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FOR DISCUSSION ONLY

UNIFORM COMMERCIAL CODE
REVISED ARTICLE 9. SECURED TRANSACTIONS; SALES OF ACCOUNTS AND CHATTEL PAPER

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UNIFORM COMMERCIAL CODE
REVISED ARTICLE 9. SECURED TRANSACTIONS; SALES OF ACCOUNTS AND CHATTEL PAPER

WITH PREFATORY NOTE AND COMMENTS

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UNIFORM COMMERCIAL CODE ARTICLE 9 - SECURED TRANSACTIONS;
SALES OF ACCOUNTS AND CHATTEL PAPER

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PREFATORY NOTE

1. Background and History of Article 9 Revisions

In 1990, the Permanent Editorial Board for the Uniform Commercial Code ("PEB"), with the support of its sponsors, the American Law Institute ("ALI") and the National Conference of Commissioners on Uniform State Laws ("Conference"), established a committee ("Study Committee") to study Article 9 of the Uniform Commercial Code ("UCC"). The PEB charged the Study Committee to consider whether Article 9 and related provisions of the UCC are in need of revision. The PEB also requested the Study Committee to recommend the nature and the substance of any revisions that it thought desirable. The Study Committee issued its report as of December 1, 1992 ("Report").

The principal recommendation of the Report called for the creation of a drafting committee ("Drafting Committee") for the revision of Article 9. The Report also recommended numerous specific changes to Article 9. The ALI and the Conference acted favorably upon the Report's principal recommendation. A Drafting Committee was organized in 1993.

2. Status and Schedule

The Drafting Committee has met five times (November 1993; March 1994; September-October 1994; December, 1994; March, 1995). The first meeting of the ALI Members Consultative Group was held on December 16-17, 1994. Meetings of the Drafting Committee are scheduled for June 9-11, 1995, and December 1-3, 1995. The Chair of the Drafting Committee and the Reporters made an informational report to the membership of the ALI during its annual meeting in May, 1995. The Conference will hold its first reading of this draft of revised Article 9 at its Annual Meeting in August, 1995. We expect the Article 9 revisions to be completed in 1997.

3. Summary of Revisions

Following is a brief summary of some of the more significant proposed revisions that are included in the draft.

a. **Scope of Article 9.** The draft expands the scope of Article 9 in several respects. First, it includes within Article 9's scope deposit accounts as original collateral. Current Article 9 deals with deposit accounts only as proceeds of other collateral.

Second, the draft includes most sales of general intangibles for money due or to become due. Current Article 9 includes sales of accounts and chattel paper, but not sales of general intangibles for the payment of money. The

Drafting Committee recognizes that certain sales of general intangibles for the payment of money -- primarily bank loan participation transactions -- should not be included within Article 9, but it has yet to agree on the appropriate way to exclude these sales. Pending the ultimate resolution of the issue by the Drafting Committee, the draft offers alternative approaches for parties to sales of general intangibles to opt in or opt out of Article 9.

Finally, for discussion purposes the draft expands the scope of Article 9 to include insurance policies and tort claims, with important exceptions such as individuals' health and disability insurance and individuals' tort claims for personal injury.

b. **Choice of Law.** The draft changes the choice of law rule governing perfection and the effect of perfection or nonperfection (i.e., priorities) for most collateral to the law of the jurisdiction where the debtor is located. Under current law, the jurisdiction of the debtor's location governs only accounts, general intangibles, mobile goods, and, for purposes of perfection by filing, chattel paper and investment property. The draft also changes the definition of the location of the debtor from the debtor's place of business (or chief executive office, if the debtor has more than one place of business) to the jurisdiction where the debtor is organized, e.g., a corporate debtor's State of incorporation. The draft also includes several refinements to the treatment of choice of law matters for goods covered by certificates of title.

c. **Perfection.** The draft expands the types of collateral in which a security interest may be perfected by filing to include instruments and deposit accounts. It also permits a security interest in a deposit account to be perfected by the secured party's acquiring "control" over the deposit account. A secured party has "control" when it obtains the depositary institution's agreement to act on the secured party's instructions (including when the secured party becomes the account holder) or when the secured party is itself the depositary institution. The draft also clarifies the circumstances under which a security interest in goods covered by a certificate of title may be perfected by the secured party's taking possession.

d. **Priority.** The draft includes several new priority rules. The draft's rules applicable to deposit accounts are similar to those incorporated in Article 9 for investment property in conjunction with the newly-revised Article 8. If a secured party is in "control" of a deposit account, its security interest is senior to a security interest perfected by filing. As between the depositary institution's security interest and one held by another secured party, the depositary institution's security interest is senior. A corresponding rule makes a depositary institution's right of setoff generally senior to a security interest held by another secured party.

The draft also includes (i) a simplified priority rule for purchasers of instruments and chattel paper who take possession of the collateral, (ii) provisions designed to ensure that security interests in deposit accounts will not extend to transferees of funds on deposit or payees from deposit accounts and will not otherwise "clog" the payments system, (iii) new priority rules to deal with the "double debtor" problem arising when a debtor creates a security interest in collateral acquired subject to a security interest created by another person, and

(iv) new priority rules to deal with the problems created when a change in corporate structure or the like results in a new entity that has become bound by the original debtor's after-acquired property agreement.

e. **Proceeds.** The draft expands the definition of "proceeds" of collateral to include additional rights and property that arise out of collateral, including distributions on account of collateral and claims arising out of the loss or non-conformity of, defects in, or damage to collateral.

f. **Filing.** Part 4 of Article 9 has been substantially rewritten to simplify the statutory text and to deal with numerous problems of interpretation and implementation that have arisen over the years. For example, it provides that a super-generic description such as "all assets" or "all personal property" in a financing statement is a sufficient indication of the collateral. The draft also introduces some new concepts and approaches. The draft is "media neutral"; that is, it permits parties to file and otherwise communicate with a filing office by means of records communicated and stored in media other than a tangible medium, such as a writing. To accommodate electronic filing, the draft does not require that the debtor's signature appear on a financing statement. Instead, it prohibits the filing of unauthorized financing statements and imposes liability upon those who violate the prohibition. The draft also restricts the discretion of filing offices, mandates performance standards for filing offices, and requires filing offices to sell filing data to the public. It provides as well for the issuance of administrative rules to deal with details best left out of the statute.

g. **Default and Enforcement.** Part 5 of Article 9 has been extensively revised.

(1) **General revisions.** The draft clarifies the identity of persons who have rights and persons to whom a secured party owes duties under Part 5. Under the draft the rights and duties are enjoyed by and run to the "debtor," defined to mean any person with a non-lien property interest in collateral, and to any "affected obligor." The latter is a new term defined to include one who is secondarily obligated on the secured obligation, e.g., a guarantor. However, the secured party is relieved from any duty or liability to any person unless the secured party knows that the person is a debtor or an affected obligor. An obligor (other than obligors in consumer secured transactions, discussed below) may effectively waive its rights and the secured party's duties to the extent and in the manner provided by other law, e.g., the law of suretyship.

The draft imposes on a secured party that disposes of collateral the warranties of title, quiet possession, and the like that are otherwise applicable under other law, and it provides rules for the exclusion or modification of those warranties. The draft also requires a secured party to give notification of a disposition of collateral to other secured parties and lien holders who have filed financing statements against the debtor which cover the collateral. (That duty was eliminated by the 1972 revisions to Article 9.) However, the draft relieves the secured party from that duty when the secured party undertakes a search of the records and a report of the search is unreasonably delayed. For transactions other than consumer secured transactions, the draft specifies the contents of a sufficient notification of disposition and provides that a notification sent 10 days or more before the earliest time for disposition is sent within a reasonable time.

The draft clarifies the effects of a disposition by a secured party, including the rights of transferees of the collateral. It also provides that a junior secured party who receives cash proceeds from a disposition in good faith and without knowledge that the receipt violates the rights of a senior secured party takes the proceeds free of the senior claim.

For transactions other than consumer secured transactions, the draft permits a secured party to retain collateral in partial satisfaction, as well as full satisfaction, of the obligations secured. This right of strict foreclosure extends to intangible as well as tangible property. The draft also clarifies the effects of a retention of collateral on the rights of junior claimants.

The draft adopts the "rebuttable presumption" test for the failure of a secured party to proceed in accordance with certain provisions of Part 5 in transactions other than consumer secured transactions. Under this approach, the deficiency claim of a noncomplying secured party is calculated by crediting the obligation with the greater of the actual net proceeds of a disposition and the amount of net proceeds that would have been realized if the disposition had been conducted in accordance with Part 5, e.g., in a commercially reasonable manner. The draft rejects the "absolute bar" test that has been judicially imposed in some jurisdictions; that approach bars a noncomplying secured party from recovering any deficiency.

(2) **Revisions related to consumer secured transactions.** The draft includes several provisions that apply only to the enforcement of consumer secured transactions. The draft defines a "consumer secured transaction" as a secured transaction in which both the obligation is incurred and the collateral is used or held by the debtor for personal, family, or household purposes. The draft contains in brackets a dollar limitation in the definition, as a substantial minority of the Drafting Committee favors a limitation that would confine consumer secured transactions to those involving a secured obligation below a specified amount.

The draft provides that obligors in consumer secured transactions may not effectively waive their rights and the secured party's duties under Part 5.

The draft mandates the information to be included in a notification of a disposition in a consumer secured transaction and provides a "plain English" sample form of notification. It also requires a secured party to give a debtor or consumer obligor notification of specified information concerning a surplus or deficiency claim at the time the secured party accounts for a surplus or first makes demand for payment of a deficiency. The draft includes a provision that would bar a deficiency in transactions in which the secured obligations are less than a specified dollar amount. The Drafting Committee has not yet reached consensus as to (i) whether the provision should be included, and (ii) if it is included, (x) whether it should be limited to consumer secured transactions and (y) the appropriate dollar amount. There appears to be some consensus, however, that if the provision is included the dollar amount should be relatively small, i.e., substantially smaller than a typical new car financing.

The draft does not permit a secured party to retain collateral in partial satisfaction of the secured obligation in a consumer secured transaction and does

not permit strict foreclosure of collateral that is not in the possession of the secured party.

In addition to the right to redeem collateral that exists under the current Article 9, for consumer secured transactions the draft gives a debtor or consumer obligor a right to reinstate a secured obligation after default by tendering to the secured party all past due payments (without acceleration), expenses of enforcement (e.g., costs of repossession and attorney's fees), and a security deposit. Although most of the Drafting Committee favor a provision of this kind, there is not yet a consensus concerning the advisability of including a security deposit or the method of calculating the deposit, the appropriate time limitations imposed on the right of reinstatement, or the appropriate limitation on the frequency with which the reinstatement right could be asserted.

The draft provides that the absolute bar rule generally applies in consumer secured transactions -- a secured party's noncompliance with Part 5 bars recovery of a deficiency. This rule is subject to two qualifications. First, the secured party would not be barred from pursuing other collateral to collect a deficiency calculated under the rebuttable presumption rule. Second, the secured party would be permitted to recover the portion of a deficiency that exceeds a specified (but as yet undetermined) dollar amount.

Numerous other consumer protection proposals and issues have been considered by the Drafting Committee, the Drafting Committee's Consumer Task Force, or both. Many of these issues relate to default and enforcement, but several concern other aspects of consumer secured transactions. The Drafting Committee and the Task Force will continue to pursue these proposals and issues.

4. Miscellaneous Style and Citation Conventions

The Drafting Committee has not reached a consensus on several matters, many of which are reflected in the draft by statutory text that appears in brackets and by bracketed alternative formulations. Contrary to the usual style for drafts of uniform acts, the brackets in the draft do not indicate that the provisions are optional or that the States are to choose one of the alternatives (there are a few exceptions, which are noted in the draft).

The draft includes each section of current Article 9 other than those that the Drafting Committee proposes to delete. The Drafting Committee has not yet considered many of these sections. Each section that has been changed to reflect the Conference's currently applicable style requirements, but has not been changed substantively, contains the following notation in its caption: [MINOR STYLE CHANGES ONLY].

Unless otherwise stated, references to "section" or "§" are to sections of the Uniform Commercial Code, 1994 Official Text, or to sections of the draft, as the context indicates.

References to "Revised Article 8" are to UCC Article 8 as adopted by the Conference in 1994 and may include conforming amendments to Article 9.

Citations to "Recommendation XX" are to a recommendation of the Study Committee contained in the Study Committee's Report.

Internal cross references to the Reporters' Explanatory Notes are to "Note XX."

5. Statement of Policy Issues

Following is a listing of some of the more important questions of policy raised by the draft.

a. Should the revised Article 9 continue to facilitate and promote the creation and enforcement of security interests?

b. Should the revised Article 9 retain its priority scheme under which perfected security interests are senior to the rights of lien creditors and unperfected security interests are junior to those rights? Should the revised Article 9 subordinate perfected security interests to the rights of certain classes of unsecured creditors? Should the revised Article 9 subordinate the rights of lien creditors to unperfected security interests?

c. Should the revised Article 9 include additional provisions designed to protect consumers? Are the new provisions included in the draft appropriate?

d. Should the revised Article 9 change the choice of law rule for perfection and priority to the location of the debtor? If so, should the location of the debtor be changed to the jurisdiction where the debtor is organized, if applicable?

e. Should the revised Article 9 include within its scope security interests in deposit accounts as original collateral? Are the perfection and priority rules for security interests in deposit accounts included in the draft appropriate?

f. Should the revised Article 9 include within its scope sales of general intangibles for money due or to become due? If so, how should certain sales, such as bank loan participations, be excluded?

g. Should the revised Article 9 include within its scope security interests in insurance policies and tort claims?

h. Should the revised Article 9 permit a secondary obligor in a non-consumer secured transaction to waive its rights and a secured party's duties under Part 5?

i. Should the revised Article 9 apply the rebuttable presumption rule in non-consumer secured transactions and the absolute bar rule in consumer secured transactions in cases of the secured party's noncompliance with Part 5?

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PART 1
SHORT TITLE AND GENERAL MATTERS

SECTION 9-101. SHORT TITLE. [MINOR STYLE CHANGES ONLY] This article may be cited as Uniform Commercial Code-Secured Transactions.

SECTION 9-102. POLICY AND SCOPE OF ARTICLE.

(a) Except as otherwise provided in Section 9-104 on excluded transactions, this article applies

(1) to any transaction (regardless of its form) that is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts;

(2) to any sale of accounts or chattel paper; and

[Subsections (a)(3) and (b) -- Alternative A]

(3) to any sale of a general intangible for money due or to become due if the general intangible is subject to an effective election.

(b) A general intangible for money due or to become due is subject to an effective election if either (i) the account debtor and the debtor agree in writing that a sale of the general intangible is covered by this article or (ii) the debtor and the secured party agree in writing that a sale of the general intangible is covered by this article.

[Subsections (a)(3) and (b) -- Alternative B]

(3) to any sale of a general intangible for money due or to become due unless the general intangible is subject to an effective election.

(b) A general intangible for money due or to become due is subject to an effective election if the account debtor and the debtor agree in writing that a sale of the general intangible is not covered by this article.

(c) This article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This article does not apply to statutory liens except as otherwise provided in Section 9-310.

(d) The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.

Reporters' Explanatory Notes

1. Subsections (a)(3) and (b) are new. They address the Study Committee's recommendation that sales of general intangibles for money due or to become due be included within the scope of Article 9. See Recommendation 1.A. This revision would afford these transactions treatment similar to that given sales of accounts and chattel paper under current Article 9. "General intangible for money due or to become due" is defined in Section 9-106 as one "under which the account debtor's principal obligation is to pay money." The term derives from current Section 9-318(4).

2. The Drafting Committee has discussed several approaches for restricting Article 9's application to sales of some, but not all, general intangibles for money due or to become due. The restriction would address concerns about including certain general intangibles, such as bank-originated "loan participations," for which the application of Article 9 (and especially its filing rules) would be impractical and unwise. These concerns were expressed by the Study Committee and are shared by the Drafting Committee and a task force (the "Securitization Task Force") that is assisting the Drafting Committee.

3. Although not unanimous, the consensus view of the Drafting Committee is opposed to an exclusion based on the character of the account debtor (e.g., a borrower from a "bank"), the sale transaction (e.g., a "participation"), or the debtor/seller (e.g., a "bank" or "regulated financial institution"). Instead, the approach taken in the draft is to set a baseline rule concerning the applicability of Article 9 to **all** sales of general intangibles for

money due and to permit designated parties to vary the rule for particular transactions by making an "effective election" under subsection (b).

Pending further discussion by the Drafting Committee, the draft offers two alternatives for the baseline rule. Under Alternative A subsection (a)(3), a general intangible for money due or to become due **would not** be subject to Article 9 unless the parties made an "effective election" to have Article apply. That is, Alternative A would permit the parties to "opt in" to Article 9. The definition of "effective election" in subsection (b) provides two methods of opting in. An effective election would occur when either (i) the account debtor and the debtor/seller agree that the sale of the general intangible is subject to Article 9 or (ii) the debtor/seller and the buyer so agree.

Alternative B, favored on balance by the Securitization Task Force in its initial report to the Drafting Committee, reflects an "opt-out" approach. The sale of a general intangible for money due or to become due **would be** subject to Article 9 unless the account debtor and the debtor/seller opt out by agreeing that the sale is **not** subject to Article 9 (or unless the sale is excluded by draft Section 9-104(f)).

4. There are both advantages and disadvantages to the opt-in and opt-out approaches as means of limiting Article 9's scope to transactions in which its provisions would be useful. For example, neither approach would eliminate the possibility that exists under current law for there to be non-Article 9 "secret" interests of buyers which are not reflected in the UCC filing records. An opt-in or opt-out at the account debtor-debtor level would allow a potential buyer to determine whether Article 9 applies to a general intangible by observing whether the terms of the general intangible provide for an opt-in or opt-out. However, an opt-in at the debtor/seller-buyer level, as under Alternative A subsection (b)(ii), or an opt-out at that level, as under Alternative B, would make it impossible to determine from the underlying contract whether the debtor/seller and an unknown buyer failed to opt in or opted out. The opt-out approach under Alternative B also imposes a greater risk that transactions for which Article 9 is inappropriate will inadvertently be included by parties who neglect to opt out. Finally, an opt-in at the account debtor-debtor level, as under Alternative A subsection (b)(i), could make it impossible or impractical to include within Article 9's scope sales of intangibles in which the parties failed to opt in (such as those arising under contracts entered into before the revised Section 9-102 were in effect).

5. Discussions of the alternatives posed by draft Section 9-102 and other approaches are continuing among members of the Securitization Task Force as well as among other interested market participants and their counsel.

6. Draft Section 1-201(37), which defines the term "security interest," appears in the Appendix to the draft. The definition has been revised to reflect the draft's inclusion of some sales of general intangibles within the scope of Article 9.

SECTION 9-103. PERFECTION OF SECURITY INTEREST IN MULTIPLE STATE TRANSACTIONS.

(a) Non-possessory security interest.

(1) This subsection applies to a non-possessory security interest in collateral other than goods covered by a certificate of title described in subsection (c), deposit accounts, investment property, and minerals and related accounts described in subsection (e).

(2) Except as otherwise provided in this subsection, during the time that the debtor is located in a jurisdiction, perfection, the effect of perfection or non-perfection, and the priority of a security interest in the collateral are governed by the local law of that jurisdiction.

(3) During the time that the debtor is located in a jurisdiction that is not a part of the United States, and that does not provide for perfection of the security interest by filing or recording in that jurisdiction, the law of the jurisdiction in the United States in which the debtor has its major executive office in the United States governs the perfection and the effect of perfection or non-perfection of the security interest through filing. In the alternative, if the debtor is located in a jurisdiction that is not a part of the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the security interest may be perfected by notification to the account debtor. As used in this paragraph, "United States" includes its territories and possessions and the Commonwealth of Puerto Rico.

(4) Except as otherwise provided in paragraph (5), for purposes of this subsection and subsections (d) and (f):

(i) a registered entity is located at its jurisdiction of organization;

(ii) any other debtor is located at its place of business if it has only one, at its chief executive office if it has more than one place of business, and at the debtor's residence if the debtor has no place of business.

(5) For purposes of this subsection and subsection (d) and (f), a foreign air carrier under the Federal Aviation Act of 1958, as amended, is located at the designated office of the agent upon whom service of process may be made on behalf of the foreign air carrier.

(6) A security interest perfected under the law of the jurisdiction of the location of the debtor remains perfected until the expiration of four months after a change of the debtor's location to another jurisdiction, or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. If it becomes perfected under the law of the other jurisdiction before the end of that period, the security interest continues perfected thereafter. If it does not become perfected under the law of the other jurisdiction before the end of that period, the security interest becomes unperfected and is deemed to have been unperfected at all times prior thereto.

(7) Insofar as it affects the priority of a security interest over a buyer of consumer goods (Section 9-307(b)), the period of the effectiveness of a filing made in the jurisdiction of the location of the debtor is governed by the rules with respect to perfection in paragraph (6).

(b) Possessory security interest.

(1) This subsection applies to a possessory security interest in collateral other than goods covered by a certificate of title described in subsection (c) and minerals described in subsection (e).

(2) Except as otherwise provided in this subsection, during the time that collateral is located in a jurisdiction, perfection, the effect of perfection or

non-perfection, and the priority of a security interest in the collateral are governed by the local law of that jurisdiction.

(3) A security interest remains continuously perfected if (i) the collateral is located in one jurisdiction and subject to a security interest perfected under the law of that jurisdiction, (ii) thereafter the collateral is brought into another jurisdiction, and (iii) upon entry into the other jurisdiction the security interest is perfected under the law of the other jurisdiction.

(c) Certificate of title.

(1) This subsection applies to goods covered by a certificate of title.

(2) In this subsection:

(i) "certificate of title" means a certificate of title with respect to which a statute provides for the security interest in question to be indicated on the certificate as a condition or result of perfection; and

(ii) goods become "covered" by a certificate of title when an appropriate application for the certificate and the applicable fee are delivered to the appropriate authority.

(3) The absence of any other relationship between the jurisdiction under whose certificate the goods are covered and the goods or the debtor does not affect the applicability of this subsection to the goods.

(4) Except as otherwise provided in this subsection, perfection, the effect of perfection or non-perfection, and the priority of the security interest are governed by the law of the jurisdiction under whose certificate the goods are covered from when the goods become covered by the certificate until the earlier of (i) when the certificate is surrendered [and canceled by the issuing authority] or (ii) when the goods become covered subsequently by another certificate of title

from another jurisdiction. After that time, the goods are not covered by the certificate of title within the meaning of this section.

(5) A security interest in goods which is perfected by any method under the law of another jurisdiction when the goods become covered by a certificate of title from this jurisdiction remains perfected [until the earlier of (i) when the security interest would have become unperfected by the law of the other jurisdiction had the goods not become so covered or (ii) the expiration of four months after the goods become so covered. If it becomes perfected under Section 9-302(d) or 9-305 before the earlier of that time or the expiration of that period, the security interest continues perfected thereafter. If it does not become perfected under Section 9-302(d) or Section 9-305 before the earlier of that time or the expiration of that period, the security interest becomes unperfected and is deemed to have been unperfected at all times prior thereto.]

(6) If, while a security interest in goods is perfected by any method under the law of another jurisdiction, this State issues a certificate of title that does not show that the goods are subject to the security interest or contain a statement that they may be subject to security interests not shown on the certificate, then:

(i) a buyer of the goods takes free of the security interest to the extent that the buyer gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest; and

(ii) the security interest is subordinate to a conflicting security interest in the goods that attaches, and is perfected in accordance with Section 9-302(d), after issuance of the certificate and without knowledge of the security interest.

(d) Deposit accounts.

(1) This subsection applies to deposit accounts.

(2) Except as otherwise provided in paragraphs (3) and (4), perfection, the effect of perfection or non-perfection, and the priority of a security interest in a deposit account are governed by the local law of the depositary institution's jurisdiction. The following rules determine a "depositary institution's jurisdiction" for purposes of this paragraph:

[Subparagraph (i) -- Alternative A]

(i) If an agreement between the depositary institution and the debtor explicitly specifies a particular jurisdiction as the depositary institution's jurisdiction for purposes of this article, that jurisdiction is the depositary institution's jurisdiction.

[Subparagraph (i) -- Alternative B]

(i) If an agreement between the depositary institution and its customer specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the depositary institution's jurisdiction.

(ii) If an agreement between the depositary institution and its customer does not specify the [depositary institution's jurisdiction] [governing law] as provided in subparagraph (i), but expressly specifies that the deposit account is maintained at an office in a particular jurisdiction, that jurisdiction is the depositary institution's jurisdiction.

