courts considering the issue has held that the noncomplying secured party is barred from recovering a deficiency unless it overcomes a rebuttable presumption that compliance with former Part 5 would have yielded an amount sufficient to satisfy the secured debt. In addition to the nonuniformity resulting from court decisions, some States have enacted special rules governing the availability of deficiencies.

5. **Burden of Proof When Section 9-615(f) Applies.** Subsection (a)(5) is new. It imposes upon a debtor or obligor the burden of proving that the proceeds of a disposition are so low that, under Section 9-615(f), the actual proceeds should not serve as the basis upon which a deficiency or surplus is calculated. If the burden were placed on the secured party, then debtors might be encouraged to challenge the price received in every disposition to the secured party, a person related to the secured party, or a secondary obligor.

6. **Delay in Applying This Section.** There is an inevitable delay between the time a secured party engages in noncomplying collections or dispositions and the time of a subsequent judicial determination that the secured party did not comply with Part 6. During the interim, the secured party, believing that the secured obligation is larger than it ultimately is determined to be, may continue to make collections on and dispositions of collateral. If the secured indebtedness is discharged thereafter by the operation of the rebuttable presumption rule, a reasonable application of this section would impose liability on the secured party for the amount of the excess, unwarranted recoveries.

[9-627]

Reporters' Comments

1. **Source.** Former Section 9-507(2).

2. **Relationship of Price to Commercial Reasonableness.** Some observers have found the notion contained in subsection (a) (former Section 9-507(2)) (the fact that a better price could have been obtained does not establish lack of commercial reasonableness) to be inconsistent with that found in Section 9-610(b) (former Section 9-504(3) (every aspect of the sale, including its terms, must be commercially reasonable). The Drafting Committee perceives no inconsistency, but it favors an explanation of the relationship between price and commercial reasonableness in the Official Comments. See, e.g., Section 9-610, Comment 10.

The law long has grappled with the problem of dispositions of personal and real property that comply with applicable procedural requirements (e.g., advertising, notice to interested persons, etc.) but which yield a price that seems low. This Article addresses that issue in Section 9-615(f). That section applies only when the transferee is the secured party, a person related to the secured party, or a secondary obligor. It contains a special rule for calculating a deficiency or surplus in a complying disposition that yields a price that is "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought. A low price is relevant to whether a disposition has been commercially reasonable in that it may suggest the need for careful judicial scrutiny of the commercial reasonableness of the disposition.

3. **"Recognized Market."** The concept of a "recognized market in subsections (b)(1) and (2) is quite limited; it applies only to markets where there are standardized price quotations for property that is essentially fungible, such as stock exchanges.

[9-628]

Reporters' Comments

1. **Source.** New.

2. **Exculpatory Provisions.** Subsections (a), (b), and (c) contain exculpatory provisions that should be read in conjunction with Section 9-605. Without this group of provisions, a secured party could incur liability to unknown persons and under circumstances that would not allow the secured party to protect itself. The broadened definition of the term "debtor underscores the need for these provisions.

3. **Inapplicability of Statutory Damages to Section 9-616.** Subsection (d) excludes noncompliance with Section 9-616 entirely from the scope of statutory damage liability under Section 9-625(c)(2).

4. **Single Liability for Statutory Minimum Damages.** Subsection (e) ensures that a secured party will incur statutory damages only once in connection with any one secured obligation.