(iii) If an agreement between the depositary institution and its customer does not specify a jurisdiction as provided in subparagraphs (i) or (ii), the depositary institution's jurisdiction is the jurisdiction in which is located the office identified in an account statement as the office serving the customer's account.

(iv) If an agreement between the depositary institution and its customer does not specify a jurisdiction as provided in subparagraphs (i) or (ii)

and an account statement does not identify an office serving the customer's account as provided in subparagraph (iii), the depositary institution's jurisdiction is the jurisdiction in which is located the chief executive office of the depositary institution.

(3) A security interest perfected under the law of the depositary institution's jurisdiction remains perfected until the expiration of four months after a change of the depositary institution's jurisdiction, or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. If it becomes perfected under the law of the other jurisdiction before the end of that period, the security interest continues perfected thereafter. If it does not become perfected under the law of the other jurisdiction before the end of that period, the security interest becomes unperfected and is deemed to have been unperfected at all times prior thereto.

(4) Perfection of a security interest by filing and automatic perfection of a security interest in a deposit account held by the depositary institution with which the account is maintained are governed by the local law of the jurisdiction in which the debtor is located. Subsection (a)(4), (5), and (6) apply to a security interest perfected by either of these methods.

(e) Minerals.

Perfection, the effect of perfection or non-perfection, and the priority of a security interest that is created by a debtor that has an interest in minerals or the like, including oil and gas, before extraction, and

(1) that attaches to the collateral as extracted; or

(2) that attaches to an account resulting from the sale of the collateral at the wellhead or minehead,

are governed by the law of the jurisdiction in which the wellhead or minehead is located.

(f) Investment property.

(1) This subsection applies to investment property.

(2) Except as otherwise provided in paragraph (6), during the time that a security certificate is located in a jurisdiction, perfection, the effect of perfection or non-perfection, and the priority of a security interest in the certificated security represented thereby are governed by the local law of that jurisdiction.

(3) Except as otherwise provided in paragraph (6), perfection, the effect of perfection or non-perfection, and the priority of a security interest in an uncertificated security are governed by the local law of the issuer's jurisdiction as specified in Section 8-110(d).

(4) Except as otherwise provided in paragraph (6), perfection, the effect of perfection or non-perfection, and the priority of a security interest in a security entitlement or securities account are governed by the local law of the securities intermediary's jurisdiction as specified in Section 8-110(e).

(5) Except as otherwise provided in paragraph (6), perfection, the effect of perfection or non-perfection, and the priority of a security interest in a commodity contract or commodity account are governed by the local law of the commodity intermediary's jurisdiction. The following rules determine a "commodity intermediary's jurisdiction" for purposes of this paragraph:

(i) If an agreement between the commodity intermediary and commodity customer specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(ii) If an agreement between the commodity intermediary and commodity customer does not specify the governing law as provided in subparagraph (i), but expressly specifies that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(iii) If an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction as provided in subparagraphs (i) or (ii), the commodity intermediary's jurisdiction is the jurisdiction in which is located the office identified in an account statement as the office serving the commodity customer's account.

(iv) If an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction as provided in subparagraphs (i) or (ii) and an account statement does not identify an office serving the commodity customer's account as provided in subparagraph (iii), the commodity intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the commodity intermediary.

(6) Perfection of a security interest by filing, automatic perfection of a security interest in investment property granted by a broker or securities intermediary, and automatic perfection of a security interest in a commodity contract or commodity account granted by a commodity intermediary are governed by the local law of the jurisdiction in which the debtor is located. Subsection (a)(4), (5), and (6) apply to a security interest perfected by any of these methods.

Reporters' Explanatory Notes

1. **Scope of Choice-of-Law Rules.** Current 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., current Section 9-103(1)(b). The draft follows the broader and more precise formulation in current 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. This section does not govern questions of attachment and enforcement.

2. **General Approach.** Section 9 of the Study Committee's Report details many of the problems with current Section 9-103. Several of these problems arise from the fact that the type of collateral determines which State's law applies to perfection and priority. In particular, current law applies different choice-of-law rules to many types of tangible collateral (e.g., ordinary goods) from those applicable to many types of intangible collateral (e.g., accounts and chattel paper). Draft subsection (a) follows Recommendation 9.A. in providing a single choice-of-law rule for most types of collateral. With some exceptions, the law applicable to non-possessory security interests in both tangible and intangible collateral, whether perfected by filing or automatically, would be the law of the jurisdiction of the debtor's location. The "debtor's location" rule derives from existing subsection (3) (now limited to accounts, general intangibles, and mobile goods).

Under draft subsection (b), which derives from existing subsection (1) (documents, instruments, and ordinary goods), the law applicable to possessory security interests would continue to be the law of the jurisdiction in which the collateral is located. See Note 5 below.

3. **Advantages and Disadvantages of Single Rule.** Subsection (a) would substantially simplify the choice-of-law rules. It eliminates existing Section 9-103(1)(c) and (d), which concern non-possessory security interests in tangible collateral that is removed from one jurisdiction to the other. It would 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 subsection (a) also would eliminate some difficult priority issues and the need to distinguish among "mobile" and "ordinary" goods, and it would reduce 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. If the scope of revised Article 9 is expanded, as by including deposit accounts as original collateral, then the application of choice-of-law rules during the transition will prove even more problematic.

4. **Location of Debtor.** Subsection (a) departs materially from existing subsection (3) with respect to the method of determining where certain debtors are located. Under subsection (a)(4)(i), "a registered entity is located at its jurisdiction of organization." Under Section 9-105, a "registered entity" is "an organization registered under the law of a State . . . and as to which the State

. . . maintains a public record showing the organization to have been organized," and the "jurisdiction of organization" is the "jurisdiction under whose law the [registered] entity is organized." For example, a Delaware corporation is a registered entity, and Delaware is its jurisdiction of organization. Other examples of registered entities are limited partnerships and limited liability companies. The location of debtors other than registered entities will continue to be determined by the current rules under subsection (a)(4)(i) (e.g., the debtor's chief executive office). The draft reproduces the current rules for determining the location of a non-U.S. debtor and a foreign air carrier (draft subsections (a)(3) and (a)(5), respectively). The Drafting Committee has yet to discuss these rules.

Determining the registered entity-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 entity-debtor's name on a financing statement -- a filing designating an incorrect corporate name for the debtor would be rejected, for example. It also could reduce pressure on the system imposed by transactions in which registered entities 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 entity or terminated by the secured parties.

During discussions of the proposal to change the location of a registered entity 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, _____ Minn. L. Rev. _____ (forthcoming 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. **Possessory Security Interests.** Subsection (b) applies to possessory security interests. Although it is patterned on current subsection (1), under which the location of collateral determines the applicable law, draft subsection (b) eliminates the "last event" test of current subsection (1).

The bifurcation of non-possessory 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, under the draft, 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.

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 existing 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 Section 9-308 were to differ in the two relevant States. If filing becomes a method of perfection for instruments (see draft Section 9-304(a)), then the potential for this problem to arise can be expected to increase. 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.

6. **Scope of Referral.** Recommendation 9.F. encourages the Drafting Committee to consider whether the reference to the governing law should include the conflict-of-law rules. To see what is at stake, consider the following example: Litigation over the priority of a security interest in accounts arises in State X. State X has adopted the Official Text of existing Section 9-103(3), which sends one to "the law (including the conflict of laws rules)" of the jurisdiction of the location of the debtor. The debtor is located in State Y. Had State Y also adopted the Official Text of Section 9-103, its choice-of-law rules would have been the same as State X's and would have indicated that the substantive law of State Y governs. But in fact State Y adopted a nonuniform provision, under which perfection is governed by the substantive law of the jurisdiction in which the debtor is located and under which the debtor is deemed located in its State of incorporation, State Z. Accordingly, perfection is to be accomplished by filing in State Z.

By eliminating the reference to the conflict-of-laws rules in the uniform version, a State X court would look only to the substantive law of State Y, which indicates that financing statements should be filed at one or more offices in State Y. This strikes many observers the desired result. Unfortunately, removing the reference to conflict-of-laws rules in the uniform version is not a complete solution. The problem arises from the enactment of a nonuniform version. If the identical perfection issue were to be litigated in State Y, the court would look to State Y's nonuniform Section 9-103 and conclude that the State Y filing is ineffective.

It is impossible to eliminate this problem through revision of the uniform text. A complete solution would require complete uniformity. Nevertheless, the draft adopts what seems to be the better approach: It eliminates the reference to the conflict-of-laws rules. This approach has two advantages. First, it is likely to minimize the impact of the nonuniformity. Under existing Section 9-103(3), every time one of the uniform provisions refers one to State Y, one winds up having to file in State Z. Inasmuch as there have been relatively few nonuniform amendments to Section 9-103, lawyers are likely to file in State Y without first checking State Y's conflict-of-laws rules. If the uniform text is revised to eliminate the reference to conflict-of-laws rules and the revised text is widely adopted, then these lawyers will have filed properly if the issue is litigated in any jurisdiction that has adopted a uniform Section 9-103 (i.e., in most jurisdictions other than State Y). The burden now falls on the litigators to file the lawsuit in the "correct" place.

Second, suppose State Y's nonuniform Section 9-103 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 9-103 says to look to State Y's choice of law, and State Y's Section 9-103 says to look to State X's choice of law. (The 1972 amendments to 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 conflict-of-laws rules would eliminate the renvoi.

7. **Failure to Reperfect after Change in Governing Law.** Draft subsection (a) follows Recommendation 9.E. inasmuch as it eliminates the bifurcated standard of existing Section 9-103(3)(e), under which the failure to reperfect within the four-month period following a change in the debtor's location subordinates a security interest to purchasers during the four-month period but not to lien creditors. Subsection (a) strays somewhat from Recommendation 9.E., however. That recommendation proposed that the failure to reperfect within the four-month period should deem the security interest to have been unperfected as against all persons who acquired an interest in the collateral after the change of location. Draft subsection (a) provides that the security interest is deemed to have been unperfected as against all persons, whether they acquired an interest in the collateral before or after the change.

The following example illustrates the difference. SP-1 acquires a security interest in Debtor's accounts in 1991; SP-2 acquires a security interest in the same collateral in 1992. Both perfect by filing immediately upon attachment. Thereafter Debtor's location changes. SP-2 reperfects in the new jurisdiction within the four-month period, but SP-1 does not. Since SP-2 was not a purchaser after the change, neither existing Section 9-103(3)(e) nor recommendation 9.E would afford priority to SP-2. Draft subsection (a) would. First, to award priority to SP-2 would be consistent with current Section 9-403(2), under which SP-1's failure to continue its financing statement would result in loss of priority. Second, to do so would eliminate the possibility of circular priorities. (Assume that SP-3 takes and perfects a security interest after the change. Under every scheme SP-2 would have priority over SP-3, who would have priority over SP-1. But, under existing Section 9-103(3) and under the Recommendation, SP-1 would be senior to SP-2.) Third, SP-2 is no less deserving than a judicial lien creditor who took a lien after the change and who would enjoy priority over SP-1.

The Drafting Committee is likely to reconsider the consequences of failure to reperfect at a future meeting.

8. **Goods Covered by Certificate of Title: Choice of Law.** Draft subsection (c) includes choice-of-law rules for goods covered by a certificate of title statute. The draft, like existing Section 9-103(2), is quite complex. The Drafting Committee has not yet considered draft subsection (c) or the issues that it addresses. Consequently, it will not be on the agenda for discussion by the Conference at the first reading. A substantially similar draft of subsection (c) and related draft revisions concerning the interface between federal and state law and intellectual property, dated October 26, 1994, was distributed to the Drafting

Committee. Interested persons should consult the October 26 draft, which contains detailed explanatory notes.

Existing subsection (2) and draft subsection (c) provide both choice-of-law rules and several substantive rules. The draft follows the basic outline of existing subsection (2). The Study Committee's Recommendations concerning Section 9-103(2) are found in Section 10 of the Report. They focus on resolving a few discrete ambiguities that have arisen in the commentary and reported cases construing Section 9-103(2)(a) and (b). The Study Committee did not discuss the substantive rules governing perfection and priority (existing subsections (2)(c) and (2)(d) and draft subsections (c)(5) and (c)(6)). The draft incorporates the Recommendations in Section 10 and makes certain other changes that seem to follow from those Recommendations. The draft also revises the perfection and priority rules. As a result of the Drafting Committee's discussions, these substantive rules (as well as substantive rules in other subsections of Section 9-103) may be relocated elsewhere in the Article.

9. **Goods Covered by Certificate of Title: Perfection.** Draft subsection (c) works from the premise that, for goods covered by a certificate of title on which a security interest may be indicated, notation on the certificate is a more appropriate method of perfection than filing. The concept of perfection by notation 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 non-uniform 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. So 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.

The Reporters strongly suspect that Article 9 could be made simpler and the Drafting Committee's work significantly reduced if perfection of security interests were divorced from certificate of title statutes. They have encouraged the Drafting Committee to consider having the normal filing rules apply to perfection of security interests in goods subject to a certificate of title statute, particularly goods other than automobiles.

10. **Deposit Accounts.** Draft subsection (d) contains choice-of-law rules for security interests in deposit accounts, which are no longer excluded as original collateral from the scope of Article 9 under the draft. See draft Section 9-104. Subsection (d) derives from existing Sections 9-103(6)(d) and 8-110(e), dealing with security entitlements and securities accounts, which were promulgated in conjunction with the recent revision of Article 8. Subsection (d)(2) provides that the law of the "depositary institution's jurisdiction" controls, and paragraphs (i), (ii), and (iii) of that subsection contain rules for determining the "depositary institution's jurisdiction." The draft contains two alternatives for

paragraph (i). Alternative B follows existing Section 8-110(e)(i); it determines the depositary institution's jurisdiction by reference to the jurisdiction whose law the depositary institution and its customer have chosen to govern their deposit agreement. Alternative A recognizes that the parties may wish to choose the law of one jurisdiction to govern perfection and priority of security interests but prefer to choose a different governing law for other purposes. Alternative A would give effect to this arrangement. If Alternative A is approved, it may be appropriate to conform Section 8-110(e).

11. **Minerals.** Subsection (e), which deals with minerals, has not yet been considered by the Drafting Committee. It is identical in substance to existing Section 9-103(5). Subsection (f) is identical to existing Section 9-103(6).

SECTION 9-104. TRANSACTIONS EXCLUDED FROM ARTICLE. This article does not apply:

[Subsection (a) -- Alternative A]

[Delete subsection (a).]

[Subsection (a) -- Alternative B]

(a) to a security interest subject to any statute or treaty of the United States, to the extent that such statute or treaty preempts this article;

(b) to a landlord's lien;

(c) to a lien given by statute or other rule of law for services or materials, except as otherwise provided in Section 9-310 on priority of such liens;

(d) to a transfer of a claim for wages, salary or other compensation of an employee;

(e) to a transfer by a government or governmental subdivision or agency;

(f) to a sale of accounts, chattel paper, or general intangibles as part of a sale of the business out of which they arose, or an assignment of accounts, chattel paper, or general intangibles which is for the purpose of collection only, or a transfer of a right to payment under a contract to an assignee that is also to do the performance under the contract or a transfer of a single account or general

intangible to an assignee in whole or partial satisfaction of a preexisting indebtedness;

(g) to a transfer by an individual of an interest in or claim under any policy of insurance which covers healthcare costs, an injury to or disability of an individual, the loss of employment or income by an individual, or funeral or burial costs;

(h) to a right represented by a judgment (other than a judgment taken on a right to payment that was collateral);

(i) to any right of recoupment or set-off, except as otherwise provided with respect to the effectiveness of rights of recoupment or set-off against deposit accounts (Section 9-312A), and except as otherwise provided with respect to defenses or claims of an account debtor (Section 9-318(a));

(j) except to the extent that provision is made for fixtures in Section 9-313, to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder;

(k) to a transfer by an individual of any tort claim for damages resulting from an injury to an individual;

(l) to a transfer of an interest in a deposit account maintained with a Federal Reserve Bank or maintained by a depositary institution with another depositary institution[;] [; or]

[(m) to a transfer of an interest in a deposit account in a consumer secured transaction; or]

(n) to a sale of a general intangible, except as otherwise provided with respect to a general intangible for money due or to become due that [is] [is not] subject to an effective election (Section 9-102).

Reporters' Explanatory Notes

1. **Federal Preemption.** The Study Committee recommended that "the Drafting Committee . . . revise Section 9-104(a) or the official comments to state that Article 9 applies to . . . security interests to the extent permitted by the Constitution and should revise Section 9-302(3) and the Official Comment to clarify the applicability of the subsection." Recommendation 2.A., Report at 50. Existing 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." The problem with the current version is that some may read it (erroneously) to suggest that Article 9 defers to federal law even when federal law does not preempt Article 9. The alternative draft versions of Section 9-104(a) respond to that concern. The first alternative deletes subsection (a) from Section 9-104. If federal law preempts Article 9 in any way, it does so on its own terms and without the aid of Article 9. The first alternative reflects the view that subsection (a) is unnecessary because the law would be exactly the same with or without it; it has no effect. The second alternative would recognize explicitly in the statute that Article 9 defers to federal law only when it must -- i.e., when federal law preempts Article 9. A modified Section 9-104(a) might prove useful in providing a section number under which research tools such as case digests might index relevant cases.

These alternative approaches were included in the October 26, 1994, draft that was distributed to the Drafting Committee. That draft included several sections of Article 9 with Reporters' Explanatory Notes dealing with the interface between federal and state law, intellectual property, and choice-of-law and perfection issues relating to goods covered by certificates of title. That draft has not yet been considered by the Drafting Committee.

2. **Sales of General Intangibles.** Current subsection (f) excludes certain sales and assignments of accounts and chattel paper. Draft subsection (f) adds to the exclusion similar sales of general intangibles. Although the draft does not limit the exclusion in subsection (f) to sales of "general intangibles for money due or to become due," defined in draft Section 9-106, only sales of those general intangibles are covered by this draft. See draft Section 9-102.

New draft subsection (n) would make clear that the sale of a general intangible for money due or to become due is not covered by Article 9 except as provided in draft Section 9-102(a). The bracketed language accommodates the opt-in and opt-out alternatives for Section 9-102(a)(3) and (b). Although the substance of draft Section 9-102 may render this new subsection superfluous, it could be useful nonetheless in the interest of clarity.

3. **Insurance.** Draft subsection (g) substantially narrows the broad exclusion of interests in insurance policies under existing subsection (g). The draft excludes only certain classes of insurance policies held by individuals and which protect important social welfare benefits. The Drafting Committee recognizes that insurance policies can be important items of collateral in many 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. Accordingly, it instructed the Reporters to prepare draft language to assist in further consideration of the issues. The Drafting Committee has not approved the concept of subsection (g), let alone the specifics or language of the draft. If

the scope of Article 9 is broadened along the lines of this draft, it may be necessary to make special provision for the obligations of the issuers of insurance policies as account debtors inasmuch as the notification provisions of Section 9-318 may be inappropriate.

4. **Tort Claims.** Much of the foregoing Note on subsection (g) applies as well to draft subsection (k), which narrows current subsection (k)'s broad exclusion of transfers of tort claims. The draft excludes only transfers by individuals of tort claims for personal injury. As with insurance policies, the Drafting Committee believes that tort claims can be important sources of collateral. As with subsection (g), however, the Drafting Committee has not approved the concept, language, or specifics of draft subsection (k).

5. **Setoffs.** Draft subsection (i) adds two exceptions to the general exclusion of setoff rights from Article 9 under current subsection (i). The first recognizes existing Section 9-318, which affords the obligor on an account, chattel paper, or general intangible the right to raise claims and defenses against an assignee/secured party. The second takes account of new Section 9-312A, which regulates the effectiveness of a setoff against a deposit account that stands as collateral.

6. **Deposit Accounts.** Current subsection (l) excludes deposit accounts as original collateral. Draft subsections (l) and (m) remove the general exclusion but retain the exclusion in three cases: accounts maintained with a Federal Reserve Bank, accounts maintained by one depositary institution with another, and accounts used as collateral in a consumer secured transaction. Inasmuch as the Drafting Committee has yet to consider the third exclusion, draft subsection (m) appears in brackets. Although the need for the other two remaining exclusions has been questioned, they may be useful in easing concerns expressed by some federal regulators and appear to be relatively innocuous.

SECTION 9-105. DEFINITIONS AND INDEX OF DEFINITIONS.

(a) In this article unless the context otherwise requires:

(1) "Account debtor" means the person obligated on an account, chattel paper, instrument[, letter of credit], or general intangible.

[Subsection (a)(2) -- Alternative A]

(2) "Affected obligor" means an obligor against which or against whose property a debtor has no recourse with respect to the obligation secured by the collateral.

[Subsection (a)(2) -- Alternative B]

(2) "Affected obligor" means an obligor whose obligation is secondary.

(3) A person "becomes bound" as debtor by a security agreement entered into by another person when:

(i) by operation of other law or by contract, the security agreement becomes effective to create a security interest in the person's property; or

(ii) the person becomes obligated generally under applicable law for the obligations of the other person, including the obligation secured under the security agreement.

(4) "Chattel paper" means a writing or writings that evidence both a monetary obligation and a security interest in or a lease of specific goods, but a charter or other contract involving the use or hire of a vessel is not chattel paper. If a transaction is evidenced both by a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper.

(5) "Collateral" means the property subject to a security interest. The term includes proceeds to which a security interest attaches pursuant to Section 9-306(b) and accounts, chattel paper, and general intangibles that have been sold.

(6) "Communicate" means to (i) send a written or other tangible record, (ii) transmit a record by any means agreed upon by the persons sending and receiving the record, or (iii) in the case of transmissions of records to and by a filing office, transmit a record by any means prescribed by the rules.

(7) "Consumer debtor" means a debtor in a consumer secured transaction.

(8) "Consumer obligor" means an obligor who is an individual and who incurred the obligation as part of a transaction entered into primarily for personal, family, or household purposes.

(9) "Consumer secured transaction" means a transaction in which an obligation is incurred primarily for personal, family, or household purposes, a security interest secures the obligation, and the collateral is used or held by the debtor for personal, family, or household purposes [, if

(i) the obligation arises out of the sale of goods, services, or another product and the portion of the obligation attributable to the cash price does not exceed $ [XX];

(ii) in the case of any other obligation, the principal amount of the obligation does not exceed $ [XX] at any time and there is no agreement to extend credit in an amount that exceeds $ [XX] outstanding at any time; or

(iii) the collateral includes [a motor vehicle or] personal property or fixtures used or expected to be used as the debtor's principal dwelling].

The term does not include a transaction to the extent that the collateral consists of investment property and the secured party is a commodity intermediary or a securities intermediary.

(10) "Debtor" means[:

(i)] a person that has a property interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor[; and

(ii) the seller of accounts, chattel paper, or general intangibles].

(11) "Deposit account" means a demand, time, savings, passbook, or like account maintained with a depositary institution. The term does not include investment property or an account evidenced by an instrument.

(12) "Depositary institution" means an organization that accepts deposits in the ordinary course of its business. The term includes a bank, savings bank, savings and loan association, credit union, or trust company.

(13) "Document" means document of title as defined in Section 1-201(15), and a receipt of the kind described in Section 7-201(2).

(14) "Encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(15) "Filing office" means an office designated in Section 9-401 as the proper place to file a financing statement.

(16) "Financing statement" means the original financing statement and any [amendment] [amended financing statement], statement of assignment (Section 9-405(b)), and continuation statement (Section 9-404(a)) relating to the original financing statement.

[(17) "Good faith," for purposes of the obligation of good faith in the performance or enforcement of contracts or duties within this article, means honesty in fact and the observance of reasonable commercial standards of fair dealing.]

(18) "Goods" includes all things that are movable at the time a security interest attaches or that are fixtures (Section 9-313), but does not include money, documents, instruments, investment property, accounts, chattel paper, general intangibles, or minerals or the like (including oil and gas) before extraction. "Goods" also includes standing timber that is to be cut and removed

under a conveyance or contract for sale, the unborn young of animals, and growing crops.

(19) "Instrument" means a negotiable instrument (Section 3-104), or any other writing that evidences a right to the payment of money and is not itself a security agreement or lease and is of a type that is in ordinary course of business transferred by delivery with any necessary indorsement or assignment. The term does not include investment property.

(20) "Jurisdiction of organization" of a registered entity means the jurisdiction under whose law the entity is organized.

(21) "Mortgage" means a consensual interest created by a real estate mortgage, a trust deed on real estate, or the like.

(22) "Obligor" means a person that (i) owes, (ii) has provided property other than the collateral to secure, or (iii) is otherwise accountable in whole or in part for payment or other performance of an obligation secured by a security interest in the collateral.

(23) "Original debtor" means a person that, as debtor, entered into a security agreement to which a new debtor has become bound.

(24) "New debtor" means a person that becomes bound as debtor by a security agreement entered into by another person.

(25) "New value" means money or money's worth in property, services, or new credit, or release by a transferee of an interest in property previously transferred to the transferee, but does not include an obligation substituted for another obligation.

(26) An advance is made "pursuant to commitment" if the secured party is bound to make it, whether or not a subsequent event of default or other

event not within the secured party's control has relieved or may relieve the secured party from its obligation.

(27) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form. The term includes a financing statement and a termination statement.

[(28) "Registered agent" means a registered agent of a debtor designated under Section 9-409.]

(29) "Registered entity" means an organization organized under the law of a State [or of the United States] and as to which the State [or the United States] maintains a public record showing the organization to have been organized.

(30) "Rule" means a rule adopted by [] pursuant to Section 9-413.

(31) "Secured party" means a lender, seller, or other person that has a security interest, including a person to whom accounts, chattel paper, or general intangibles have been sold. If a security interest is created in favor of a trustee, indenture trustee, agent, collateral agent, or other representative, the representative is the secured party.

(32) "Security agreement" means an agreement that creates or provides for a security interest.

(33) "Sign" means to identify a record by means of a signature, mark, or other symbol with intent to authenticate it.

(34) "State" means a State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or insular possession subject to the jurisdiction of the United States.

(35) "Transmitting utility" means any person primarily engaged in the railroad, street railway or trolley bus business, the electric or electronics communications transmission business, the transmission of goods by pipeline, or the transmission or the production and transmission of electricity, steam, gas or water, or the provision of sewer service.

(b) Other definitions applying to this article and the sections in which they appear are:

"Account"	Section 9-106.
"Attach"	Section 9-203.
"Certificate of title"	Section 9-103.
"Commodity contract"	Section 9-115.
"Commodity customer"	Section 9-115.
"Commodity intermediary"	Section 9-115.
"Construction mortgage"	Section 9-313.
"Consumer goods"	Section 9-109.
"Control" (deposit account)	Section 9-117.
"Control" (investment property)	Section 9-115.
"Equipment"	Section 9-109.
"Farm products"	Section 9-109.
"Fixture"	Section 9-313.
"Fixture filing"	Section 9-313.
"General Intangible for Money Due or to Become Due"	Section 9-106.
"General intangibles"	Section 9-106.
"Inventory"	Section 9-109.
"Investment property"	Section 9-115.

"Lien creditor"	Section 9-301.
"Proceeds"	Section 9-306.
"Purchase money security interest"	Section 9-107.
"United States"	Section 9-103.

(c) The following definitions in other articles apply to this article:

"Broker"	Section 8-102.
"Certificated security"	Section 8-102.
"Check"	Section 3-104.
"Clearing corporation"	Section 8-102.
"Contract for sale"	Section 2-106.
"Control"	Section 8-106.
"Customer"	Section 4-104.
"Delivery"	Section 8-301.
"Entitlement holder"	Section 8-102.
"Financial asset"	Section 8-102.
"Holder in due course"	Section 3-302.
"Note"	Section 3-104.
"Sale"	Section 2-106.
"Securities intermediary"	Section 8-102.
"Security"	Section 8-102.
"Security certificate"	Section 8-102.
"Security entitlement"	Section 8-102.
"Uncertificated security"	Section 8-102.

(d) Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

Reporters' Explanatory Notes

1. **Filing-related Definitions.** Several of the definitions in draft Section 9-105(a) are used exclusively or primarily in the filing-related provisions in Part 4. These include "becomes bound," "filing office," "financing statement," "jurisdiction of organization," "original debtor," "new debtor," "registered agent," "registered entity," "rule," "sign," and "State." Most of these definitions are self-explanatory, and many are discussed in the Notes to Part 4.

2. **"Record."** A "record" includes information that is in intangible form (e.g., electronically stored) as well as tangible form (e.g., written). 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.

The first sentence of the definition of "record" is the definition approved by the Conference's Committee on Style for revised UCC Article 5 and the Uniform Limited Liability Company Act. The second sentence is added for clarity. The following language, provided to us by Commissioner Patricia Brumfield Fry (North Dakota) and lightly edited by us, might be suitable for the Official Comment to the definition of record:

> This definition is designed to embrace all means of communicating or storing information except human memory. Given the rapid development and commercial adoption of modern communication and storage technologies, requirements that documents or communications be "written" or "in writing" do not necessarily reflect or aid commercial practices. 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" 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. A record may be signed. See Section 1-201(39). 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. A record may or may not be admissible in evidence, satisfy Statutes of Frauds, or be in appropriate form for filing with a filing office. Other provisions of this [Article] [Act] must be consulted to determine the admissibility, etc. of any particular record.
>
> * * *
>
> A specification that a document or communication must be in writing excludes the use of any other form of record. In some instances,

statutes or the rules of filing offices may require that a writing be filed or that a particular form of signature be employed. In such cases, whether or not a record is permitted under this [Article] [Act], compliance with those statutes or rules is necessary. When a filing office adopts modern technologies, any record satisfying modified statutes or rules as may be adopted would be sufficient under this [Article] [Act].

3. **"Communicate."** The definition of "communicate" derives in part from recently revised Section 8-102(a)(5); it includes the act of transmitting both tangible and intangible records.

4. **"Debtor"; "Obligor"; "Affected Obligor."** Current paragraph (d) defines "debtor" as follows:

> "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the Article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires.

This definition has proved to be unsatisfactory in several respects. The courts have disagreed, for example, about whether a guarantor of a secured obligation is a debtor. Also, a broad construction of the term "debtor" could affect the secured party's duties under Part 5, especially the duty to send notification under Section 9-504.

In large part to resolve these problems, the draft redefines "debtor" and adds new defined terms, "affected obligor" and "obligor." In the context of Part 5, these definitions distinguish between two 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 in the collateral, and (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. Persons in the former class are debtors. Persons in the latter class are affected obligors.

The definitions of "affected obligor" and "obligor" distinguish among obligors who have a stake in the proper enforcement and those who do not. The draft presents two alternative definitions of "affected obligor," each of which captures the same idea, and each of which incorporates principles of non-UCC law (under Alternative A, one must look to non-UCC law to determine rights of recourse; under Alternative B, one must look to non-UCC law to determine whether the obligation is secondary). The Drafting Committee has considered other formulations for an obligor with a stake in the enforcement, but the Reporters believe that the draft Alternatives capture the appropriate class of obligors more directly. Alternative A may be more precise, whereas Alternative B is likely to be more readily understandable.

Some examples may be helpful:

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 before, Mooney is the debtor and an obligor. As a secondary obligor, Harris is an affected obligor.

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, not a secondary obligor, Mooney is not an affected 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 an affected 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 an affected obligor.

5. **Unknown "Debtor."** The new definition of "debtor" 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 5 protect the secured party in that circumstance. See draft Sections 9-501(i), 9-507(i) and (j).

6. **Sales of Intangibles.** Article 9 applies to most sales of accounts and chattel paper. Under draft Section 9-102, Article 9 also would embrace sales of certain general intangibles for money due or to become due. Article 9 applies to these sales the terms associated with secured debt (i.e., security interest, debtor, secured party, collateral). This "definitional shorthand" presents a number of problems, and the Drafting Committee has yet to consider whether to continue this convention. Pending a resolution of the issue, the part of the definition of "debtor" that includes the seller of accounts, chattel paper, or general intangibles appears in brackets. If the current approach is followed, some of the rules of Part 5 are likely to need adjustment. For one approach to these issues, see Plank, Sacred Cows and Warhorses: The Sale of Accounts and Chattel Paper Under the U.C.C. and the Effects of Violating a Fundamental Drafting Principle, 26 Conn. L. Rev. 397 (1994).

7. **Consumer-related Definitions.** The definitions of "consumer debtor," "consumer obligor," and "consumer secured transaction" have been added in connection with various new (and old) consumer protection rules in Part 5. The brackets around subparagraphs (i) - (iii) in the definition of "consumer secured transaction" indicate that the Drafting Committee has reached no consensus on the wisdom of including such details.

8. **"Collateral."** The definition of "collateral" has been revised to contemplate the expansion of Article 9's scope to include sales of some general intangibles. See draft Section 9-102. It also has been revised to make clear that collateral includes proceeds. See draft Section 9-306, Note 1.

9. **"Deposit Account"; "Depositary Institution."** The definition of "deposit account" has been revised in three ways. First, it incorporates the definition of "depositary institution," which also is new. The latter term is a useful shorthand that also appears in other related draft provisions. Unlike the definition of bank in existing Section 4-105(1), which focuses on whether the organization "engaged in the business of banking," the definition of "depositary institution" focuses on whether the organization accepts deposits.

Second, the draft excludes all accounts evidenced by Article 9 "instruments" from the scope of "deposit account." The existing version, which excludes from the "deposit account" definition "an account evidenced by a certificate of deposit [CD]," does not make clear the treatment of non-negotiable or uncertificated CD's. Under the draft, the latter would be a deposit account (assuming there is no writing evidencing the depositary institution's obligation to pay) whereas the former would be a deposit account only if it is not an Article 9 "instrument" (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.")

The draft contemplates that a deposit account evidenced by an instrument would be 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 draft Section 9-117), and the special priority rules applicable to deposit accounts (see draft Sections 9-312 and 9-312A) do not apply. In addition, the draft (like existing Article 9) is silent as to the obligation of a depositary institution to pay to a secured party any deposit evidenced by an instrument.

Third, the draft excludes "investment property" from the term "deposit account." "Investment property" is a term that appears in the revisions to Article 9 that accompany Revised Article 8 and includes both securities and securities entitlements (i.e., rights against brokers and other securities intermediaries). Thus, the definition of "deposit account" would not include shares in a money market mutual fund that could be redeemed by check.

10. **"Good Faith."** The draft expands the definition of "good faith" to include "the observance of reasonable commercial standards of fair dealing." It restricts the purposes of the definition to "purposes of the obligation of good faith in the performance or enforcement of contracts or duties within this Article." That obligation is imposed by Section 1-203. This paragraph appears in brackets to indicate that the Drafting Committee has reached no consensus on the proposed

revision. This version of the definition is included in Revised Article 8, Section 8-102(a)(10).

11. **"New Value."** The new definition of "new value" derives from Section 547(a) of the Bankruptcy Code and replaces the quasi-definition that now appears in Section 9-108. The term is used in draft Sections 9-304(d) and 9-308 (existing Sections 9-304(4) and 9-308).

12. **"Secured Party."** The definition of "secured party" clarifies the status of representatives other than indenture trustees. Under the draft, 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 5 imposes upon the 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.

SECTION 9-106. DEFINITIONS: "ACCOUNT"; "GENERAL INTANGIBLES"; "GENERAL INTANGIBLE FOR MONEY DUE OR TO BECOME DUE."

(a) "Account" means any right to payment for personal property sold, leased, licensed, or otherwise disposed of or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts.

(b) "General intangibles" means any personal property other than goods, accounts, chattel paper, documents, instruments, investment property, deposit accounts, and money.

(c) "General intangible for money due or to become due" means a general intangible under which the account debtor's principal obligation is to pay money.

Reporters' Explanatory Notes

1. Draft subsection (b) establishes deposit accounts as a separate type of collateral. One important consequence is that the depositary institution is not an "account debtor" having the rights and obligations set forth in Section 9-318. In particular, it is not obligated to pay an assignee (secured party) upon receipt of the notification described in Section 9-318(3). Another important consequence relates to the adequacy of the description in the security agreement. See draft Section 9-110.

2. Many sales of general intangibles for money due or to become due will be covered by Article 9 under draft Section 9-102. A definition of "general intangible for money due or to become due" in draft Section 9-106(c) is needed to distinguish sales of commercially valuable "receivables" from the vast array of transfers of interests in intangible rights that should be subjected to Article 9 only when the transfer secures an obligation. The defined term is borrowed from the undefined reference in existing Section 9-318(4). Virtually any intangible right could be "for money due" once one hypothesizes, for example, that the account debtor is in breach of its obligation. The definition proposed in draft subsection (c) would embrace general intangibles "under which the account debtor's **principal** obligation is to pay money." (Emphasis added.) Although there may be difficult cases at the margin, attempting a more precise statutory line may not be worthwhile. As with any classification issue, from a planning standpoint it may be necessary for counsel to make alternative assumptions (i.e., inclusion and exclusion from Article 9).

SECTION 9-107. DEFINITION: "PURCHASE MONEY SECURITY INTEREST." [MINOR STYLE CHANGES ONLY] A security interest is a "purchase money security interest" to the extent that it is

(a) taken or retained by the seller of collateral to secure all or part of its price; or

(b) taken by a person that by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if the value is in fact so used.

SECTION 9-108. WHEN AFTER-ACQUIRED COLLATERAL NOT SECURITY FOR ANTECEDENT DEBT.

[Deleted]

Reporters' Explanatory Note

The Drafting Committee proposes to delete 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. A new definition of the term "new value" is included in draft Section 9-105.

SECTION 9-109. CLASSIFICATION OF GOODS: "CONSUMER GOODS"; "EQUIPMENT"; "FARM PRODUCTS"; "INVENTORY." Goods are:

(a) "consumer goods" if they are used or bought for use primarily for personal, family or household purposes;

(b) "equipment" if they are used or bought for use primarily in business (including farming or a profession) or by a debtor that is a non-profit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods;

(c) "farm products" if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory; and

(d) "inventory" if they are (i) leased by a person, (ii) held by a person for sale or lease or to be furnished under contracts of service, (iii) furnished by a person under contracts of service, or (iv) raw materials, work in process or materials used or consumed in a business. Inventory of a person is not the person's equipment.

Reporters' Explanatory Note

The draft revises the definition of inventory to include goods leased by the debtor to others as well as goods held for lease.

SECTION 9-110. SUFFICIENCY OF DESCRIPTION.

(a) Except as otherwise provided in subsection (b), for the purposes of this article a description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described.

(b) A description of a deposit account is insufficient unless it describes the deposit account (i) by item, (ii) as all of the debtor's deposit accounts, or (iii) as an identified class of the debtor's deposit accounts.

Reporters' Explanatory Note

The revision reflects the Drafting Committee's view that, except perhaps in consumer secured transactions, a debtor should be able to grant a blanket security interest in all deposit accounts, existing and after-acquired, but neither a security agreement containing a "super-generic" description (e.g., "all my personal property") nor one covering "all general intangibles" should be deemed to be sufficient evidence that the debtor intended to create a security interest in all its deposit accounts. The revision would not affect accounts evidenced by an instrument (e.g., certain CD's), which by definition are not "deposit accounts."

The Drafting Committee may wish to consider a similar approach for investment property, insurance policies, and tort claims.

[**SECTION 9-111. APPLICABILITY OF ARTICLE ON BULK SALES.** [MINOR STYLE CHANGES ONLY] The creation of a security interest is not a bulk sale under Article 6 (Section 6-102).]

Legislative Note: States that adopt Article 6, Alternative A, should not adopt this section.

SECTION 9-112. WHERE COLLATERAL IS NOT OWNED BY DEBTOR.

[Deleted]

Reporters' Explanatory Note

The revised definition of "debtor" in Section 9-105 renders this section unnecessary.

SECTION 9-113. SECURITY INTERESTS ARISING UNDER ARTICLE ON SALES OR UNDER ARTICLE ON LEASES. [MINOR STYLE CHANGES ONLY] A security interest arising solely under the Article on Sales (Article 2) or the Article on Leases (Article 2A) is subject to the provisions of this article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods

(a) no security agreement is necessary to make the security interest enforceable;

(b) no filing is required to perfect the security interest; and

(c) the rights of the secured party on default by the debtor are governed (i) by the Article on Sales (Article 2) in the case of a security interest arising solely under such Article or (ii) by the Article on Leases (Article 2A) in the case of a security interest arising solely under that article.

SECTION 9-114. CONSIGNMENT. [MINOR STYLE CHANGES ONLY]

(a) A person that delivers goods under a consignment that is not a security interest and that would be required to file under this article by Section 2-326(3)(c) has priority over a secured party that is or becomes a creditor of the consignee and that would have a perfected security interest in the goods if they were the property of the consignee, and also has priority with respect to identifiable cash proceeds received on or before delivery of the goods to a buyer, if

(1) the consignor complies with the filing provision of the Article on Sales (Article 2) with respect to consignments (Section 2-326(3)(c)) before the consignee receives possession of the goods;

(2) the consignor gives notification in writing to the holder of the security interest if the holder has filed a financing statement covering the same types of goods before the date of the filing made by the consignor;

(3) the holder of the security interest receives the notification within five years before the consignee receives possession of the goods; and

(4) the notification states that the consignor expects to deliver goods on consignment to the consignee, describing the goods by item or type.

(b) In the case of a consignment that is not a security interest and in which the requirements of the preceding subsection have not been met, a person that delivers goods to another is subordinate to a person that would have a perfected security interest in the goods if they were the property of the debtor.

SECTION 9-115. INVESTMENT PROPERTY. [MINOR STYLE CHANGES ONLY]

(a) In this article:

(1) "Commodity account" means an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer.

(2) "Commodity contract" means a commodity futures contract, an option on a commodity futures contract, a commodity option, or other contract that, in each case, is:

(i) traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to the federal commodities laws; or

(ii) traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer.

(3) "Commodity customer" means a person for whom a commodity intermediary carries a commodity contract on its books.

(4) "Commodity intermediary" means:

(i) a person that is registered as a futures commission merchant under the federal commodities laws; or

(ii) a person that in the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to the federal commodities laws.

(5) "Control" with respect to a certificated security, uncertificated security, or security entitlement has the meaning specified in Section 8-106. A secured party has control over a commodity contract if by agreement among the commodity customer, the commodity intermediary, and the secured party, the commodity intermediary has agreed that it will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer. If a commodity customer grants a security interest in a commodity contract to its own commodity intermediary, the commodity intermediary as secured party has control. A secured party has control over a securities account or commodity account if the secured party has control over all security entitlements or commodity contracts carried in the securities account or commodity account.

(6) "Investment property" means:

(i) a security, whether certificated or uncertificated;

(ii) a security entitlement;

(iii) a securities account;

(iv) a commodity contract; or

(v) a commodity account.

(b) Attachment or perfection of a security interest in a securities account is also attachment or perfection of a security interest in all security entitlements carried in the securities account. Attachment or perfection of a security interest in a commodity account is also attachment or perfection of a security interest in all commodity contracts carried in the commodity account.

(c) A description of collateral in a security agreement or financing statement is sufficient to create or perfect a security interest in a certificated security, uncertificated security, security entitlement, securities account, commodity contract, or commodity account whether it describes the collateral by those terms, or as investment property, or by description of the underlying security, financial asset, or commodity contract. A description of investment property collateral in a security agreement or financing statement is sufficient if it identifies the collateral by specific listing, by category, by quantity, by a computational or allocational formula or procedure, or by any other method, if the identity of the collateral is objectively determinable.

(d) Perfection of a security interest in investment property is governed by the following rules:

(1) A security interest in investment property may be perfected by control.

(2) Except as otherwise provided in paragraphs (3) and (4), a security interest in investment property may be perfected by filing.

(3) If the debtor is a broker or securities intermediary, a security interest in investment property is perfected when it attaches. The filing of a

financing statement with respect to a security interest in investment property granted by a broker or securities intermediary has no effect for purposes of perfection or priority with respect to that security interest.

(4) If a debtor is a commodity intermediary, a security interest in a commodity contract or a commodity account is perfected when it attaches. The filing of a financing statement with respect to a security interest in a commodity contract or a commodity account granted by a commodity intermediary has no effect for purposes of perfection or priority with respect to that security interest.

(e) Priority between conflicting security interests in the same investment property is governed by the following rules:

(1) A security interest of a secured party that has control over investment property has priority over a security interest of a secured party that does not have control over the investment property.

(2) Except as otherwise provided in paragraphs (3) and (4), conflicting security interests of secured parties each of whom has control rank equally.

(3) Except as otherwise agreed by the securities intermediary, a security interest in a security entitlement or a securities account granted to the debtor's own securities intermediary has priority over any security interest granted by the debtor to another secured party.

(4) Except as otherwise agreed by the commodity intermediary, a security interest in a commodity contract or a commodity account granted to the debtor's own commodity intermediary has priority over any security interest granted by the debtor to another secured party.

(5) Conflicting security interests granted by a broker, a securities intermediary, or a commodity intermediary which are perfected without control rank equally.

(6) In all other cases, priority between conflicting security interests in investment property is governed by Section 9-312(h), (i), and (j). Section 9-312(d) does not apply to investment property.

(f) If a security certificate in registered form is delivered to a secured party pursuant to agreement, a written security agreement is not required for attachment or enforceability of the security interest, delivery suffices for perfection of the security interest, and the security interest has priority over a conflicting security interest perfected by means other than control, even if a necessary indorsement is lacking.

Reporters' Explanatory Note

This section, which was added in conjunction with Revised Article 8, contains a variety of rules applicable to security interests in investment property. The Drafting Committee may wish to place these rules in the related sections of Article 9. See, e.g., draft Section 9-305A (perfection by control). For the time being, however, this draft makes no substantive changes to Section 9-115.

SECTION 9-116. SECURITY INTEREST ARISING IN PURCHASE OR DELIVERY OF FINANCIAL ASSET. [MINOR STYLE CHANGES ONLY]

(a) If a person buys a financial asset through a securities intermediary in a transaction in which the buyer is obligated to pay the purchase price to the securities intermediary at the time of the purchase, and the securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary, the securities intermediary has a security interest in the buyer's security entitlement securing the buyer's obligation to pay. A security agreement is not required for attachment or enforceability of the security interest, and the security interest is automatically perfected.

(b) If a certificated security, or other financial asset represented by a writing which in the ordinary course of business is transferred by delivery with any necessary indorsement or assignment is delivered pursuant to an agreement between persons in the business of dealing with such securities or financial assets and the agreement calls for delivery versus payment, the person delivering the certificate or other financial asset has a security interest in the certificated security or other financial asset securing the seller's right to receive payment. A security agreement is not required for attachment or enforceability of the security interest, and the security interest is automatically perfected.

SECTION 9-117. "CONTROL" OVER A DEPOSIT ACCOUNT.

(a) A secured party has "control" over a deposit account if:

(1) the secured party is the depositary institution with which the deposit account is maintained;

(2) the depositary institution with which the deposit account is maintained agrees in writing that, without further consent by the debtor, the depositary institution will comply with instructions originated by the secured party directing disposition of the funds in the account; or

(3) the secured party becomes the depositary institution's customer (Section 4-104) with respect to the deposit account.

(b) A secured party that has satisfied the requirements of subsection (a)(2) or (a)(3) has control even if the debtor retains the right to direct the disposition of funds from the deposit account.

(c) This article does not require a depositary institution to enter into an agreement of the type described in subsection (a)(2) even though its customer so requests or directs. A depositary institution that has entered into such an

agreement is not required to confirm the existence of the agreement to another person unless requested to do so by its customer.

(d) Whenever there is no outstanding secured obligation and the secured party has no commitment to make advances, incur obligations, or otherwise give value:

(1) a secured party that has control over a deposit account under subsection (a)(2) shall, within 10 days following written demand by the debtor, send the depositary institution with which the deposit account is maintained a written statement that releases the depositary institution from any further obligation to comply with instructions originated by the secured party.

(2) a secured party that has control over a deposit account under subsection (a)(3) shall, within 10 days following written demand by the debtor, pay the debtor all funds on deposit in the account.

(e) A secured party that fails to send a statement as required by subsection (d) is liable to the debtor for $ 500 and, in addition, for any loss caused to the debtor by the failure.

Reporters' Explanatory Notes

1. The revisions to Article 9 that accompany Revised Article 8 contemplate that security interests in investment property generally may be perfected by filing or by control and that security interests perfected by control take priority over security interests perfected by filing. This draft provides likewise with respect to security interests in deposit accounts. See draft Sections 9-304 (perfection by filing), 9-305A (perfection by control), and 9-312(g)(1) (priority to security interests perfected by control). This section, which derives from Section 8-106 of Revised Article 8, explains the concept of "control."

2. Under Revised Article 8, roughly speaking, a secured party obtains control over a brokerage account by becoming the "entitlement holder" (i.e., by having the account maintained in the secured party's name) or by obtaining the broker's agreement to comply with instructions originated by the secured party without the debtor's further consent. The Drafting Committee believes that a similar alternative to perfection by filing should be available in the case of deposit accounts. Among the reasons expressed are the following:

First, the existence of such an alternative reduces the need to distinguish between securities accounts (included in "investment property") and deposit accounts.

Second, control provides ample notice to those subsequent secured parties who would act in reliance upon the existence or non-existence of a security interest in the deposit account. A secured party who is concerned about being able to enforce its security interest in a deposit account ordinarily will need to obtain control. See draft Section 9-318A. In attempting to obtain control, the secured party ordinarily will discover whether another secured party has taken control. For example, discovery of the fact that a deposit account is not maintained in the debtor's name (a circumstance that would constitute control by the named account holder under subsection (a)(3)) suggests that the account may be encumbered. And the secured party is unlikely to succeed in obtaining the depositary institution's agreement under subsection (a)(2) if another secured party already has control.

Third, as a practical matter a secured party who has taken the steps necessary to obtain control but who has not filed (or whose filing is ineffective) will be able to enforce its security interest by obtaining payment from the depositary institution; a secured party who has filed but who lacks control will not (absent a court order). It seems incongruous to elevate the claim of the latter over the claim of the former.

Revised Article 8 does not require that the agreement giving rise to control be written, although any prudent secured party would reduce such an agreement to writing. The draft reflects the Drafting Committee's view that a written control agreement should be required when the collateral consists of a deposit account.

3. Revised Article 8 affords a third means of obtaining control over a brokerage account. It provides (again, roughly speaking) that a broker obtains control over a brokerage account maintained with that broker if the broker is granted an interest in the account. Draft Section 9-117 reflects this aspect of control in the deposit account setting, as well. The effect of this aspect of control would be to afford automatic perfection to a security interest granted to the depositary institution with which the deposit account is maintained. Automatic perfection reflects the Drafting Committee's view that all actual and potential creditors of the debtor are always on notice that the depositary institution with which the debtor's deposit account is maintained may assert a claim against the deposit account.

4. Perfection by control would not be available for accounts evidenced by an instrument (e.g., certain CD's), which by definition are not "deposit accounts." Revised Article 8 reaches an analogous result by defining "control" in the case of a securities certificate (as opposed to a securities entitlement against a broker) to require possession of the certificate by or on behalf of the secured party.

5. Subsections (b) and (c) derive from Revised Article 8. The former makes clear that "control" need not deprive the debtor of the ability to reach the funds on deposit. The latter protects depositary institutions from the need to

enter into a agreements against their will and from the need to respond to inquiries from persons other than their customers.

6. Subsection (d) requires the relinquishment of control under certain circumstances, and subsection (e) provides a remedy in the case of a secured party's failure to comply. The circumstances and the penalty track those applicable to termination statements. See draft Section 9-404. These requirements can be varied by agreement under existing Section 1-102(3). For example, a debtor could by contract require the secured party to release its control over an account earlier than 10 days following demand. Also, these requirements should not be read to conflict with the terms of the deposit account itself. For example, if the deposit account were a time deposit, a secured party with control under subsection (a)(3) would not be required to make an early withdrawal of the funds (assuming that were even possible) in order to pay them over to the debtor.

PART 2

VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES TO SECURITY AGREEMENT

SECTION 9-201. GENERAL VALIDITY OF SECURITY AGREEMENT; GENERAL INTANGIBLE SUBJECT TO EFFECTIVE ELECTION.

(a) Except as otherwise provided by this Act, a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.

[Subsection (b) -- Alternative A]

(b) Nothing in this article (i) validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail installment sales, or the like, or extends the application of any such statute or regulation to any transaction not otherwise subject thereto, (ii) affects the rights of a person that acquires an interest in a general intangible for money due or to become due, if the person acquires the interest before the general intangible becomes subject to an effective election (Section 9-102), or (iii) affects the rights or duties of an account debtor on a general intangible for money due or to become due unless the account debtor agrees to an effective election (Section 9-102).

[Subsection (b) -- Alternative B]

(b) Nothing in this article (i) validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail installment sales, or the like, or extends the application of any such statute or regulation to any transaction not otherwise subject thereto, or (ii) affects a right or duty of an account debtor on a general intangible for money due or to become

due, if the right or duty arises after the debtor and the account debtor agree to an effective election (Section 9-102).

Reporters' Explanatory Notes

1. Alternatives A and B of draft Section 9-102(a)(3) and (b) propose opt-in and opt-out alternatives, respectively, for sales of general intangibles for money due or to become due. See Notes to draft Section 9-102. Draft Section 9-201(b) reflects the inherent limitations on the role of Article 9 that would result from an opt-in or opt-out regime.

Alternative A of draft Section 9-201(b) corresponds to Alterative A of Section 9-102(a)(3) and (b), the opt-in alternative. It provides that Article 9 does not affect the rights or interests of those who acquired interests in general intangibles before the general intangibles became subject to an effective election. Nor would Article 9 affect the rights of an account debtor who has not agreed to an effective election (i.e., who has not opted in). Alternative B of draft Section 9-201(b) corresponds to Alterative B of Section 9-102(a)(3) and (b), the opt-out alternative. It provides that Article 9 does not affect the rights of an account debtor who has agreed to an effective election (i.e., who has opted out).

2. It may be useful to consider an example of the operation of the priority rules that emanate from draft Section 9-201 when read with the rest of Article 9. Consider the following hypothetical under the Alternative A (opt-in) regime:

> On 4/1 D sells a general intangible for the payment of money (GI) to SP-1. D and the account debtor (AD) on the GI failed to make an effective election, and SP-1 and D, similarly, did not make an effective election. On 5/1, LC-1, a judgment creditor of D, serves a garnishment on AD. On 5/15, D sells the same GI to SP-2, D and SP-2 make an effective election in the sale (security) agreement, and SP-2 immediately files a financing statement. On 6/1, LC-2, another judgment creditor of D, has another garnishment served on AD. On 6/15, D sells the same GI to SP-3, but D and SP-3 do not make an effective election. SP-3 does not file a financing statement. On 7/1, D files a petition under the Bankruptcy Code.

Article 9 does not apply until 5/15, when SP-2 and D made an effective election. Consequently, the rights and relative priorities of SP-1 and LC-1 are governed by non-Article 9 law. Assuming SP-1 complied with any applicable perfection steps under other law, SP-1's interest is senior to that of LC, a lien creditor who probably could reach no more than the debtor's rights (here, nothing) under applicable law. Under draft Section 9-201(b) (Alternative A), the fact that Article 9 applies from and after 5/15 would not affect the pre-existing rights of SP-1 and LC-1 (assuming it has any rights, given the sale to SP-1). Thus, the rights of SP-1 and LC-1 (if any) also are senior to those of SP-2, LC-2, and SP-3.

The rights of SP-1 also are senior to those of the trustee in bankruptcy (TIB). Because D has no interest in the GI at the time of the filing of the

bankruptcy petition, the GI does not become property of the estate under Bankruptcy Code § 541(a)(1). Because a judicial lien creditor of D could not reach any interest in the GI on 7/1, the strong-arm clause (Bankruptcy Code § 544(a)) is ineffective against SP-1.

If we assume SP-1 never entered the picture, then LC-1's lien would be senior to the TIB's rights under Bankruptcy Code § 544(a), but its lien may be avoidable as a preference under Bankruptcy Code § 547.

If we assume away the existence of both SP-1 and LC-1, then the Article 9 priority rules, applicable from 5/15, would afford SP-2 first priority. Again, the GI would not be property of the estate. Because Article 9 already applied by virtue of the effective election made by SP-2 and D, SP-3's failure to make an effective election has no effect. SP-3, here, should have searched and investigated.

Were it not for the sale to SP-2, Article 9 would never apply to rights in the GI. Under normal first-in-time principles, LC-2 would be senior to both SP-3, who bought the GI later in time, and the TIB's rights under the strong-arm clause (but subject to possible preference avoidance). Note that if SP-2 is assumed away, then SP-3's failure to file is meaningless inasmuch as Article 9 would not be applicable. Regardless of whether SP-3 filed, the TIB might preserve LC-2's avoided (Bankruptcy Code § 547) lien and assert it against SP-3. See Bankruptcy Code § 551.

3. Working through an analogous hypothetical under the Alternative B (opt-out) regime also might yield sensible results. The rules of Article 9 would apply until D and AD opt out by entering into an effective election. But if they were to opt out, earlier vested interests that arose under the Article 9 regime, such as a perfected security interest, should not be adversely affected. Similarly, if D and AD were to cancel their effective election, putting the GI once again under Article 9, interests that arose during the opt-out period also should not be adversely affected.

4. One can glean sensible outcomes for priority contests from either alternative of draft Section 9-201 read with common-law principles of first-in-time-first-in-right and nemo dat quod non habet (one cannot give what one does not have). But one can only hope that courts would reach those sensible results. Both the opt-in and opt-out regimes could play havoc with the Article 9 priority rules. And addressing the priority problems in the statute might prove no less problematic. If the opt-in or opt-out alternative is necessary for Article 9 to accommodate sales of general intangibles for money due or to become due, the benefits for covered sales cannot be based on assurances of priority over all competing purchasers. Instead, the benefits will derive mainly from the assurances of perfection and priority over lien creditors (read trustees in bankruptcy) under Article 9.

SECTION 9-202. TITLE TO COLLATERAL IMMATERIAL. [MINOR STYLE CHANGES ONLY] Each provision of this article with regard to rights,

obligations and remedies applies whether title to collateral is in the secured party or in the debtor.

SECTION 9-203. ATTACHMENT AND ENFORCEABILITY OF SECURITY INTEREST; PROCEEDS; FORMAL REQUISITES.

(a) Subject to the provisions of Section 4-208 on the security interest of a collecting bank, Sections 9-115 and 9-116 on security interests in investment property, Section 9-113 on a security interest arising under the Article on Sales (Article 2), and subsection (b) on new debtors, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:

(1) the collateral is in the possession of the secured party pursuant to agreement, the collateral is investment property and the secured party has control pursuant to agreement, or the debtor has signed a security agreement that contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned;

(2) value has been given; and

(3) the debtor has rights in the collateral.

(b) If a new debtor becomes bound as debtor by a security agreement entered into by another person, the agreement satisfies the requirement of subsection (a)(1) as to existing or after-acquired property of the new debtor to the extent the property is described in the agreement, and no other agreement is necessary to make a security interest enforceable in that property.

(c) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the

events specified in subsection (a) have taken place unless explicit agreement postpones the time of attaching.

(d) Unless otherwise agreed a security agreement gives the secured party the rights to proceeds provided by Section 9-306.

(e) A transaction, although subject to this article, is also subject to _____ *, and in the case of conflict between the provisions of this article and that statute, the provisions of that statute control. Failure to comply with any applicable statute has only the effect that is specified therein.

Legislative Note: At * in subsection (e) insert reference to any local statute regulating small loans, retail installment sales and the like. Subsection (e) is designed to make it clear that certain transactions, although subject to this article, also must comply with other applicable legislation.

Reporters' Explanatory Notes

1. Draft Section 9-203(a)(1) (existing Section 9-203(1)(a)) contains one of the three requirements for attachment of a security interest: a security agreement, evidenced either by a signed writing describing the collateral or by the secured party's possession of the collateral. A statute or treaty of the type described in Section 9-302(3) may limit descriptions of collateral that appear on a certificate of title or in a registry. Those statutes or treaties override the otherwise applicable Article 9 filing (perfection) rules. The draft would revise Official Comment 3 to Section 9-203 to make clear that the description of collateral in the security agreement controls for purposes of determining whether a security interest has attached. The revised Comment would be along the following lines (added text is underlined):

> 3. One purpose of the formal requisites stated in subsection (1)(a) is evidentiary. The requirement of written record minimizes the possibility of future dispute as to the terms of a security agreement and as to what property stands as collateral for the obligation secured. Where the collateral is in the possession of the secured party, the evidentiary need for a written record is much less than where the collateral is in the debtor's possession; customarily, of course, as a matter of business practice the written record will be kept, but, in this Article as at common law, the writing is not a formal requisite. Subsection (1)(a), therefore, dispenses with the written agreement -- and thus with signature and description -- if the collateral is in the secured party's possession.
>
> <u>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</u>

4, explained in Section 9-402, comment 3. When perfection is achieved by compliance with the requirements of a statute or treaty described in Section 9-302(3), 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 9-110. However, it is the description contained in the security agreement, not the description in a public registry or on a certificate of title, that is controlling for those purposes.

2. New draft subsection (b) makes clear that the enforceability requirements of subsection (a)(1) are met when a new debtor becomes bound under an original debtor's security agreement. This subject is discussed in more detail in the Notes to draft Section 9-402A.

SECTION 9-204. AFTER-ACQUIRED PROPERTY; FUTURE ADVANCES. [MINOR STYLE CHANGES ONLY]

(a) Except as provided in subsection (b), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral.

(b) No security interest attaches under an after-acquired property clause to consumer goods other than accessions (Section 9-314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.

(c) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment (Section 9-105(a)).

SECTION 9-205. USE OR DISPOSITION OF COLLATERAL WITHOUT ACCOUNTING PERMISSIBLE. [MINOR STYLE CHANGES ONLY] A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods or make repossessions, or to

use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee.

SECTION 9-206. AGREEMENT NOT TO ASSERT DEFENSES AGAINST ASSIGNEE; MODIFICATION OF SALES WARRANTIES WHERE SECURITY AGREEMENT EXISTS. [MINOR STYLE CHANGES ONLY]

(a) Subject to any statute or decision that establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee not to assert against an assignee any claim or defense that the buyer or lessee may have against the seller or lessor is enforceable by an assignee that takes an assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type that may be asserted against a holder in due course of a negotiable instrument (Section 3-305). A buyer that as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.

(b) If a seller retains a purchase money security interest in goods Article 2 governs the sale and any disclaimer, limitation or modification of the seller's warranties.

SECTION 9-207. RIGHTS AND DUTIES IF COLLATERAL IS IN SECURED PARTY'S POSSESSION. [MINOR STYLE CHANGES ONLY]

(a) A secured party must use reasonable care in the custody and preservation of collateral in the secured party's possession. In the case of an

instrument or chattel paper reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(b) Unless otherwise agreed, if collateral is in the secured party's possession

(1) reasonable expenses (including the cost of any insurance and payment of taxes or other charges) incurred in the custody, preservation, use or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(2) the risk of accidental loss or damage is on the debtor to the extent of any deficiency in any effective insurance coverage;

(3) the secured party may hold as additional security any increase or profits (except money) received from the collateral, but money so received, unless remitted to the debtor, must be applied in reduction of the secured obligation;

(4) the secured party shall keep the collateral identifiable but fungible collateral may be commingled; and

(5) the secured party may repledge the collateral upon terms that do not impair the debtor's right to redeem it.

(c) A secured party is liable for any loss caused by the failure to meet any obligation imposed by subsection (a) or (b) but does not lose the security interest.

(d) A secured party may use or operate collateral for the purpose of preserving the collateral or its value or pursuant to an order of a court of appropriate jurisdiction or, except in the case of consumer goods, in the manner and to the extent provided in the security agreement.

SECTION 9-208. REQUEST FOR STATEMENT OF ACCOUNT OR LIST OF COLLATERAL. [MINOR STYLE CHANGES ONLY]

(a) A debtor may sign a statement indicating what the debtor believes to be the aggregate amount of unpaid indebtedness as of a specified date and may send it to the secured party with a request that the statement be approved or corrected and returned to the debtor. If the security agreement or any other record kept by the secured party identifies the collateral, a debtor may similarly request the secured party to approve or correct a list of the collateral.

(b) The secured party shall comply with a request pursuant to subsection (a) within two weeks after receipt by sending a written correction or approval. If the secured party claims a security interest in all of a particular type of collateral owned by the debtor the secured party may indicate that fact in the reply and need not approve or correct an itemized list of the collateral. If the secured party without reasonable excuse fails to comply the secured party is liable for any loss caused to the debtor by the noncompliance. If the debtor has properly included in a request pursuant to subsection (a) a good faith statement of the obligation or a list of the collateral or both, the secured party may claim a security interest only as shown in the statement against persons misled by the secured party's noncompliance. If the secured party no longer has an interest in the obligation or collateral at the time the request is received, the secured party shall disclose the name and address of any successor in interest known to the secured party and is liable for any loss caused to the debtor as a result of the failure to disclose. A successor in interest is not subject to this section until a request is received by the successor.

(c) A debtor is entitled to a statement under this section once every six months without charge. The secured party may require payment of a charge not exceeding $ 10 for each additional statement furnished.

SECTION 9-209. EFFECT OF SECURITY INTEREST ON DEPOSITARY INSTITUTION'S RIGHT OF SET-OFF. Except as otherwise provided in Section 9-312A(b), the application of this article to a security interest in a deposit account does not affect a right of recoupment or set-off of the secured party as to a deposit account maintained with the secured party.

Reporters' Explanatory Note

This section is new and is based on a nonuniform Illinois amendment. It makes clear that a depositary institution may hold both a right of set-off against, and an Article 9 security interest in, the same deposit account. The section does not pertain to accounts evidenced by an instrument (e.g., certain CD's), which are excluded from the definition of "deposit accounts." Draft Section 9-312A addresses the priority contest between a security interest in a deposit account and the depositary institution's right of set-off.

PART 3

RIGHTS OF THIRD PARTIES; PERFECTED AND UNPERFECTED SECURITY INTERESTS; RULES OF PRIORITY

SECTION 9-301. PERSONS THAT TAKE PRIORITY OVER UNPERFECTED SECURITY INTERESTS; RIGHTS OF "LIEN CREDITOR."

(a) Except as otherwise provided in subsection (b), an unperfected security interest is subordinate to the rights of

(1) persons entitled to priority under Section 9-312;

(2) a person that becomes a lien creditor before the security interest is perfected;

(3) in the case of goods, instruments, documents, and chattel paper, a person that is not a secured party and that is a transferee in bulk or other buyer not in ordinary course of business or is a buyer of farm products in ordinary course of business, to the extent that the person gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(4) in the case of accounts, general intangibles, and investment property, a person that is not a secured party and that is a transferee to the extent that the person gives value without knowledge of the security interest and before it is perfected.

(b) If the secured party files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral, the secured party takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(c) A "lien creditor" means a creditor that has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment.

(d) A person that becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before the person becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.

SECTION 9-302. WHEN FILING IS REQUIRED TO PERFECT SECURITY INTEREST; SECURITY INTERESTS TO WHICH FILING PROVISIONS OF THIS ARTICLE DO NOT APPLY.

(a) A financing statement must be filed to perfect all security interests except the following:

(1) a security interest in collateral in the secured party's possession under Section 9-305;

(2) a security interest perfected under Section 9-103(a)(6), in instruments, certificated securities, or documents without delivery under Section 9-304(d) or (e), or in proceeds under Section 9-306(e);

(3) a security interest created by an assignment of a beneficial interest in a trust or a decedent's estate;

(4) a purchase money security interest in consumer goods; but subsection (d) applies to consumer goods that are subject to a statute or treaty described in subsection (c)[, a filing is required for priority over a buyer to the

extent provided in Section 9-307(b), and a fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9-313];

(5) an assignment of accounts which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor;

(6) a security interest of a collecting bank (Section 4-210) or arising under the Article on Sales (see Section 9-113);

(7) an assignment for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder;

(8) a security interest in investment property which is perfected without filing under Section 9-115 or 9-116;

(9) a security interest in property subject to a statute or treaty described in subsection (c); and

(10) a security interest in a deposit account over which the secured party has control under Section 9-117.

(b) If a secured party assigns a perfected security interest, no action under this article is required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(c) The filing of a financing statement is not necessary or effective to perfect a security interest in property subject to:

(1) a statute or treaty of the United States under which the exclusive method of perfecting a security interest is (i) compliance with the requirements of a national or international registration system or a national or international certificate-of-title system or (ii) filing at an office that is different from the office specified in this article for filing of a financing statement; or

(2) the following statutes of this State; [list any certificate-of-title statute covering automobiles, trailers, mobile homes, boats, farm tractors, or the like, which provides for a security interest to be indicated on the certificate as a condition or result of perfection, and any non-UCC central filing statute]; but during any period in which collateral is inventory held for sale or lease or leased by a person that is in the business of selling or leasing goods of that kind, the otherwise applicable filing provisions of this article (Parts 3 and 4) apply to a security interest in that collateral created by that person as debtor[; or

(3) a-certificate-of-title statute of another jurisdiction which provides for a security interest to be indicated on the certificate as a condition or result of perfecting the security interest.]

(d) Compliance with the requirements for perfecting a security interest prescribed by a statute or treaty described in subsection (c) is equivalent to the filing of a financing statement under this article. Except as otherwise provided in Sections 9-103(c) and 9-305 for goods covered by a certificate of title, a security interest in property subject to a statute or treaty described in subsection (c) can be perfected only by compliance with the requirements for perfecting a security interest prescribed by the statute or treaty and a security interest so perfected remains perfected notwithstanding a change in the use or transfer of possession of the collateral. Except as otherwise provided in Section 9-103(c), duration and renewal of perfection of a security interest perfected by compliance with the requirements for perfecting a security interest prescribed by the statute or treaty are governed by the provisions of the statute or treaty. In other respects the security interest is subject to this article.

Reporters' Explanatory Notes

1. For the most part the Drafting Committee has not yet discussed draft Section 9-302.

2. **When Filing Not Required.** Existing Section 9-302(1) establishes a central Article 9 principle: Filing a financing statement is necessary for perfection unless that subsection specifies otherwise. Draft subsection (a) retains that principle, although it includes several clarifying revisions. Draft paragraph (2) is expanded to refer to the perfection rules in Section 9-103. Draft paragraph (4) eliminates the confusing reference to filing for consumer goods that are registered motor vehicles and, instead, makes clear that the automatic perfection rule for purchase money security interests in consumer goods does not apply to goods covered by a statute or treaty described in subsection (c). The draft also adds a reference to the priority rule of draft Section 9-307(b) (current Section 9-307(2)) that parallels the existing reference to fixture filing in Section 9-313. Both references are in brackets, however, to indicate that they are unnecessary and probably should be deleted. Both Sections 9-307(2) and 9-313 contain **priority** rules, but do not contain exceptions to the requirement that filing is required for **perfection**. New paragraph (9) excepts from the filing requirement property covered by a statute or treaty described in subsection (c). See the discussion of draft subsections (c)(1) and (d) in Notes 4 and 7-9 below. New paragraph (10) makes clear that control is an alternative to filing. (Section 9-117, Notes 2 and 3, explain the reasons for permitting perfection by control.)

3. **Assignment of Perfected Security Interest.** Draft subsection (b) substitutes "action" for the term "filing," thereby extending to security interests perfected under subsection (d) the benefits of the existing rule that no assignment need be filed for continuation of perfection against an underlying debtor. A proposal of the State Bar of California would amend existing Section 9-302(2) (i.e., draft Section 9-302(b)) to create a special rule to govern the case where the secured party is the depository institution at which the account is maintained, the security interest is perfected without filing, and the secured party assigns the security interest to a third party. The California proposal would create a 10-day temporary perfection rule. Inasmuch as assignees ordinarily should be able to file or take control before taking the assignment, the draft contains no such automatic perfection rule. Implicit in the draft is that upon loss of control by the depositary institution, the security interest would become unperfected upon assignment unless the assignee perfected. This result could be made explicit in the Official Comments.

4. **Federal Statutes and Treaties.** Draft subsection (c)(1) provides explicitly that the Article 9 filing requirement defers only to federal statutes or treaties that provide that compliance therewith is the **exclusive** method of perfection. This clarification responds to Recommendation 2.A., which recommends that the applicability of existing Section 9-302(3) be clarified. The language chosen is not perfect, in that Section 9-303 provides that "perfection" requires compliance with applicable actions under Part 3 and draft subsections (c) and (d) refer to "perfecting" a security interest under a different statute. Ideally, of course, the applicable statutes and treaties would be refined to eliminate any confusion. Proposed reforms to the federal laws that deal with copyrights, patents, and trademarks, for example, would achieve that goal. But even with respect to non-UCC law that is not so refined, draft subsections (c) and (d) should be adequate, particularly if accompanied by amplification in the Official Comments. In particular, the Reporters suggest that an Official Comment explain that, as used in draft Section 9-302(c) and (d), "perfecting" means

acquiring priority over a subsequent lien creditor. Cf. draft Section 9-301(a)(2) (existing Section 9-301(1)(b)).

5. **Forum's Certificate of Title Statute.** The description of certificate of title statutes in draft subsection (c)(2) has been revised to track the language of draft Section 9-103(c). Draft paragraph (2) also expands the exclusion for inventory to encompass inventory held for lease as well as inventory held for sale. It takes account of the fact that dealers, particularly of automobiles, often do not know whether a particular item of inventory will be sold or leased. Under existing law, 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. Under the draft, notation would be both unnecessary and ineffective. The filing provisions of Article 9 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 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" (existing Section 9-101(4)) contains a similar phrase, but omits any reference to goods that are "leased." Draft Section 9-109(d) conforms the definition of inventory to draft Section 9-302(c)(2) by including a reference to "leased" goods. (See also existing Section 9-103(3)(a), which seems to distinguish goods "leased" and goods "held for lease.")

6. **Foreign Jurisdiction's Certificate of Title Statute.** Draft subsection (c) retains paragraph (3) (existing subsection (3)(c)), with appropriate revisions to conform that paragraph to draft Section 9-103(c). However, paragraph (3) appears in brackets because draft Section 9-103(c) apparently makes the paragraph unnecessary. Assume that a court is applying draft Section 9-302 as enacted in State B. If goods are covered by a State A certificate of title and State B has not issued a certificate, then State A's law, including its Section 9-302(c)(2), will apply. Once State B issues a certificate, State B's law will apply, including State B's Sections 9-103(c)(3) and 9-302(c)(5). There seems to be no room for a security interest to be perfected **under the law of State B** through compliance with **State A's certificate of title act**. Note, however, that State B's Section 9-103(c)(5) does terminate perfection if perfection would have lapsed under the law of State A.

7. **Compliance with Perfection Requirements of Other Statute.** The draft clarifies subsection (d) (existing subsection (4)). Compliance with the perfection requirements, but not other requirements, of a statute or treaty described in subsection (c) is equivalent to filing and is sufficient for perfection.

The Study Committee recommended that Article 9 preempt non-UCC law in this regard and 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." Recommendation 22.A. The draft does not include such a preemptive rule in Article 9 itself. The Reporters recognize

that, in jurisdictions where perfection occurs upon issuance of a certificate, the absence of a preemptive rule may create a gap between the time that the goods are "covered" by the certificate under draft Section 9-103(c) and the time of perfection and also may result in turning some unobjectionable transactions into avoidable preferences under Bankruptcy Code § 547. (The preference risk arises if more than ten days pass between the time a security interest attaches and the time it is perfected.) The Drafting Committee may consider including a Note that instructs the legislature to amend the applicable certificate of title act to reflect the result urged by the Study Committee. Unless adjustments were made to a certificate of title act itself, conflicting rules in the act and Article 9 could create confusion and uncertainty.

8. **Compliance with Other Statute as Equivalent of Filing.** Both existing Section 9-302(4) and draft Section 9-302(d) provide that compliance with a statute or treaty described in Section 9-302(c) (existing Section 9-302(3)) "is equivalent to the filing of a financing statement." The meaning of this 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. There are at least three separate approaches for applying Article 9 filing rules to compliance with other statutes and treaties. First, as discussed in Note 7 above, there are rules such as the rule establishing time of perfection (draft Section 9-403(a)) that the Reporters believe should be determined by the other statutes themselves. Second, some Article 9 filing rules can be applied to perfection under other statutes or treaties by revisions to the Article 9 text. Examples are draft Section 9-302(b), discussed in Note 3 above, and draft Section 9-408. Third, other Article 9 rules may be made applicable to security interests perfected by compliance with another statute through the "equivalent to . . . filing" provision in the first sentence of draft Section 9-302(d). The Reporters suggest that the third approach be reflected for the most part in the Official Comments. For an example of this approach, see Note 11 to draft Section 9-306. Similar Comments could be added to reflect the applicability of other "filing" provisions when perfection is accomplished under draft Section 9-302(d), such as draft Section 9-402(h) (concerning errors that are not seriously misleading). In the alternative, the Official Comments to Section 9-302 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.

9. **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 draft Section 9-103(c)(5) in which to (re)perfect 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 existing 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, as the Report observes, the "solution" may not work. Report, 176. Existing 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."

The draft would resolve this conflict in draft Sections 9-103(c)(5), 9-302(d), and 9-305(b) to provide that a security interest that remains perfected solely by virtue of Section 9-103(c)(5) can be (re)perfected by the secured party's taking possession of the collateral.

SECTION 9-303. WHEN SECURITY INTEREST IS PERFECTED; CONTINUITY OF PERFECTION. [MINOR STYLE CHANGES ONLY]

(a) A security interest is perfected if it has attached and all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9-115, 9-302, 9-304, 9-305, and 9-306. If such steps are taken before the security interest attaches, it is perfected when it attaches.

(b) If a security interest is originally perfected in any way permitted under this article and is subsequently perfected in some other way under this article, without an intermediate period when it was unperfected, the security interest is perfected continuously for the purposes of this article.

SECTION 9-304. PERFECTION OF SECURITY INTERESTS IN INSTRUMENTS, DEPOSIT ACCOUNTS, DOCUMENTS, AND GOODS COVERED BY DOCUMENTS; PERFECTION BY PERMISSIVE FILING; TEMPORARY PERFECTION WITHOUT FILING OR TRANSFER OF POSSESSION.

(a) A security interest in instruments, deposit accounts, chattel paper, or negotiable documents may be perfected by filing. A security interest in money can be perfected only by the secured party's taking possession, except as otherwise provided in Section 9-306(e) for cash proceeds.

(b) During the period that goods are in the possession of the issuer of a negotiable document for the goods, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during the such period is subject thereto.

(c) A security interest in goods in the possession of a bailee other than one that has issued a negotiable document for the goods is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.

(d) A security interest in instruments, certificated securities, or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(e) A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument, a certificated security, a negotiable document, or goods in possession of a bailee other than one that has issued a negotiable document for the goods

(1) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange, but priority among conflicting security interests in the goods is subject to Section 9-312(c); or

(2) delivers the instrument or certificated security to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal, or registration of transfer.

(f) After the 21-day period in subsections (d) and (e) perfection depends upon compliance with the applicable provisions of this article.

Reporters' Explanatory Notes

1. **Instruments.** The Study Committee recommended the revision of Article 9 to permit perfection of a security interest in an instrument by filing. Recommendation 18.A. The Study Committee's recommendation was based largely on perceived cost savings that could be realized from the change. The Drafting Committee generally agrees with the Recommendation, and draft subsection (a), the language of which has not yet been reviewed by the Drafting Committee, gives effect to the Recommendation. Section 9-115(4)(b), recently promulgated in conjunction with Revised Article 8, likewise permits perfection by filing for security interests in investment property, including security certificates.

There is a generally accepted need to enable a purchaser of an instrument (including a secured party) which takes possession to take the instrument free of undisclosed claims. Existing Section 9-309 provides that a filed financing statement does not constitute notice that would preclude a subsequent purchaser from becoming a holder in due course. Under draft Section 9-308, purchasers that take possession of an instrument and give new value generally would achieve priority over a security interest in the instrument perfected by filing. Draft Sections 9-304(a) and 9-308 would provide fully parallel treatment for security interests in chattel paper and instruments. An alternative approach, which the Drafting Committee has yet to consider, would be to subordinate a security interest in an instrument perfected by filing to one perfected by possession. This is the approach that Article 9 now takes with respect to security certificates in Section 9-115(6).

2. **Deposit Accounts.** Draft subsection (a) also provides that a security interest in a deposit account can be perfected by filing. This is consistent with existing Section 9-115(4)(b), which permits perfection by filing for investment property, including security entitlements and securities accounts.

SECTION 9-305. WHEN POSSESSION BY SECURED PARTY PERFECTS SECURITY INTEREST WITHOUT FILING.

(a) A security interest in goods, instruments, money, negotiable documents, or chattel paper may be perfected by the secured party's taking possession of the collateral.

(b) A security interest in goods covered by a certificate of title issued by this State may be perfected by the secured party's taking possession of the collateral only in the circumstances described in Section 9-103(c)(5).

(c) If collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without a relation back and continues only while possession is retained, unless otherwise specified in this article.

(d) A security interest may be otherwise perfected as provided in this article before or after the period of possession by the secured party.

Reporters' Explanatory Note

New subsection (b) is necessary to effect the changes described in Note 9 to draft Section 9-302. The Drafting Committee has not yet discussed Section 9-305.

SECTION 9-305A. PERFECTION BY CONTROL.

(a) A security interest in a deposit account or investment property may be perfected by control of the collateral (Section 9-117 or 9-115).

(b) A security interest is perfected by control from the time the secured party obtains control [without a relation back] and continues only while control is retained[, unless otherwise specified in this article].

(c) A security interest may be otherwise perfected as provided in this article before or after the period of control by the secured party.

Reporters' Explanatory Note

This section provides a single statement of the rules for perfecting security interests in deposit accounts and investment property by control. Perfection of security interests in investment property by control is provided in existing Section 9-115(4)(a), recently added in conjunction with Revised Article 8. The Drafting Committee may wish to reorganize other portions of the rules now found in Section 9-115. For the time being, however, this draft does not include any changes to that section.

SECTION 9-306. "PROCEEDS"; SECURED PARTY'S RIGHTS ON DISPOSITION OF COLLATERAL; SECURED PARTY'S RIGHTS IN PROCEEDS.

(a) "Proceeds" includes the following property:

(1) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;

(2) whatever is collected on, or distributed on account of, collateral;

(3) rights arising out of collateral;

(4) to the extent of the value of collateral, claims arising out of the loss or non-conformity of, defects in, or damage to the collateral; and

(5) to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or non-conformity of, defects in, or damage to the collateral.

(b) Money, checks, deposit accounts, and the like are "cash proceeds." All other proceeds are "noncash proceeds."

(c) Except as otherwise provided by this article, a security interest continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest in the security agreement or otherwise, and also attaches to any identifiable proceeds.

[Subsection (d) -- Alternative A]

(d) Nothing in this article prohibits the application of other law, including equitable tracing rules, to determine whether proceeds that are commingled with other property are identifiable.

[Subsection (d) -- Alternative B]

(d) Proceeds that are commingled with other property are identifiable proceeds:

(1) if the proceeds are goods, to the extent provided by Section 9-315; and

(2) if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing that is available under other law with respect to commingled property of the type involved.

(e) A security interest in proceeds is a perfected security interest if the interest in the original collateral was perfected. The security interest in proceeds ceases to be a perfected security interest and becomes unperfected on the 21st day after the security interest attaches to the proceeds unless:

(1) a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the office or offices where the financing statement has been filed and, if the proceeds are acquired with cash proceeds or funds from a deposit account, the description of collateral in the financing statement indicates the type of property constituting the proceeds;

(2) the proceeds are identifiable cash proceeds; or

(3) the security interest in the proceeds is perfected before the 21st day after the security interest attaches to the proceeds.

(f) Except as provided in subsection (e), a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in this article for original collateral of the same type.

(g) If a filed financing statement covers the original collateral, a security interest in proceeds that remains perfected under subsection (e)(1) becomes unperfected when the effectiveness of the filed financing statement lapses (Section 9-403) or is terminated (Section 9-404), but in no event before the 21st day after the security interest attaches to the proceeds.

Reporters' Explanatory Notes

1. **What Constitutes Proceeds.** Subsection (a) expands the definition of proceeds. It generally follows Study Committee Recommendations 15.A.1., 15.A.2., and 15.A.3. The Study Committee recommended that the Drafting Committee consider the issue of licenses of intellectual property; the draft includes in the definition of "proceeds" any property that a debtor acquires upon the license of collateral.

The phrase "whatever is distributed on account of, collateral," in subsection (a)(2), is broad enough to cover cash or stock dividends distributed on account of securities or other investment property that is original collateral. For that reason, the draft deletes a sentence added to existing subsection (1) in conjunction with Revised Article 8: "Any payments or distributions made with respect to investment property collateral are proceeds." Although UCC definitions generally do not control the meaning of terms found in the Bankruptcy Code, draft subsection (a)(2) might influence courts to reject the reasoning of cases such as Hastie v. FDIC, 2 F.3d 1042 (10th Cir. 1993), which held that post-petition cash dividends on stock subject to a pre-petition pledge are not proceeds protected under Bankruptcy Code § 552(b).

The deletion of the phrase "or proceeds" in draft subsection (a)(1) is not intended to work a change in meaning. The same idea, that proceeds of proceeds are themselves proceeds, is expressed in the revised definition of "collateral" in draft Section 9-105.

When collateral is sold subject to a security interest and the buyer then resells the collateral, a question may arise under current law concerning whether the "debtor" has "received" what the buyer received on resale and, therefore, whether those receipts are "proceeds." See existing Section 9-306(2). Under this draft, there is 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.

2. **Authorized Dispositions.** Subsection (c) derives from existing subsection (2). The changes are intended to conform that subsection to subsection (a) and to make clear that it addresses authorized dispositions "free of" security interests. See P.E.B. Commentary No. 3. This change 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.

3. **Identifiability; Tracing.** The Study Committee recommended that either Section 9-306 or the Official Comment be revised to recognize that courts should apply non-UCC tracing principles in order to determine whether cash proceeds are "identifiable." Recommendation 15.C. The Study Committee deferred to the views of the Drafting Committee concerning whether it would be better to revise the statute or, instead, the Official Comment. Some members of the Drafting Committee favor addressing the issue in the Official Comments rather than the statute. Alternatives A and B of draft subsection (d), on the other hand, respond to the view of a majority of the Drafting Committee members, who would prefer a statutory approach. However, both alternatives defer to

other law for the substance of tracing rules. Alternative A makes clear that Article 9 does not interfere with otherwise applicable tracing rules. Alternative B provides an affirmative direction to look to non-Article 9 tracing rules.

Any effort to codify the details of tracing principles could be difficult and might result in a complex statutory treatment. Some members of the Drafting Committee favor a statutory statement of the rules nonetheless. Following is a sample formulation that would codify the "lowest intermediate balance rule" of tracing, a rule that courts have applied when determining identifiability under existing Section 9-306. Even this extended formulation lacks some details of the rule.

(x) Proceeds that are commingled with other property are identifiable proceeds to the extent:

(1) provided by Section 9-315 for proceeds that are goods,

(2) that the proceeds are cash proceeds and are identified by applying the lowest intermediate balance rule under subsection (y), and

(3) that the proceeds are not goods, are not cash proceeds, or are cash proceeds not governed by subsection (y), and are identified by a method of tracing that is available under other law with respect to commingled property of the same type.

(y) This subsection applies if identifiable cash proceeds and money, checks, or the like that are not cash proceeds are deposited to the same deposit account.

(1) If no reduction of the balance of the deposit account occurs after the deposit of identifiable cash proceeds to the deposit account, the deposit account is cash proceeds to the extent of the aggregate amount of the deposits of identifiable cash proceeds.

(2) Except as otherwise provided in paragraph (3), if any reduction of the balance of the deposit account occurs after the deposit of identifiable cash proceeds to the deposit account, the deposit account is cash proceeds to the extent of the lesser of (A) the amount provided in paragraph (1) and (B) the lowest intermediate balance of the deposit account following the first reduction of the balance.

(3) If money, checks, or the like that are not cash proceeds are deposited to the deposit account under circumstances that manifest the depositor's intention to make restitution for reductions under paragraph (2) of the extent to which the deposit account is cash proceeds, in applying paragraph (2) the aggregate amount of those deposits must be added to the amount specified in paragraph (2)(B).

4. **Automatic Perfection in Proceeds.** Current Section 9-306(3) provides that the security interest in proceeds is perfected automatically for ten days after the debtor receives the proceeds. The draft extends this period of automatic perfection to 20 days, commencing with the day the security interest

attaches to the proceeds. This is consistent with the Study Committee's recommendation that 10- and 21-day periods generally be changed to 20 days. See generally Report § 16.

5. **Proceeds Acquired with Cash Proceeds or Funds from Deposit Account.** Under existing Section 9-306, a lender (Lender) who takes a security interest in, say, equipment risks losing priority to a competing secured party (Bank) who claims the equipment as proceeds of its original collateral. Existing Section 9-306(3)(a) recognizes that, when the equipment was acquired with cash proceeds, Lender faces particular difficulty in determining whether the equipment constitutes Bank's proceeds. Under that section, if Lender discovers that the debtor paid for the equipment with cash or a check, then once the 10-day period of automatic perfection passes, Lender need not concern itself with any financing statements except those that refer to equipment. (In contrast, if the equipment were acquired in exchange for Bank's inventory-collateral, Bank's financing statement covering "inventory" would be sufficient to continue perfection in the equipment until lapse.)

Subsection (e)(1) of the draft applies the rule of existing Section 9-306(3)(a) to proceeds that have been acquired with funds from a deposit account serving as original collateral. Thus, if Bank or any third party claimed a security interest in the deposit account as original collateral, the security interest in the proceeds-equipment would become unperfected at the end of 20 days, unless a properly filed financing statement covering equipment were of record before the expiration of the period. Arguably the burden on Lender to discover Bank's security interest in the equipment as first-generation proceeds of the deposit account is less than would be the case if the equipment were second-generation proceeds of inventory. Nevertheless, the burden appears to be too great to require Lender to make further inquiry concerning the identity of the account from which payment was made and the status of that account. This burden is compounded if the security interest in the deposit account is perfected only by control.

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

6. **Continuation of Perfection in Cash Proceeds.** Existing 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 10-day period of automatic perfection. Draft subsection (e)(2) responds to the Study Committee's recommendation that the benefits of existing paragraph (3)(b) "be extended to proceeds of original collateral in which a security interest is perfected by a method other than filing." See Recommendation 15.D.

The Study Committee also recommended that when a security interest in cash proceeds continues to be perfected beyond the proposed 20-day period, the perfected status should lapse if the filing covering the original collateral lapses or if the security interest in the original collateral otherwise ceases to be perfected. Recommendation 15.E.5. The Drafting Committee has considered statutory formulations that would give effect to that recommendation. These formulations necessarily brought additional complexity. Accordingly, the Drafting Committee

reconsidered the wisdom of conditioning the continuance of perfection in cash proceeds on the continued effectiveness of the filing or other means of perfection in respect of the original collateral. Given the inherent vagaries of tracing and the fleeting nature of cash proceeds, a majority of the Drafting Committee members prefer a simpler rule that provides for permanent perfection of security interests in identifiable cash proceeds. Draft subsection (e)(2) reflects this view.

7. **Transferees of Cash Proceeds.** The Study Committee recognized that the current 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 the payee of a check drawn on a deposit account. This issue is addressed by draft Section 9-308A and the accompanying Notes.

8. **Obligations of Account Debtors on Proceeds.** The Study Committee recommended that Section 9-318 and its Official Comment be revised to make it clear that the rules of that section "apply to all account debtors, including account debtors on general intangibles that are proceeds." Recommendation 15.B.1. It also recommended revisions to that section and its Official Comment in order to clarify that the term "assignee" includes a secured party claiming proceeds and "is not limited to an outright buyer of an account." Recommendation 15.B.2. The draft does not include revisions to the text of Section 9-318 to address this issue. Instead, it contemplates revisions to the Official Comments that would explain and clarify these issues along the lines of the discussion of Recommendation 15.B. in the Report.

9. **Insolvency Proceedings.** Following Recommendation 15.G., the draft deletes existing subsection (4), which deals with proceeds in insolvency proceedings. A strong consensus has emerged to the effect that there is no justification for a proceeds rule applicable only in insolvency proceedings.

10. **Returned and Repossessed Goods.** In accordance with Recommendation 15.H., the draft also deletes subsection (5) of Section 9-306, which deals with returned and repossessed goods. With respect to this issue, the Study Committee recommended revisions to Section 9-308, which are addressed in draft Section 9-308, as well as revisions to the Official Comments to Article 9, in order "to explain and clarify the application of priority rules to returned and repossessed goods in the absence of Section 9-306(5)." The Notes to draft Section 9-308 contain proposed Official Comments that address returned and repossessed goods as proceeds of chattel paper.

11. **Compliance Equivalent to Filing.** As noted in Note 8 to Section 9-302, existing Section 9-302(4) and draft Section 9-302(d) provide that compliance with a statute or treaty described in Section 9-302(c) (existing Section 9-302(3)) (e.g., a certificate of title statute) "is equivalent to the filing of a financing statement." To make clear that the reference to a filed financing statement in draft Section 9-306(e)(1) embraces compliance with such a statute, the Official Comments might be revised along the following lines:

> Section 9-302(d) provides that compliance with the perfection requirements of a statute or treaty described in Section 9-304(c) "is equivalent to the filing of a financing statement." It follows that collateral subject to a security interest perfected by such compliance

under Section 9-302(d) is covered "by a filed financing statement" within the meaning of paragraph (1) of Section 9-306(e).

SECTION 9-307. PROTECTION OF BUYERS OF GOODS. [MINOR STYLE CHANGES ONLY]

(a) A buyer in ordinary course of business (Section 1-201(9)) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by the buyer's seller even if the security interest is perfected and even if the buyer knows of its existence.

(b) A buyer of consumer goods takes free of a security interest even if perfected if the buyer buys without knowledge of the security interest, for value and for the buyer's own personal, family or household purposes, unless before the buyer's purchase the secured party filed a financing statement covering the goods.

(c) A buyer other than a buyer in ordinary course of business takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the buyer's purchase, or more than 45 days after the purchase, whichever first occurs, unless made pursuant to a commitment entered into without knowledge of the buyer's purchase and before the expiration of the 45 day period.

SECTION 9-308. PURCHASE OF CHATTEL PAPER AND INSTRUMENTS.

(a) A purchaser of chattel paper or an instrument has priority over a security interest in the chattel paper or instrument and, except as otherwise provided in Section 9-312(g), in the proceeds of either if the purchaser, in the ordinary course of the purchaser's business and without knowledge that the

purchase violates the rights of the secured party, gives new value and takes possession of the chattel paper or instrument.

(b) For purposes of subsection (a), if chattel paper or an instrument indicates that it has been assigned to an identified assignee, a purchaser of the chattel paper or instrument has knowledge that the purchase violates the rights of the assignee.

Reporters' Explanatory Notes

1. **General Approach.** The Study Committee recommended that Section 9-308 be revised.

> Section 9-308 should be revised either to (i) eliminate the distinction between subsections (a) and (b) by creating a single set of circumstances under which a purchaser of chattel paper achieves priority over an earlier-perfected security interest or to (ii) clarify the bifurcated standards established by clauses (a) and (b).

Recommendation 21.A.

Draft Section 9-308 reflects the first alternative presented by Recommendation 21.A. -- it creates a single test for priority instead of the bifurcated test of the current subsections (a) and (b). It borrows the "violation of rights" standard from the definition of "buyer in ordinary course of business" in Section 1-201(9). Clarifying the existing bifurcated standards probably would result in undesirable complexity and detail. (P.E.B. Commentary No. 8 consumed eight full printed pages in clarifying clauses (a) and (b).)

2. **"Ordinary Course"; "New Value."** The draft 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 latter, the draft deletes existing Section 9-108 and adds to draft Section 9-105 a new definition of the term "new value." See draft Section 9-105 and Note 11; Section 9-108 and Note.

3. **Priority in Proceeds.** The Study Committee also recommended that Section 9-308 be revised to accommodate the proposed deletion of existing Section 9-306(5).

> Section 9-308 should be revised to provide that the priority afforded thereunder to purchasers of chattel paper also extends to the goods covered by the chattel paper if the transferor reacquires an interest (other than a bare possessory interest) in the goods.

Recommendation 15.I.

Draft Section 9-308 responds to Recommendation 15.I. by stating a general principle: the priority afforded a purchaser extends to proceeds of the chattel paper or instrument. Although the Study Committee's recommendation called only for a revision that would address returned and repossessed goods as proceeds, the draft reflects a more general statement of the priority principle. Currently, Article 9 is silent as to the priority of a security interest in proceeds of chattel paper when a purchaser qualifies for priority under Section 9-308. A similar silence under the pre-1972 Article 9 led the drafters to explicate the treatment of proceeds of collateral that qualifies for purchase money priority under existing subsections (3) and (4) of Section 9-312. The Drafting Committee may consider whether the statute should make explicit that the purchaser acquires priority in proceeds regardless of whether the purchaser perfects as to the proceeds.

4. **Priority in Returned and Repossessed Goods.** The Study Committee also recommended that the Drafting Committee revise the Official Comments to Article 9 in order "to explain and clarify the application of priority rules to returned and repossessed goods in the absence of Section 9-306(5)." Recommendation 15.J. The following draft Official Comment derives substantially from the discussion of Recommendations 15.H., I., and J. in the Report. (Note that, as written, draft Section 9-308 makes no explicit reference to returned or repossessed goods.)

X. Returned and repossessed goods may constitute proceeds of chattel paper. Consider the following 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). Secured Party 2 (SP-2) purchases the chattel paper from Dealer and takes possession of the paper 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.

The following discussion explains the treatment of returned and repossessed goods as proceeds of chattel paper in the context of this example.

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 9-306(c)). Pursuant to Section 9-308, 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 9-105(a)(4) (defining "chattel paper"), (a)(18) (defining "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 were entitled to reject or revoke acceptance of the goods. See Section 2-602 (rejection); Section 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 Section 9-206; Section 9-318(a). 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 an "in kind" collection on or distribution on account of the chattel paper. See Section 9-306(a). 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 be perfected. See Section 9-306(e)(1).

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 9-306(e)(1). However, if the 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 9-306(e)(3). Nevertheless, SP-2's unperfected security interest in the goods would be senior to SP-1's security interest under Section 9-308. 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 9-504(n).

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 9-308. 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 9-308.

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. Section 1-201(37); Section 9-102(a)(2). 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 9-306(c). 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 9-308 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.

Assignment of Lease Chattel Paper.

Chattel paper includes not only writings that evidence security interests in specific goods but also those that evidence true leases of goods. Section 9-105(a)(4) (defining "chattel paper").

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 Section 2A-307(3); Section 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 9-308 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 9-312(h)(1).

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 9-308, 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.

5. **Legend on Chattel Paper.** New subsection (b) provides a statutory basis for the common practice of placing a "legend" on chattel paper to indicate that it has been assigned. The legend would cause a purchaser to have wrongful knowledge for purposes of subsection (a), thereby preventing the purchaser from qualifying for priority under that subsection, even if the purchaser did not have actual knowledge.

SECTION 9-308A. TRANSFER OF FUNDS FROM DEPOSIT ACCOUNT.

If a transferee of funds from a deposit account [gives value for the transfer and] does not know at the time of the transfer that the transfer is wrongful as to the holder of a security interest in the deposit account, the transferee is not liable to any person on any legal or equitable theory based upon the security interest and takes the funds free of the security interest.

Reporters' Explanatory Notes

1. **Background.** Draft Section 9-308A protects certain transferees of funds from a deposit account against security interests in the deposit account. Some background may be useful before turning to the section itself.

A security interest may attach in a deposit account as proceeds under current law. See existing Section 9-306(1). Consider, for example, a seller of goods who takes in exchange the cash proceeds of SP's collateral (e.g., money or a check drawn on a deposit account containing only proceeds). Standing alone, existing Section 9-306(2) might suggest that the payment remains subject to a security interest, so that SP might enjoy a cause of action against seller. This would be the wrong result.

Official Comment 2(c) to Section 9-306 provides to the contrary (at least as to the check), stating as follows:

> Where cash proceeds are covered into the debtor's checking account and paid out in the operation of the debtor's business, recipients of the funds of course take free of any claim which the secured party may have in them as proceeds. What has been said relates to payments and transfers in ordinary course.

The existing Official Comment is problematic. Recent cases that have grappled with issues of this kind have focused on the undefined phrase "ordinary course." In J.I. Case v. First National Bank, 991 F.2d 1272 (7th Cir. 1993), for example, the court reached the right result but only after subjecting the Comment to the same rigorous linguistic analysis that one properly would apply only to statutes (the court relied in part on the definition of "buyer in ordinary course"). Read in this manner, the Comment's limitations are obvious: it makes no mention of cash payments, nor does it address ordinary-course payments by consumers and other non-business entities.

The Study Committee was of the view that, insofar as the rights of purchasers are concerned, a security interest in cash proceeds should be treated no differently from any other encumbrance or other defect in the transferor's title. A body of non-UCC law addresses the rights of those who receive funds (cash or bank credit) in which a third party claims an interest. See, e.g., Restatement (Second) of Contracts § 342 (1981) (Successive Assignees from the Same Assignor); Restatement of Restitution § 126 (1937) Rights of Intended Payee or Grantee. Business Transaction.). The Study Committee recommended that the Official Comments be revised to make clear that a good faith purchaser for value of money proceeds or of funds from a deposit account containing cash proceeds cuts off a security interest in the proceeds to the extent that the purchaser would take free of other claims to that property. See Recommendation 15.F. This approach is consistent with PEB Commentary No. 7, concerning the rights of junior secured parties who receive collections on accounts, chattel paper, and general intangibles. Examples of other sources of law that would be useful in sorting out the conflicting claims to cash proceeds include the law governing restitution, finality of payment, and the negotiability of money.

2. **Draft's Approach.** Some have expressed concern that including deposit accounts as original collateral, as the draft does, will exacerbate the problems that currently exist with deposit accounts as cash proceeds. Draft Section 9-308A is an alternative to reliance upon non-UCC law. It would provide a statutory rule for transferees of funds from deposit accounts. To qualify under draft Section 9-308A(a)(1), the transferee must be free of wrongful knowledge at the time of the transfer. An additional requirement, that the transferee give value, appears in brackets to indicate that the Drafting Committee has not yet taken a position on that point.

Draft Section 9-308A both exculpates a qualifying transferee from liability and provides that the transferee takes the funds free of a security interest. It is inspired in part by Sections 8-502 and 8-510 of Revised Article 8. Failure to qualify for protection under draft Section 9-308A would mean that otherwise applicable provisions of Article 9 would apply, together with any supplemental principles of law and equity that Article 9 does not displace. See Section 1-103.

The Drafting Committee favors a statutory rule that would ensure that security interests in deposit accounts do not inhibit or cloud the free transferability of funds; however, it has not reviewed or approved the text of draft Section 9-308A. The Drafting Committee discussed an earlier, substantially more complex draft of Section 9-308A, which dealt generally with purchases of cash collateral. Subsequent discussions suggest that the more limited approach of draft Section 9-308A is preferable. The draft focuses only on the transfer of funds from a deposit account subject to a security interest, which is the only problem that is caused by Article 9's coverage of deposit accounts. Competing claims to the deposit account itself are dealt with by other Article 9 priority rules. See draft Section 9-301(a); Section 9-312(g); Section 9-312A; Section 9-318A. If the debtor obtains a cashier's check with the funds, the rules governing competing claims to instruments will control thereafter. See Section 3-306; Section 9-309. If the debtor withdraws money (currency), then the rules of Article 9, supplemented by the common law relating to money, apply. Section 9-308A applies only to transactions in which funds are transferred to a transferee by means of a check drawn on the deposit account or a funds transfer from the deposit account.

SECTION 9-309. PROTECTION OF PURCHASERS OF INSTRUMENTS, DOCUMENTS, AND SECURITIES. [MINOR STYLE CHANGES ONLY] Nothing in this article limits the rights of a holder in due course of a negotiable instrument (Section 3-302) or a holder to whom a negotiable document of title has been duly negotiated (Section 7-501) or a protected purchaser of a security (Section 8-303) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under

this article does not constitute notice of the security interest to such holders or purchasers.

SECTION 9-310. PRIORITY OF CERTAIN LIENS ARISING BY OPERATION OF LAW. [MINOR STYLE CHANGES ONLY] When a person in the ordinary course of the person's business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of the person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

SECTION 9-311. ALIENABILITY OF DEBTOR'S RIGHTS. [MINOR STYLE CHANGES ONLY] A debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of a security interest, attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default.

SECTION 9-312. PRIORITIES AMONG CONFLICTING SECURITY INTERESTS IN THE SAME COLLATERAL.

(a) The rules of priority stated in other sections of this part and in the following sections govern when applicable: Section 4-210 with respect to the security interests of collecting banks in items being collected, accompanying documents and proceeds; Section 9-103 on security interests related to other jurisdictions; Section 9-114 on consignments; Section 9-115 on security interests in investment property.

(b) A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that the earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.

(c) A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and, except as otherwise provided in subsection (X-R), also has priority in its identifiable cash proceeds received on or before the delivery of the inventory to a buyer if

(1) the purchase money security interest is perfected at the time the debtor receives possession of the inventory;

(2) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the 21 day period if the purchase money security interest is temporarily perfected without filing or possession (Section 9-304(e));

(3) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(4) the notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing the inventory by item or type.

(d) A purchase money security interest in collateral other than inventory, investment property, or a deposit account has priority over a conflicting security interest in the same collateral and, except as otherwise provided in subsection (X-R), also has priority in its identifiable proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter.

(e) If a debtor acquires property subject to a security interest created by another person:

(1) if the security interest is perfected at the time the debtor acquires the property and there is no period thereafter when it is unperfected, any security interest created by the debtor is subordinate to the security interest created by the other person, notwithstanding anything to the contrary in this section; and

(2) if the security interest created by the other person is unperfected at the time the debtor acquires the property or at any time thereafter, the other applicable subsections of this section govern.

[Subsection (f) -- Alternative A]

(f) The time when a new debtor becomes bound by a security agreement entered into by an original debtor is the time of filing as to collateral for purposes of subsection (h).

[Subsection (f) -- Alternative B]

(f) A security interest that is perfected by a filed financing statement that is effective solely under Section 9-402A(a) and (b)(1) in collateral in which a new debtor has or acquires rights is subordinate to a security interest in the same collateral that is perfected in another manner.

(g) Priority between conflicting security interests in the same deposit account is governed by the following rules:

(1) A security interest held by a secured party that has control over the deposit account has priority over a conflicting security interest held by a secured party that does not have control.

(2) Except as otherwise provided in paragraphs (3) and (4), security interests perfected by control rank equally.

(3) Except as otherwise provided in paragraph (4), a security interest held by the depositary institution with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.

(4) A security interest perfected by control pursuant to Section 9-117(a)(3) has priority over a security interest held by the depositary institution with which the deposit account is maintained.

(h) In all cases not governed by other rules stated in this section, including cases of purchase money security interests and security interests in deposit accounts that do not qualify for the special priorities set forth in subsection (g), priority between conflicting security interests in the same collateral is determined according to the following rules:

(1) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, if there is no period thereafter when there is neither filing nor perfection.

(2) So long as conflicting security interests are unperfected, the first to attach has priority.

(i) For the purposes of subsection (h) a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.

(j) If future advances are made while a security interest is perfected by filing, by the taking of possession, by control, or under Section 9-115 or 9-116 on investment property, the security interest has the same priority for the purposes of subsection (h) or Section 9-115(e) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made.

Reporters' Explanatory Notes

1. **Purchase Money Priority.** Draft subsection (d) follows Recommendation 14.F. It extends from 10 days to 20 days the "grace period" for achieving purchase money priority in non-inventory collateral found in existing Section 9-312(4). It also excludes from that purchase money priority rule investment property and deposit accounts as well as inventory.

2. **"Double Debtor" Problem.** Draft subsection (e) responds to Study Committee Recommendation 17.H. (Report, at 149-51). It addresses the "double debtor" problem created when a debtor acquires property that is subject to a security interest created by another debtor. In the simplest example, A sells an item of its equipment to B, not in the ordinary course of business. The equipment is subject to a security interest in favor of SP-A. If SP-A's security interest is perfected, B will acquire its interest subject to SP-A's security interest. See draft Section 9-201; Section 9-301(a)(3). Under draft subsection (e)(1), if B creates a security interest in the equipment in favor of SP-B, SP-B's interest also is subject 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. This result is premised on the belief that 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.

If SP-A's security interest is unperfected, B will take free of it as long as B gives value and takes delivery of the equipment without knowledge of the security interest. See draft Section 9-301(a)(3). If B takes free of SP-A's security interest and then creates a security interest in favor of SP-B, no priority issue arises; SP-B has the only security interest in the equipment. Suppose, however, 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 and SP-B perfects its security interest, then under draft subsection (e)(2) the priority rules of Section 9-312 other than subsection (e) govern. Under Section 9-312(h)(1) (existing Section 9-312(5)(a)), 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.

If SP-A's interest is perfected when B acquires the equipment but for some reason SP-A's security interest later becomes unperfected, under draft subsection (e)(2) the priority rules of Section 9-312 other than subsection (e) govern. For example, if SP-A's financing statement were to lapse and SP-B's security interest were perfected, SP-B's security interest then would become senior to SP-A's security interest. See draft Section 9-312(h)(1); Section 9-403(j).

3. **New Debtors.** Draft subsection (f) addresses the priority contest that arises when a new debtor becomes bound by the security agreement of an original debtor and each has a secured creditor. The general subject of new debtors is addressed in the Notes to draft Section 9-402A, and the priority issue is discussed in Note 4 to that section. Alternative A of draft subsection (f) makes the time that the new debtor becomes bound the filing date for the original debtor's secured party. Alternative B subordinates the original debtor's secured party's security interest perfected under draft Section 9-402A to security interests in the same collateral perfected in another manner. Although the Drafting Committee favors a priority rule along these lines, it has not approved the statutory language.

4. **Deposit Accounts: Priority of Depositary Institution.** The special priority rules in subsection (g) are derived from Revised Article 8. The Drafting Committee has approved their substance but has not reviewed the statutory language. The rules do not apply to accounts evidenced by an instrument (e.g., certain CD's), which by definition are not "deposit accounts." Under draft paragraph (3), the security interest of the depositary institution with which the deposit account is maintained normally takes priority over all other conflicting security interests in the deposit, regardless of whether the conflicting security interest was perfected by filing or by control and regardless of whether the deposit account constitutes the competing secured party's original collateral or its proceeds. A rule of this kind enables depositary institutions 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 depositary institution's customer (i.e., by having the account in its name). Under subsection (g)(4), this arrangement operates to subordinate the depositary institution's security interest. Alternatively, the secured party can obtain an express subordination agreement from the depositary institution. See Section 9-316.

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 depositary institution 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 would risk being subordinated.

5. **Deposit Accounts: Control.** Under draft subsection (g)(1), security interests perfected by control take priority over those perfected by filing or otherwise. The section reflects the view that 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 (g)(2) governs the case (expected to be very rare) in which a depositary institution enters into a Section 9-117(a)(2) control agreement with more than one secured party. If the depositary institution is solvent, there is no need for a priority rule. If not, the security interests rank equally.

6. **Deposit Accounts: Priority in Proceeds.** The priority afforded by subsection (g) is not intended to extend to proceeds of a deposit account. Accordingly, subsection (h), the first-to-file-or perfect rule, will govern priorities in proceeds. This means that a secured party who obtains control but who nevertheless leaves the debtor with the power (but perhaps not the right) to withdraw from the deposit account would not be entitled to special priority. Rather, the secured party who obtained control would be subordinate to a competing secured party who filed earlier. This result would obtain regardless of whether the earlier filing covered the deposit account or other collateral whose proceeds were deposited into the deposit account. Draft Section 9-306(e) addresses continuation of perfection in proceeds of deposit accounts. As to funds transferred from a deposit account that serves as collateral, see draft Section 9-308A.

7. **Future Advances.** Draft subsection (j) derives from existing Section 9-312(7). The draft adds security interests in deposit accounts perfected by control to those in respect of which subsection (h) (first-to-file-or-perfect) and not the time of an advance determines priority.

SECTION 9-312A. EFFECTIVENESS OF RIGHT OF RECOUPMENT OR SET-OFF AGAINST DEPOSIT ACCOUNT.

(a) Except as otherwise provided in subsection (b), the depositary institution with which a deposit account is maintained may exercise against a secured party that holds a security interest in the deposit account any right of recoupment and any right of set-off.

(b) The exercise by a depositary institution of a set-off against a deposit account is ineffective against a secured party that holds a security interest in the deposit account that is perfected by control pursuant to Section 9-117(a)(3).

Reporters' Explanatory Notes

1. **General Approach.** This section resolves the conflict between a security interest in a deposit account and the depositary institution'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 draft Section 9-104(i). The issue has been the subject of much dispute under existing Article 9. The Drafting Committee considered several approaches, ranging from leaving resolution of the issue to non-UCC law to codifying the entire law of setoff in Article 9.

Subsection (a) states the general rule and provides that the depositary bank may effectively exercise rights of recoupment and set-off against the secured party. Subsection (b) contains an exception: if the secured party has control under draft Section 9-117(a)(3) (i.e., if it has become the depositary institution's customer), then any setoff exercised by the depositary institution is ineffective. This result is consistent with the priority rule in draft Section 9-312(g)(4), under which the security interest of a depositary institution in a deposit account is subordinate to that of a secured party that has control under draft Section 9-117(a)(3).

2. **Deposit Evidenced by Instrument.** Under draft Section 9-105, a deposit evidenced by an instrument (e.g., certain CD's) would not be a "deposit account." Accordingly, draft Section 9-312A would not apply to the depositary institution's right to set off against such an account. If the instrument is an Article 3 "instrument" and the secured party is a holder in due course (HDC), existing Article 9 makes clear that Article 3 would govern and the secured party would prevail. See Section 9-309 (protection of purchasers of instruments). But if the secured party is not a holder in due course, the result under existing Article 9 is uncertain: either the security interest prevails over the right of set-off under existing Section 9-201 or the secured party has the rights of any other non-HDC under Article 3 (in which case it might or might not prevail, depending on whether the right of set-off is a defense or claim in recoupment of the kind described in Section 3-305(a)(2) or (3)). A similar uncertainty arises under current law if the Article 9 instrument is not negotiable: either the secured party prevails over the right of set-off under Section 9-201 or the secured party has the rights of any other assignee under the common law or any applicable statute. The Drafting Committee has yet to determine whether to resolve these issues and, if so, how to do so.

SECTION 9-313. PRIORITY OF SECURITY INTERESTS IN FIXTURES.

[MINOR STYLE CHANGES ONLY]

(a) In this section and in the provisions of Part 4 of this article referring to fixture filing, unless the context otherwise requires

(1) goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law;

(2) a "fixture filing" is the filing in the office where a mortgage on the real estate would be filed or recorded of a financing statement covering goods which are or are to become fixtures and conforming to the requirements of subsection (a) of Section 9-402; and

(3) a mortgage is a "construction mortgage" to the extent that it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates.

(b) A security interest under this article may be created in goods that are fixtures or may continue in goods that become fixtures, but no security interest exists under this article in ordinary building materials incorporated into an improvement on land.

(c) This article does not prevent creation of an encumbrance upon fixtures under real estate law.

(d) A perfected security interest in fixtures has priority over the conflicting interest of an encumbrancer or owner of the real estate if

(1) the security interest is a purchase money security interest, the interest of the encumbrancer or owner arises before the goods become fixtures, the security interest is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the debtor has an interest of record in the real estate or is in possession of the real estate;

(2) the security interest is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the security interest has

priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the debtor has an interest of record in the real estate or is in possession of the real estate;

(3) the fixtures are readily removable factory or office machines or readily removable replacements of domestic appliances that are consumer goods, and before the goods become fixtures the security interest is perfected by any method permitted by this article; or

(4) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this article.

(e) A security interest in fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if

(1) the encumbrancer or owner has consented in writing to the security interest or has disclaimed an interest in the goods as fixtures; or

(2) the debtor has a right to remove the goods as against the encumbrancer or owner. If the debtor's right terminates, the priority of the security interest continues for a reasonable time.

(f) Notwithstanding paragraph (1) of subsection (d) but otherwise subject to subsections (d) and (e), a security interest in fixtures is subordinate to a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent that it is given to refinance a construction mortgage, a mortgage has this priority to the same extent as the construction mortgage.

(g) In cases not within the preceding subsections, a security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real estate that is not the debtor.

(h) If a secured party has priority over all owners and encumbrancers of the real estate, the secured party may, on default, subject to the provisions of Part 5, remove the collateral from the real estate but the secured party shall reimburse any encumbrancer or owner of the real estate that is not the debtor and that has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

SECTION 9-314. ACCESSIONS. [MINOR STYLE CHANGES ONLY]

(a) A security interest in goods that attaches before they are installed in or affixed to other goods takes priority as to the goods installed or affixed (called in this section "accessions") over the claims of all persons to the whole except as stated in subsection (c) and subject to Section 9-315(a).

(b) A security interest that attaches to goods after they become part of a whole is valid against all persons subsequently acquiring interests in the whole, except as stated in subsection (c), but is invalid against any person with an interest in the whole at the time the security interest attaches to the goods that has not in writing consented to the security interest or disclaimed an interest in the goods as part of the whole.

(c) The security interests described in subsections (a) and (b) do not take priority over

(1) a subsequent purchaser for value of any interest in the whole;

(2) a creditor with a lien on the whole subsequently obtained by judicial proceedings; or

(3) a secured party with a prior perfected security interest in the whole to the extent that the secured party makes subsequent advances;

if the subsequent purchase is made, the lien by judicial proceedings obtained or the subsequent advance under the prior perfected security interest is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the whole at a foreclosure sale other than a secured party with a perfected security interest purchasing at the secured party's own foreclosure sale is a subsequent purchaser under this section.

(d) When under subsections (a), (b), and (c) a secured party has an interest in accessions that has priority over the claims of all persons that have interests in the whole, the secured party may on default, subject to the provisions of Part 5, remove the collateral from the whole, but the secured party shall reimburse any encumbrancer or owner of the whole that is not the debtor and that has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

SECTION 9-315. PRIORITY IF GOODS ARE COMMINGLED OR PROCESSED. [MINOR STYLE CHANGES ONLY]

(a) If a security interest in goods was perfected and subsequently the goods or a part thereof become part of a product or mass, the security interest continues in the product or mass if

(1) the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass; or

(2) a financing statement covering the original goods also covers the product into which the goods have been manufactured, processed or assembled.

(b) In a case to which subsection (a)(2) applies, no separate security interest in that part of the original goods that has been manufactured, processed or assembled into the product may be claimed under Section 9-314.

(c) When under subsection (a) more than one security interest attaches to the product or mass, they rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.

SECTION 9-316. PRIORITY SUBJECT TO SUBORDINATION. [MINOR STYLE CHANGES ONLY] Nothing in this article prevents subordination by agreement by any person entitled to priority.

SECTION 9-317. SECURED PARTY NOT OBLIGATED ON CONTRACT OF DEBTOR. [MINOR STYLE CHANGES ONLY] The mere existence of a security interest or authority given to a debtor to dispose of or use collateral does not impose contract or tort liability upon a secured party for the debtor's acts or omissions.

SECTION 9-318. DEFENSES AGAINST ASSIGNEE; MODIFICATION OF CONTRACT AFTER NOTIFICATION OF ASSIGNMENT; TERM PROHIBITING ASSIGNMENT INEFFECTIVE; IDENTIFICATION AND PROOF OF ASSIGNMENT.

(a) Unless an account debtor has made an enforceable agreement not to assert defenses or claims arising out of a sale as provided in Section 9-206 the rights of an assignee are subject to

(1) all the terms of the contract between the account debtor and assignor and any defense or claim arising therefrom; and

(2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment.

(b) So far as the right to payment or a part thereof under an assigned contract has not been fully earned by performance, and notwithstanding notification of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards is effective against an assignee unless the account debtor has otherwise agreed but the assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor.

(c) The account debtor is authorized to pay the assignor until the account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee. A notification that does not reasonably identify the rights assigned is ineffective. If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made and unless he does so the account debtor may pay the assignor.

[Subsection (d) -- Alternative A]

(d) An account debtor [who is a consumer debtor or a consumer obligor] is authorized to make all payments to the first assignee from whom the

account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee, whether or not (1) only a portion of an account, chattel paper, or general intangible has been assigned to that assignee, (2) a portion has been assigned to another assignee, or (3) the account debtor knows that the assignment to that assignee is limited.

[Subsection (d) -- Alternative B]

(d) An assignee shall not notify an account debtor [who is a consumer debtor or a consumer obligor] to make less than the full amount of any installment payment to the assignee, whether or not (1) only a portion of the account, chattel paper, or general intangible has been assigned to that assignee, (2) a portion has been assigned to another assignee, and (3) the account debtor knows that the assignment to that assignee is limited. An account debtor is under no obligation to comply with a notification that does not comply with this subsection.

(e) A term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in a general intangible for money due or to become due or requires the account debtor's consent to such assignment or security interest.

Reporters' Explanatory Note

It has become common in financing transactions to assign interests in a single obligation to more than one assignee. The draft offers two alternative approaches for protecting account debtors from multiple notifications and claims. The Drafting Committee has not yet evaluated the alternatives, nor has it determined whether protection should be afforded to all account debtors or only to consumers. Although the draft needs refinement, it is offered here as the basis for the Drafting Committee's further discussions.

SECTION 9-318A. DEPOSITARY INSTITUTION'S RIGHT TO DISPOSE OF FUNDS IN DEPOSIT ACCOUNT. Except as otherwise provided in Section 9-312A(b), and unless the depositary institution otherwise agrees [in writing], a

depositary institution's rights and duties with respect to a deposit account maintained with the depositary institution are not terminated, suspended, or modified by:

(a) the creation or perfection of a security interest in the deposit account;

(b) the depositary institution's knowledge of the security interest; or

(c) the depositary institution's receipt of instructions from the secured party.

Reporters' Explanatory Notes

1. This new 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 depositary institution'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 depositary institution's knowledge of the security interest. In addition, the section permits the depositary institution to ignore the instructions of the secured party unless it had agreed to honor them or unless other law provides to the contrary. Under the draft, 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 depositary institution, utilize the judicial process, or comply with procedures set forth in other law. The Official Comments might make clear that 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.

2. The general rule of this section is subject to draft Section 9-312A, under which the setoff or recoupment rights of the depository institution may not be exercised against a deposit account in the secured party's name. 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 9-312A, is the depositary institution'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 in control of the deposit account.

3. This section does not address the obligations of depositary institutions that issue instruments evidencing deposits (e.g., certain CD's).

PART 4

FILING

Reporters' Introductory Note to Part 4

The filing system is the heart of Article 9. Part 4, which governs the filing system, has been revised substantially, with a view toward reducing the costs of filing and searching the public records and reducing the burdens upon the filing office that Article 9 now imposes. Efforts also have been made to promote uniformity in the policies and practices of filing offices. The draft attempts to curtail the nearly unbridled discretion that existing Article 9 affords to filing offices. This discretion increases the costs to users of the system and conflicts with the goal of uniformity.

The proposed revisions stem largely from two new concepts that the draft introduces. These concepts are drawn from recommendations of the Study Committee (see Section 11 of the Report), from suggestions made by participants in the Article 9 Filing Project (a joint project sponsored by the University of Minnesota with the cooperation of the Conference), and the Drafting Committee (including members, advisors, and observers), and from preliminary deliberations of the Drafting Committee. First, the draft is "media neutral." It recognizes that one can "communicate" a "record" (both defined in draft Section 9-105) by means other than writing or other tangible media. This approach is designed to facilitate receipt, processing, maintenance, retrieval, reporting, and transmission of Article 9 filing data by means of electronic, voice, optical, and other technologies. In short, under the draft, a filing office may maintain and operate, in addition to or instead of a paper-based system, a non-paper-based system using any technology that will accomplish the purposes of the filing system.

Second, draft Section 9-413 provides for administrative rules to address details that are better left outside of the statute. While recognizing that each filing office may have particular needs, the provision for administrative rules stresses the importance of establishing uniform policies and procedures to the greatest extent possible. To this end, a set of model rules is being developed by participants in the Article 9 Filing Project. The Conference may wish to consider whether the draft appropriately allocates legal rules between the statute and the administrative rule.

In reviewing Part 4, the reader should keep in mind that draft Section 9-105 defines the term "financing statement" to include not only the original financing statement and amendments (or amended financing statements) but also the remaining parts of the package that constitute the complete financing statement of record -- assignments and continuation statements.

SECTION 9-401. PLACE OF FILING.

(a) Except as otherwise provided in subsection (b), if the law of this State governs perfection of a security interest (Section 9-103), the proper place to file a financing statement to perfect the security interest is:

(1) in the office where a mortgage on the real estate would be filed or recorded if the collateral is timber to be cut or is minerals or the like, including oil and gas, or accounts subject to Section 9-103(e), or the financing statement is filed as a fixture filing (Section 9-313) and the collateral is goods that are or are to become fixtures; [and]

[(2) in the office of the debtor's registered agent if the debtor has designated a registered agent under Section 9-409; and]

(3) in the office of [] in all other cases.

(b) Subject to Section 9-302(c), the proper place to file a financing statement to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of []. This financing statement constitutes a fixture filing (Section 9-313) as to the described collateral that is or is to become fixtures.

Legislative Note: The State should designate the filing office where the brackets appear. The filing office may be that of a governmental official (e.g., the Secretary of State) or a private party that maintains the State's filing system (see Section 9-410).

Reporters' Explanatory Notes

1. Draft Section 9-401(a) indicates where in a given State a financing statement is to be filed. Existing 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) no longer is substantial. Accordingly, the draft removes the Second and Third Alternatives of current Section 9-401(1), each of which provides for local filing under certain circumstances.

Draft subsection (a) dictates central filing for most situations, while retaining local filing for real-estate-related collateral and special filing provisions

for transmitting utilities. (The Drafting Committee has yet to consider whether the current definition of "transmitting utility" is adequate.) The elimination of alternatives for local filing for collateral such as farm products and consumer goods, and for dual (central and local) filing for businesses that have a place of business in only one county, makes it possible to delete three current subsections as unnecessary.

2. The Reporters distributed to the Drafting Committee a proposal under which a State would permit each debtor to select a "registered agent" to maintain financing statements and other Article 9 records pertaining to the debtor. Draft subsection (a)(2) provides for filing with such a registered agent, should the Drafting Committee elect to pursue this proposal.

SECTION 9-402. CONTENTS OF FINANCING STATEMENT; MORTGAGE AS FINANCING STATEMENT; EFFECTIVENESS OF FINANCING STATEMENT AFTER CERTAIN CHANGES; [AMENDMENTS] [AMENDED FINANCING STATEMENTS]; WHEN AUTHORIZATION REQUIRED; LIABILITY FOR UNAUTHORIZED FILING.

(a) A financing statement is sufficient only if it gives the names and mailing addresses of the debtor and the secured party or a representative of the secured party and contains a statement indicating the collateral covered by the financing statement. If the financing statement covers timber to be cut or covers minerals or the like, including oil and gas, or accounts subject to Section 9-103(e), or if the financing statement is filed as a fixture filing (Section 9-313) and the collateral is goods that are or are to become fixtures, the financing statement also must show that it covers this type of collateral, recite that it is to be filed [for record] in the real estate records, contain a description of the real estate [sufficient if it were contained in a mortgage of the real estate to give constructive notice of the mortgage under the law of this State], and, if the debtor does not have an interest of record in the real estate, show the name of a record owner.

Legislative Note: Language in brackets is optional.

(b) A real estate mortgage is effective as a financing statement filed as a fixture filing from the date of its recording only if:

(1) the mortgage contains a statement indicating the goods that it covers;

(2) the goods are or are to become fixtures related to the real estate described in the mortgage;

(3) the mortgage complies with the requirements for a financing statement in this section other than a recital that it is to be filed in the real estate records; and

(4) the mortgage is duly recorded.

(c) A financing statement sufficiently gives the name of the debtor:

(1) if the debtor is a registered entity, only if the financing statement gives the name of the debtor as shown on the public records of the debtor's jurisdiction of organization;

(2) if the debtor is a decedent's estate, only if the financing statement gives [the name of the decedent and indicates that the debtor is an estate];

(3) if the debtor is a trust, only if the financing statement indicates, in the debtor's name or otherwise, that the debtor is a trust and gives the name[, if any, specified for the trust in its organic documents or, if no name is specified, gives the name of the settlor and additional information sufficient to distinguish the debtor from other trusts having one or more of the same settlors];

(4) in other cases, only if it gives the individual, partnership, or association name of the debtor.

(d) A financing statement that sufficiently gives the name of the debtor is not rendered ineffective by the absence of trade or other names or names of partners.

(e) A financing statement may give the name of more than one debtor, may give, as an additional debtor, a trade or other name for the debtor, and may give the name of more than one secured party.

(f) The failure to indicate the representative capacity of a secured party or a representative of a secured party does not affect the sufficiency of the financing statement.

(g) A description of the collateral, an indication of the type of collateral, or a statement to the effect that the financing statement covers all assets or all personal property is sufficient to indicate the collateral that is covered by the financing statement.

(h) A financing statement substantially complying with the requirements of this section is effective even if it contains minor errors that are not seriously misleading. A financing statement that does not sufficiently give the name of the debtor is seriously misleading unless the filing office would discover the financing statement in a search of its records conducted [in accordance with a rule adopted pursuant to Section 9-413(c)(5)] in response to a request using the debtor's correct name, in which case the insufficiency of the debtor's name does not render the financing statement seriously misleading.

(i) If a debtor so changes its name that a filed financing statement becomes seriously misleading:

(1) the financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the change; and

(2) the financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless an [amendment to the] [amended] financing statement that renders the financing statement not seriously misleading is filed within four months after the change.

(j) A filed financing statement remains effective with respect to collateral that is sold, exchanged, leased, licensed, or otherwise disposed of and in which a security interest continues under Section 9-306(b), even if the secured party knows of or consents to the disposition.

(k) Except as otherwise provided in subsection (i) and Section 9-402A, a financing statement is not rendered ineffective if, after the financing statement is filed, the information contained in the financing statement becomes inaccurate and seriously misleading.

[Subsection (l) -- Alternative A]

(l) Subject to Section 9-406, a secured party of record may add or release collateral covered by a financing statement or otherwise amend the information contained in a financing statement by filing an amendment that identifies the original financing statement by the date of filing and the file number assigned under Section 9-403(m) or by another method prescribed by rule. An amendment does not extend the period of effectiveness of a financing statement. If an amendment adds collateral, it is effective as to the added collateral only from the filing date of the amendment.

[Subsection (l) -- Alternative B]

(l) Subject to Section 9-406, a secured party of record may add or release collateral covered by a financing statement or otherwise amend the information contained in a financing statement by filing an amended financing statement. An amended financing statement is sufficient only if it complies with

subsection (a) and, in addition, identifies the original financing statement by the date of filing and the file number assigned under Section 9-403(m) or by another method prescribed by rule. The filing of an amended financing statement does not extend the period of effectiveness of the original financing statement. If an amended financing statement adds collateral, it is effective as to the added collateral only from its filing date.

[(m) A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.]

(n) A person may not file an original financing statement or an [amendment] [amended financing statement] that adds collateral covered by a financing statement unless the debtor authorizes the filing in a signed writing or in a signed record in another medium authorized by the debtor in a signed writing. [By signing a security agreement, the debtor authorizes the secured party to file an original financing statement and an [amendment] [amended financing statement] covering the collateral described in the security agreement.]

(o) A person that files an original financing statement or an [amendment] [amended financing statement] in violation of subsection (n) is liable to the debtor for $ 500 and, in addition, for any loss thereby incurred by the debtor.

Legislative Note: Where the State has any special recording system for real estate other than the usual grantor-grantee index (as, for instance, a tract system or a title registration or Torrens system) local adaptations of subsection (a) and Section 9-403(n) may be necessary. See Mass. Gen. Laws Chapter 106, Section 9-410.

Reporters' Explanatory Notes

1. **Organization.** This section has been substantially reorganized. Subsection (a) sets forth the requirements of an effective financing statement. Subsections (c) through (h) amplify upon these requirements. Subsections (i), (j), and (k) address post-filing changes. Subsection (l) governs amendments. Subsections (m), (n), and (o) deal with the time when and the circumstances

under which a financing statement can be filed and provide a remedy for unauthorized filings.

2. **Debtor's Signature.** Revised subsection (a) omits the current requirement that the debtor sign a financing statement. This revision is essential to facilitate electronic, paperless filing initiated by a secured party. The draft still requires that the debtor authorize any filings against it; however, the draft does not require that the authorization be contained in the public record. More specifically, subsection (n) permits a person to file an original financing statement or an amendment that adds collateral only if the debtor authorizes the filing, and subsection (o) provides a remedy for unauthorized filings. See Note 13 below. Sections 9-413(c)(15) and 9-403(b)(1) supplement these provisions by permitting the filing office to prescribe criteria for determining, for example, whether the filer is who the filer purports to be and to refuse to accept for filing a fraudulent record. Elimination of the debtor's signature requirement makes the exceptions provided by current subsection (2) unnecessary.

3. **Certain Other Requirements.** The draft deletes other currently-required information from this subsection because it seems unwise (real estate description for financing statements covering crops), unnecessary (adequacy of copies of financing statements), or both (copy of security agreement as financing statement). Inasmuch as a secured party owes no obligation to disclose information concerning the security interest to third parties, the draft changes the address requirement to refer to "a mailing address" for the secured party as well as for the debtor.

4. **Real-Estate-Related Filings.** The second sentence of subsection (a) contains the requirements for fixture filings and financing statements covering timber, minerals, and certain accounts. It derives from current Section 9-402(5). Subsection (b) explains when a real estate mortgage is effective as a fixture filing. It derives from current Section 9-402(6).

Draft subsections (a) and (b) (current subsections (5) and (6)) contain the following terms: "for record," "real estate records," "interest of record," and "record owner." The Official Comments should be revised to explain that these are terms traditionally used in real estate law and that this context "otherwise requires" that the proposed definition of "record" in draft Section 9-105 is not applicable.

5. **Debtor's Name.** The requirement that a financing statement give the debtor's name is particularly important. Financing statements are indexed under the name of the debtor, and those who wish to find financing statements search for them under the debtor's name. Subsection (c) explains what the debtor's name is for purposes of a financing statement. If the debtor is a registered entity (defined in draft Section 9-105 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 9-105). Subsections (c)(2) and (c)(3) contain special rules for decedent's estates and trusts, as to which current law is now silent. The Drafting Committee instructed the Reporters to prepare special rules, but it has yet to consider the substance. Subsection (c)(4) essentially follows current law.

Together with subsection (d), the draft responds to Study Committee Recommendation 17.A and reflects the prevailing view that the actual individual, partnership, or corporate name of the debtor on a financing statement is both necessary and sufficient, whether or not trade or other names are given.

6. **Secured Party's Name.** Draft subsection (f) is new. It 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. For example, consider a transaction in which a security interest is granted to a group of secured parties, but not to their representative, the collateral agent. The representative of the secured parties would not itself be a secured party. See draft Section 9-105 and Note 12. Under subsections (a) and (f), however, a financing statement would not be insufficient because it names the collateral agent instead of the actual secured parties even if it omitted the collateral agent's representative capacity.

Difficulties may arise if (i) a person (A) is the agent for one secured party (SP-1), (ii) the financing statement names A as the secured party without indicating that A serves as agent for SP-1, and (iii) A agrees to serve as agent for another secured party (SP-2). The Drafting Committee has yet to address how SP-2's security interest should rank with SP-1's.

7. **Multiple Names.** Subsection (e) makes explicit what is implicit in current law, that a financing statement may give the name of more than one debtor or secured party.

8. **Indication of Collateral.** Subsection (g) expands the class of sufficient collateral references to embrace "a statement to the effect 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.

9. **Errors.** Subsection (h) derives from current subsection (8). It adds two per se rules concerning the effectiveness of financing statements in which the debtor's name is incorrect. If the financing statement nevertheless would be discovered in a search under the debtor's correct name, as a matter of law the incorrect name does not make the financing statement seriously misleading. If the financing statement would not be discovered in a search under the debtor's correct name, as a matter of law the financing statement is seriously misleading.

10. **Post-filing Changes in Extrinsic Facts.** Draft subsections (i), (j), and (k) deal with situations in which the information in a proper financing statement becomes inaccurate. Draft subsection (i) responds to Study Committee Recommendations 17.B and 17.C and addresses a "pure" change of name that does not implicate a new debtor. It clarifies 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 (or amended financing statement) that specifies the debtor's new correct name or otherwise renders the financing statement not seriously misleading.

Subsection (j) clarifies the third sentence of current Section 9-402(7), as proposed in Recommendation 17.G, by providing that a financing statement remains effective following the transfer of collateral only when the security interest continues in that collateral. This result is consistent with the conclusion of PEB Commentary No. 3.

Subsection (k) provides that, except for the four-month rules in subsection (i) ("pure" name change) and Section 9-402A (new debtor that becomes bound), post-filing changes that render a financing statement inaccurate and seriously misleading have no effect on a financing statement. The financing statement remains effective.

11. **Changes to Financing Statements.** Subsection (l) addresses changes to financing statements, including addition and release of collateral. Although an assignment is a type of amendment, the draft follows current law and treats assignments separately, in Section 9-405.

The Drafting Committee has yet to determine the best approach to changes. Alternative A contemplates that changes would be made by filing an amendment. Alternative B contemplates that changes would be accomplished by filing an amended (restated) financing statement, rather than an amendment. Under Alternative B, an inspection of the amended financing statement would reveal the current status of the financing statement, without the need to review the original; however, the searcher would need to compare the amended financing statement with prior versions in order to determine what change had been effected. Draft Section 9-405(b) contains similar alternatives for effectuating an assignment.

As to amendments, both alternatives to Section 9-402(l) revise current subsection (4) to permit secured parties to make changes in the public record without the need to obtain the debtor's signature. However, the filing of an amendment or amended financing statement that adds collateral must be authorized by the debtor. See subsection (n).

12. **Security Agreement as Financing Statement.** Subsection (m), which appears as part of existing Section 9-402(1), may be unnecessary and so appears in brackets. The Official Comments could make clear that no change in substance was intended. See also Section 9-303(a) (contemplating situations in which a financing statement is filed before a security interest attaches).

13. **Unauthorized Filings.** Subsection (n) substitutes for the debtor's signature a requirement that the debtor authorize the filing of an original financing statement or an amendment that adds collateral. The Drafting Committee is agreed that oral authorization would be insufficient, but it has not yet considered the specific means of authorization set forth in the draft (i.e., "in a signed writing or in a signed record in another medium authorized in a signed writing"). The Drafting Committee also has not considered whether to add the bracketed last sentence of subsection (n), which establishes authorization as a matter of law under limited circumstances.

Subsection (o) imposes liability upon a person who makes an unauthorized filing in violation of subsection (n). The liability is identical to that imposed by draft Section 9-404 for failure to provide a termination statement.

SECTION 9-402A. EFFECTIVENESS OF FINANCING STATEMENT IF NEW DEBTOR BECOMES BOUND BY SECURITY AGREEMENT.

(a) Except as otherwise provided in subsections (b) and (c), a filed financing statement naming an original debtor is effective to perfect a security interest in collateral described in the security agreement and covered by the financing statement and in which a new debtor has or acquires rights.

(b) If a filed financing statement that is effective under subsection (a) is seriously misleading with respect to the name of the new debtor:

(1) the financing statement is effective to perfect a security interest in collateral acquired by the new debtor before, and within four months after, the new debtor becomes bound; and

(2) the financing statement is not effective to perfect a security interest in collateral acquired by the new debtor more than four months after the new debtor becomes bound unless an amendment to the financing statement that renders the financing statement not seriously misleading is filed before the expiration of that time.

(c) This section does not apply to collateral as to which a filed financing statement remains effective against the new debtor under Section 9-402(j).

Reporters' Explanatory Notes

1. **The Problem.** Draft Sections 9-203(b) and 9-402A 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 current law and the draft, collateral that is transferred in the course of the incorporation or merger normally would remain subject to a perfected security interest. See

Section 9-306; Section 9-402. Current law is less clear with respect to whether an after-acquired property clause in a security agreement signed 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. Sections 9-203(b) and 9-402A are an attempt at clarification.

2. **How a New Debtor Becomes Bound.** Normally, a security interest is unenforceable unless the debtor has signed a security agreement describing the collateral. See draft Section 9-203(a). New Section 9-203(b) creates an exception, under which a security agreement signed 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 three new subsections of Section 9-105.) If a new debtor does become bound, then the security agreement signed by the original debtor satisfies the security-agreement requirement of draft Section 9-203(a)(1) 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.

Draft Section 9-105 provides two ways in which the new debtor "becomes bound" by the original debtor's security agreement. First, the new debtor becomes bound as debtor if it becomes bound by contract or by operation of non-UCC law. The latter would occur if, for example, the applicable corporate law of mergers provides that, if A Corp merges into B Corp, B Corp becomes a debtor under A Corp's security agreement. The former might occur when B contractually assumes A's obligations under the security agreement.

Second, a new debtor can "become bound" for purposes of Article 9 even though it would not be bound under other law. This would occur when the debtor becomes obligated not only for the secured obligation but also generally under applicable non-UCC law for the obligations of the original debtor. For example, some corporate laws provide that, when two corporations merge, the surviving corporation "has all liabilities" of both. 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, B Corp would "become bound" for purposes of draft Sections 9-203(b) and 9-402A.

Although the Drafting Committee generally was of the view that Article 9 should indicate when a new debtor becomes bound, the Committee has not yet considered the specific approach taken by draft Section 9-105.

3. **When a Financing Statement Is Effective Against a New Debtor.** The Study Committee was divided over when a financing statement filed against the original debtor should be effective against the new debtor. See Recommendations 17.E and F. The draft adopts the Study Committee's "View B." It provides, in subsection (a), that a filing against the original debtor is

effective to perfect a security interest in collateral that a new debtor acquires before the expiration of four months after the new debtor becomes bound by the security agreement. 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 the secured party files during the four-month period an amendment (or amended financing statement) rendering the filing not seriously misleading. A similar rule appears in draft Section 9-402(i) with respect to changes in a debtor's name.

Note, however, that this section does not apply to collateral transferred by the original debtor to a new debtor. Under those circumstances, the filing against the original continues to be effective until it lapses. See subsection (c); draft Section 9-402(j).

4. **Priority.** The Drafting Committee's approach necessitates a new priority rule to deal with the contest between a secured creditor of the original debtor and a secured creditor of the new debtor. Draft Section 9-312(f) addresses this priority contest. This complex priority rule no doubt will be both under- and over-inclusive. One way to reduce the problem of overinclusiveness is to limit application of Section 9-402A to new debtors who become bound in transactions in which they succeed to some or all of the original debtor's business, not just the original debtor's liabilities. This refinement would limit the circumstances under which a secured party's filing against the original debtor continues to be effective as to the new debtor's property during the four-month period to those most likely to be sympathetic to the original debtor's secured party -- i.e., where there has been no apparent change in the original debtor's business.

SECTION 9-403. WHAT CONSTITUTES FILING A RECORD; REFUSAL TO ACCEPT RECORD; DURATION OF FINANCING STATEMENT; EFFECT OF LAPSED FINANCING STATEMENT; DUTIES OF FILING OFFICE.

(a) Except as otherwise provided in subsection (b), presentation of a record to a filing office and tender of the filing fee or acceptance of the record by the filing office constitutes filing under this article.

(b) Filing does not occur with respect to a record that a filing office refuses to accept because:

(1) the record is not communicated by a method or medium of communication authorized by the filing office;

(2) an amount equal to or greater than the applicable filing fee is not tendered;

(3) the filing office is unable to index the record because:

(i) in the case of an original financing statement, the record gives no name for a debtor or the filing office is unable to read or decipher the names given; or

(ii) in other cases, the record fails to identify the original financing statement as required by this part or the filing office is unable to read or decipher the identification;

(4) the filing office is unable to determine the secured party of record because the record fails to give a name for the secured party of record or the filing office is unable to read or decipher the name given;

[(5) in the case of an original [or amended] financing statement, the statement fails:

(i) to indicate whether the debtor is an individual or an organization; or

(ii) if the financing statement indicates that the debtor is an organization, to indicate the type of organization, to give a jurisdiction of organization for the debtor, or to give an organizational identification number for the debtor or indicate that the debtor has none;] or

(6) in the case of an assignment in an original financing statement (Section 9-405(a)) or an amended financing statement filed under Section 9-405(b), the record fails to give a name for the assignee.

(c) A filing office may refuse to accept a record for filing only for a reason set forth in subsection (b).

(d) If a filing office refuses to accept a record for filing, it shall communicate the fact of and reason for its refusal to the person that presented the record. The communication must be made at the time and in the manner prescribed by rule, but in no event more than two business days after the filing office receives the record.

(e) Except as otherwise provided in subsection (f), a filed financing statement that complies with the requirements of Section 9-402(a) is effective, even if some or all of the information described in subsection (b)(5) is not given or is incorrect.

[(f) A security interest perfected by a filed financing statement that complies with the requirements of Section 9-402(a) but that contains information described in subsection (b)(5) that is incorrect is subordinate to the rights of a purchaser of the collateral which gives value in reasonable reliance upon the incorrect information.]

(g) A record as to which filing occurs but which the filing office refuses to accept for a reason other than one set forth in subsection (b) is effective as a filed record except as against a purchaser of the collateral which gives value in reliance upon the absence of the record in the files.

(h) The filing office may not refuse to accept a written original financing statement in the following form except for a reason set forth in subsection (b):

[INSERT FINANCING STATEMENT FORM]

[INSERT ADDENDUM FORM]

(i) The filing office may not refuse to accept a written record in the following form except for a reason set forth in subsection (b):

[INSERT [CHANGE] FORM]

(j) Except as otherwise provided in subsection (l), a filed financing statement is effective for a period of five years after the date of filing. The effectiveness of a filed financing statement lapses on the expiration of the five-year period unless before the lapse a continuation statement is filed pursuant to subsection (k) [, notwithstanding the commencement of insolvency proceedings by or against the debtor]. Upon lapse, a financing statement becomes ineffective and any security interest that was perfected by the financing statement becomes unperfected, unless the security interest is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected [as against a person that became a purchaser or lien creditor before lapse] [at all previous times].

(k) A continuation statement may be filed by a secured party of record for a financing statement only within [six months] [one year] before the expiration of the five-year period specified in subsection (j). A continuation statement must identify the original financing statement by file number and the date of filing or by another method prescribed by rule and state that it is a continuation statement or that it is filed to continue the effectiveness of the financing statement. Subject to Section 9-406, upon timely filing of a continuation statement, the effectiveness of the original financing statement is continued for five years after the last date on which the financing statement was effective, whereupon the financing statement lapses in the same manner as provided in subsection (j) unless before the lapse another continuation statement is filed pursuant to this subsection. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original financing statement. The filing office may cause the files to reflect the fact that a financing statement has lapsed under this section or has become ineffective under Section

9-404. Unless a statute governing disposition of public records provides otherwise, immediately upon lapse the filing office may destroy any written record evidencing the financing statement. If the filing office destroys a written record evidencing a financing statement, it shall maintain another record of the financing statement which is recoverable by using the file number of the destroyed record.

(l) If a debtor is a transmitting utility and a filed financing statement so states, the financing statement is effective until a termination statement is filed. A real estate mortgage that is effective as a fixture filing under Section 9-402(b) remains effective as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real estate.

(m) Except as otherwise provided in subsection (n) and in Section 9-405(d), for each record filed with the filing office, the filing office shall:

(1) assign a file number to the record;

(2) create a record that bears the file number and the date and time of filing;

(3) maintain the filed record for public inspection;

(4) index the filed record according to the name of the debtor in such a manner that each original financing statement is interrelated to all filed records relating to it; and

(5) note in the index the file number and the date and time of filing.

(n) If a financing statement covers timber to be cut or covers minerals or the like, including oil and gas, or accounts subject to Section 9-103(e), or is filed as a fixture filing, [it must be filed for record and] the filing office shall index it under the names of the debtor and any owner of record shown on the financing statement as if they were the mortgagors under a mortgage of the real

estate described, and, to the extent that the law of this State provides for indexing of mortgages under the name of the mortgagee, under the name of the secured party as if the secured party were the mortgagee thereunder, or, if indexing is by description, as if the financing statement were a mortgage of the real estate described.

(o) The filing office shall perform the acts required by subsections (m) and (n) at the time and in the manner prescribed by rule, but in no event later than two business days after the filing office receives the record.

(p) Except as otherwise provided in subsection (q), the failure of the filing office to index a record correctly does not affect the effectiveness of the record.

(q) A filed but improperly indexed record is ineffective against a purchaser of the collateral that gives value in reliance upon the apparent absence of the record in the files.

Legislative Note: In States in which writings will not appear in the real estate records and indices unless actually recorded the bracketed language in subsection (n) should be used.

Reporters' Explanatory Notes

1. **What Constitutes Filing; Effectiveness of Rejected Filings.** Draft subsection (a) deals generically with what constitutes filing of a record, including an original financing statement, an amendment, an amended financing statement, a statement of assignment, a termination statement, and a continuation statement. The draft follows current law, under which either acceptance of a record by the filing office or presentation of the record and tender of the filing fee constitutes filing.

A financing statement or other record that is presented to the filing office but which the filing office rejects provides no public notice, regardless of the reason for the rejection. However, the draft distinguishes between records that the filing office rightfully rejects and those that it wrongfully rejects. (The grounds for rejection are discussed below in Note 2.) 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 (g) 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 (g) contains a special rule to protect a third party purchaser of the collateral (e.g., a buyer or competing secured party) that gives value in reliance upon the apparent absence of the record in the files. As against an innocent reliance party, subsection (g) imposes upon the filer the risk that a record failed to make its way into the filing system. The Drafting Committee has considered subsection (g) only in general concept, and no consensus has been reached about the proper allocation of risk between the filer and the searcher. Subsection (f), discussed in the following Note, contains a somewhat different formulation of a similar rule.

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 the draft, the filing office would not be expected to make legal judgments and would not be permitted to impose additional conditions or requirements.

Subsections (b) and (c), which are new, limit the bases for the filing office to reject records. 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 illegible, because the record is not communicated by an 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. See subsections (b)(1)-(4) and (6).

There is some support on the Drafting Committee to include among the reasons for rejection of an original financing statement the failure to give various types of information that would assist a searcher in weeding out "false positives," i.e., records that a search reveals but which do not pertain to the debtor in question. Draft subsection (b)(5), which is bracketed to reflect disagreement on the issue, would permit the filing office to refuse to accept an otherwise legally sufficient financing statement because it 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. If, however, the filing office accepts a financing statement that does not give this information at all, the filing would be fully effective. The Drafting Committee has yet to determine what consequences should attach to a filed financing statement containing information required by subsection (b)(5) that is incorrect. There is some sentiment for the approach reflected in draft subsection (f), under which there would be no adverse consequences to the filer unless a purchaser of the collateral gives value in reasonable reliance upon the incorrect information. See subsection (f). Some would like to see more of a safe harbor for the filer. Suggestions have included making the financing statement effective if the filer reasonably relied on misinformation obtained from the debtor, or if the filer made a good faith effort to get the information correct.

Draft subsection (d) is new. It 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.

3. **"Safe Harbor" Written Forms.** Although subsections (b) and (c) limit the bases upon which the filing office can refuse to accept records, subsections (h) and (i) provide sample written forms that would be acceptable in every filing office in the country. By using one of the statutory forms, a secured party could be certain that the filing office is obligated to accept every record it presents. The forms were developed by participants in the Article 9 Filing Project.

4. **Lapse.** Subsection (j) is a modified version of existing Section 9-403(2), concerning lapse. Section 204 of the Bankruptcy Reform Act of 1994 permits a secured party to continue or maintain the perfected status of its security interest without first obtaining relief from the automatic stay. Accordingly, subsection (j) deletes the existing tolling provision. It also contains bracketed language for the Drafting Committee's consideration, to the effect that lapse occurs notwithstanding the debtor's entry into insolvency proceedings. With or without the bracketed language, the draft 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 leaves for Drafting Committee resolution the question of the effect of lapse. Of course, to the extent that federal bankruptcy law dictates the consequences of lapse, the provisions of the draft would be of no effect.

5. **Continuation Statements.** Draft subsection (k) deals with the details of filing continuation statements. Current subsection (3) provides a six-month window before expiration during which a continuation statement may be filed. The draft offers an additional alternative for the Drafting Committee -- a one-year window. Consistent with the media neutral approach of draft Part 4 as a whole, the secured party's signature is not required under the draft. The other changes give effect to the media neutral approach or are for clarification.

6. **Filing Officer's Duties; Standards of Performance; Mis-indexing.** Draft subsections (m) and (n) derive from current subsections (4) and (7). The revisions largely reflect media neutral drafting. Subsection (o) 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.

The same is true for a record that has been accepted but mis-indexed by the filing office. Subsections (p) and (q), which are new, treat mis-indexing much like wrongful rejection: generally, the filing office's error does not affect the effectiveness of the filing; however, the filer (who knows how the record should have been indexed and can verify whether in fact it was indexed properly) runs the risk that a purchaser of the collateral will give value in reliance upon the apparent absence of the record in the files. These subsections raise questions that the Drafting Committee has not yet fully addressed, including how to distinguish reporting or processing errors, for which the filer should not be responsible,

from indexing errors, and how to deal with mis-indexed records that are re-indexed correctly and vice versa. The Drafting Committee continues to discuss the appropriate allocation of the risk of errors by the filing office.

7. **Miscellaneous.** Current subsection (5), which deals with fees for filing, has been consolidated with the other, similar provisions elsewhere in Part 4. See draft Section 9-412.

Concerning the references to "of record" and "for record" in draft subsections (l) and (n), see Note 4 to draft Section 9-402.

SECTION 9-404. TERMINATION STATEMENT.

(a) A termination statement for a financing statement is a record that is signed by the secured party of record, identifies the financing statement by file number and date of filing or by another method prescribed by rule, and states either that it is a termination statement or that the identified financing statement is no longer effective.

(b) A secured party of record for a financing statement may file a termination statement for the financing statement.

(c) If a financing statement covers [consumer goods], then within one month or within 10 days after written demand by the debtor after there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value, the secured party of record shall file with the filing office a termination statement for the financing statement. In other cases, whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value, the secured party of record for a financing statement, within 10 days after written demand by the debtor, shall send the debtor a termination statement for the financing statement or file the termination statement with the filing office. A secured party of record that fails to file or send a termination statement as required by this subsection is

liable to the debtor for $ 500 dollars and, in addition, for any loss thereby incurred by the debtor.

(d) Subject to Section 9-406, upon the filing of a termination statement with the filing office under subsection (b), the financing statement to which the termination statement relates becomes ineffective.

Reporters' Explanatory Notes

1. Subsection (a) establishes the requirements for a termination statement, thereby eliminating some redundancies in existing Section 9-404. Most of the other changes in the section are for clarification or to embrace media neutral drafting. Note that an electronic record can be "signed." See Section 9-105.

2. Draft subsection (b) provides that a secured party of record may file a termination statement. Draft subsection (c), which derives from existing Section 9-404(1), specifies when a secured party of record must file or send to the debtor a termination statement. The liability imposed upon a secured party that fails to comply with subsection (c) is identical to that imposed by draft Section 9-402(o) for the filing of an unauthorized financing statement or amendment.

3. Subsection (d) is new. It states the effect of filing a termination statement.

4. Filing offices in some States have been beset by "bogus" filings containing forged debtor signatures. Apparently, some of these filings have been made as a form of protest or civil disobedience. It has been suggested that the statute should provide an efficient means for the filing offices or the aggrieved "debtors" to remove these filings. The Drafting Committee has not yet considered this suggestion.

SECTION 9-405. ASSIGNMENT OF SECURITY INTEREST; DUTIES OF FILING OFFICE.

(a) Except as otherwise provided in subsection (c), an original financing statement may reflect an assignment of all of the secured party's rights under the financing statement with respect to some or all of the collateral by giving in the financing statement the name and mailing address of the assignee. Upon filing, the assignee named in an assignment filed under this subsection is a secured party of record for the financing statement. An assignment in an original financing

statement may state that the rights under the financing statement are being assigned only with respect to the portion of the collateral covered by the financing statement that is indicated in the assignment; otherwise, the rights under the financing statement are assigned of record with respect to all of the collateral covered by the financing statement.

(b) Except as otherwise provided in subsection (c), a secured party of record may assign of record all or part of the secured party's rights under a financing statement by filing in the filing office an [amendment that] [amended financing statement that complies with Section 9-402(a),] identifies the original financing statement by file number and the date of filing or by another method prescribed by rule[,] and gives the names of the secured party of record and the debtor and the name and mailing address of the assignee. Upon filing, the assignee named in an [amendment] [amended financing statement] filed under this subsection is a secured party of record for the financing statement.

(c) An assignment of record of a security interest in a fixture covered by a real estate mortgage that is effective as a fixture filing under Section 9-402(b) may be made only by an assignment of record of the mortgage in the manner provided by the law of this State other than this article.

(d) In the case of a fixture filing, or a financing statement covering timber to be cut, or covering minerals or the like, including oil and gas, or accounts subject to Section 9-103(e), the filing office shall index an assignment filed under subsection (a) or an amended financing statement filed under subsection (b) under the name of the assignor as grantor and, to the extent that the law of this State provides for indexing the assignment of a real estate mortgage under the name of the assignee, the filing office shall index the assignment or the amended financing statement under the name of the assignee.

(e) The filing office shall perform the acts required by subsection (d) at the time and in the manner prescribed by rule, but in no event later than two business days after the filing office receives the record in question.

Reporters' Explanatory Note

As a general matter, the draft preserves the opportunity given by existing 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 rights with respect to some or all of the collateral covered by an original financing statement by naming an assignee in the financing statement. The secured party may accomplish the same result under subsection (b), by making a subsequent filing. (The Drafting Committee has yet to determine whether that filing should be an amendment to the original financing statement or an amended (restated) financing statement. The same issue arises under draft Section 9-402(l) with respect to amendments.) Subsection (b) also may be used for an assignment of part of the secured party's rights with respect to some or all of the covered collateral.

Most of the proposed changes in draft Section 9-405 are for clarification, to embrace media neutral drafting, or to impose standards of performance on the filing office. (The indexing duty and standard of performance with respect to assignments other than those relating to real-estate-related collateral are in draft Section 9-402(m) and (n).)

SECTION 9-406. MULTIPLE SECURED PARTIES OF RECORD.

(a) If there is more than one secured party of record for a financing statement, each secured party of record may file an [amendment,] [amended financing statement,] continuation statement, or termination statement concerning its rights under the financing statement.

(b) A filing by one secured party of record does not affect the rights under the financing statement of another secured party of record.

Reporters' Explanatory Notes

1. The draft deletes the entire statutory text of current Section 9-406, which deals with releases of collateral. Under draft Section 9-402(l), releases of collateral are dealt with as a form of amendment that modifies the indication of collateral covered by a financing statement.

2. Draft Section 9-406 deals with multiple secured parties. It permits a secured party of record to make filings concerning its own rights under a financing statement, but protects the secured party's rights from the effects of filings made by another secured party of record. For example, assume that a

financing statement names A and B as the secured parties. If B files an amendment that limits the collateral covered by the financing statement or files a termination statement, A's rights would not be affected. The financing statement would continue to name A as a secured party and, as to A, the collateral description would remain unaffected by B's amendment.

SECTION 9-407. INFORMATION FROM FILING OFFICE; SALE OR LICENSE OF RECORDS.

(a) If a person filing a written record furnishes a copy to the filing office, the filing office upon request shall note upon the copy the file number and date and time of the filing of the original and deliver or send the copy to the person.

(b) Upon request of any person, the filing office shall [issue its certificate showing] [communicate to the requester]:

(1) whether there is on file on a date and time specified by the filing office, but in no event a date earlier than three business days before the filing office receives the request, any financing statement that designates a particular debtor or, if the request so states, designates a particular debtor at the address specified in the request, and has neither lapsed under Section 9-403 nor become ineffective under Section 9-404;

(2) the date and time of filing of each financing statement; and

(3) the information contained in each financing statement.

(c) The filing office shall perform the acts required by subsections (a) and (b) at the time and in the manner prescribed by rule, but in no event later than two business days after the filing office receives the request.

(d) At least weekly, the [insert appropriate official or governmental agency] [filing office] shall sell or license to the public on a nonexclusive basis, in bulk, copies of all records filed with it under this part, in every medium from time to time available to the filing office.

Reporters' Explanatory Notes

1. This section no longer is presented to state legislatures as optional. Most of the proposed changes are for clarification, to embrace media neutral drafting, or to impose standards of performance on the filing office.

2. 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 (c), which is new, 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 (b).

3. Existing law provides that the filing office respond to a request for information by providing a certificate. The principle of media neutrality would suggest that the statute not require a written certificate. However, official written certificates might be introduced into evidence more easily than official communications in another medium. The draft includes bracketed alternative formulations in subsection (b). The first would follow existing law; the second would permit the response to be communicated by any medium authorized in the administrative rules. The Drafting Committee has yet to decide whether to pick one or the other, include both, or keep the brackets and suggest that each State make its own decision.

4. Draft subsection (d), 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 the administrative rules. See draft Section 9-413(11).

SECTION 9-408. FILING AND COMPLIANCE WITH OTHER STATUTES AND TREATIES FOR CONSIGNMENTS, LEASES, BAILMENTS, AND OTHER TRANSACTIONS. A consignor, lessor, [or] bailor[, or buyer] of property may file a financing statement, or may comply with a statute or treaty described in Section 9-302(c), using the terms "consignor," "consignee," "lessor," "lessee," "bailor," "bailee," "owner," "registered owner"[, "buyer," "seller,"] or the like instead of the terms "debtor" and "secured party." This part applies, as appropriate, to the financing statement and to the compliance that is equivalent to filing a financing statement under Section 9-302(d), but the filing or compliance is not of itself a factor in determining

whether the consignment, lease, bailment[, sale,] or other transaction creates a security interest (Section 1-201(37)). However, if it is determined for another reason that the consignment, lease, bailment, [sale,] or other transaction creates a security interest, a security interest held by the consignor, lessor, bailor, owner[, or buyer] which attaches to the collateral is perfected by the filing or compliance.

Reporters' Explanatory Notes

1. The Drafting Committee has yet to consider draft Section 9-408. The draft provides the same benefits for compliance with a statute or treaty described in Section 9-302(c) that existing 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 the draft 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 bracketed language would encompass sales transactions, primarily sales of intangibles. Whether the bracketed language is appropriate will depend on the Drafting Committee's ultimate decisions about the scope of Article 9.

2. The last two sentences of the section substitute the concept of "creation" of a security interest for the existing "intention" standard. The Reporters expect to revise the definition of "security interest" in Section 1-201(37) by deleting all references to the "intention" standard.

[**SECTION 9-409. REGISTERED AGENT.**]

[Intentionally omitted]

Reporters' Explanatory Note

The Reporters distributed to the Drafting Committee a proposal under which a State would permit each debtor to select a "registered agent" to maintain financing statements and other Article 9 records pertaining to the debtor. Pending the Drafting Committee's determination whether it wishes to pursue that proposal, the Reporters have not prepared the draft statutory text that would be needed to give effect to that proposal.

SECTION 9-410. ASSIGNMENT OF FUNCTIONS TO PRIVATE CONTRACTOR. The [insert appropriate official or governmental agency] [filing office] may contract with a private party to perform some or all of its functions

under this part, other than the adoption of rules under Section 9-413. A contract under this section is subject to [insert reference to any applicable statute that regulates government contracting and procurement].

Reporters' Explanatory Note

Draft Section 9-410, which is new, explicitly confers on the filing office or the appropriate government agency the power to make arrangements with a private contractor for the performance of the functions of the filing office.

SECTION 9-411. DELAY BY FILING OFFICE. Delay by the filing office beyond the time limits prescribed in this part is excused if (i) the delay is caused by interruption of communication or computer facilities, war, emergency conditions, failure of equipment, or other circumstances beyond control of the filing office and (ii) the filing office exercises reasonable diligence under the circumstances.

Reporters' Explanatory Note

This new section derives from Section 4-109.

SECTION 9-412. FEES.

(a) The fee for filing and indexing a [record under this part] [financing statement, amendment, continuation statement, or termination statement] [and for marking a written copy furnished by the secured party to show the time and place of filing] is $ _____ if the record is communicated in writing and $ _____ if the record is communicated by another medium authorized by rule, [plus in each case, if the financing statement is subject to the last sentence of Section 9-402(a), $ _____]. The fee for each name more than one required to be indexed is $ _____ . [The fee for filing a written record in a form other than as set forth in Section 9-403(i) and (j) may not be less than the fee charged for filing a written record of the same kind in the form set forth in those sections.] [With reference to a mortgage filed as a financing statement a

fee is not required other than the regular recording and satisfaction fees with respect to the mortgage.]

(b) The fee for responding to a request for information from the filing office, including for [issuing a certificate showing] [communicating] whether there is on file any financing statement naming a particular debtor, is $ _____ if the request is communicated in writing and $ _____ if the request is communicated by another medium authorized by rule.

Reporters' Explanatory Note

Section 9-412 collects in a single section all fee requirements for filing and for responding to requests for information. It derives from various sections of existing Part 4. Inasmuch as the draft dispenses with the notion of a "standard form," the penultimate sentence of subsection (a) may be surplusage.

SECTION 9-413. ADMINISTRATIVE RULES.

(a) The [insert appropriate official or governmental agency] [filing office] shall adopt rules to carry out the provisions of this article. The rules [must be adopted in accordance with the [insert any applicable state administrative procedure act] and] must be consistent with this article.

(b) To keep the rules and practices of the filing office in harmony with the rules and practices of filing offices in other jurisdictions that enact substantially this part of the Uniform Commercial Code, and to keep the technology used by the filing office compatible with the technology used by filing offices in other jurisdictions that enact substantially this part of the Uniform Commercial Code, the filing office shall, so far as is consistent with the purposes, policies, and provisions of this article:

(1) before adopting, amending, and repealing rules, consult with filing offices in other jurisdictions that enact substantially this part of the Uniform Commercial Code; and

(2) in adopting, amending, and repealing rules, take into consideration the rules and practices of, and the technology used by, filing offices in other jurisdictions that enact substantially this part of the Uniform Commercial Code.

(c) The rules may:

(1) prescribe the method and medium for communicating records to a filing office for filing and for communicating with the filing office;

(2) prescribe the form and content of requests for information from the filing office[, [and] notices of [insert other liens, if any, to be "perfected" by filing in the financing statement records, such as statutory agricultural liens, judicial liens, and state tax liens; also insert statutory cross references] [, and designations of registered agents];

(3) prescribe the duties of the filing office in addition to those created by this part;

(4) prescribe the business hours of the filing office;

(5) prescribe the manner in which the filing office maintains, preserves, indexes, searches, and makes available records;

(6) govern the transition from the previous filing system to the system established under this part;

(7) prescribe the manner of payment of fees to the filing office and the amount of fees payable for services other than those described in Section 9-412;

(8) prescribe the basis for determining the date and time of filing records and assigning file numbers to records;

(9) prescribe the basis for determining the date and time that the filing office has accepted, received, or indexed a record and require or permit the

use of a record to confirm that the filing office has received, accepted, or indexed a record;

(10) require or permit the amendment or remedy of an error made by the filing office, including errors in filing, failing or refusing to accept records for filing, indexing records, and searching records;

(11) prescribe the terms and manner of selling or licensing to the public records filed with the filing office under this part, including the price to be charged for the records;

(12) establish standards of performance for the filing office, including standards concerning the timeliness and quality of performance of duties by the filing office;

(13) prescribe protocols, abbreviations, symbols, and definitions of terms that may be used to communicate with the filing office and in the preservation and organization of records by the filing office;

(14) prescribe procedures for filing a termination statement or otherwise terminating the effectiveness of a financing statement if the secured party cannot be found, has ceased to exist, or otherwise is unavailable;

(15) prescribe criteria for determining questions of authenticity and authority for purposes of accepting records for filing; and

[(16) govern other matters if the [] determines that the rule will further the purposes and policies of this article.]

Reporters' Explanatory Notes

1. This section is new. Subsection (a) requires the issuance of administrative rules to carry out the provisions of Article 9. The rules must be consistent with the provisions of the statute and adopted in accordance with local procedures.

2. Subsection (b) derives in part from the Uniform Consumer Credit Code (1974). 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 Drafting Committee has approved the concept but not the draft language.

3. Subsection (c) sets forth the subject matter that the rules may address. It derives in part from provisions in the Personal Property Security Acts of British Columbia and Saskatchewan.

SECTION 9-414. DUTY TO REPORT. The [insert appropriate official or governmental agency] [filing office] shall report [annually on or before _____] to the [Governor and Legislature] on the operation of the filing office. The report must contain a statement of the extent to which the filing office has complied with the time limits prescribed in this part and the reasons for any noncompliance, a statement of the extent to which the rules are not in harmony with the rules of filing offices in other jurisdictions that enact substantially this part of the Uniform Commercial Code and the reasons for these variations.

Reporters' Explanatory Note

This section is new and has been approved by the Drafting Committee in concept but not language. It derives from the Uniform Consumer Credit Code (1974) and 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 5

DEFAULT

Reporters' Introductory Notes to Part 5

1. Part 5 has been extensively revised in this draft. The Drafting Committee has devoted more meeting time to discussions of Part 5 than to any other portion of Article 9.

2. **Definitions.** The definitions of "affected obligor," "consumer debtor," "consumer obligor," "consumer secured transaction," "debtor," and "obligor" are discussed in Notes 4 and 7 to draft Section 9-105. These terms play a significant role in draft Part 5 inasmuch as they identify certain classes of persons that have rights and to which a secured party owes duties under Part 5 and certain transactions that are subject to special treatment in Part 5.

3. **Consumer-protection Provisions.** Several provisions of the draft address issues of consumer protection. As mentioned in the Reporters' Prefatory Notes to this draft, the Reporters and the Drafting Committee benefitted substantially from the work of the Consumer Financing Task Force. **It is particularly important to reiterate that the Drafting Committee has not yet reached a consensus on the substance of most of these provisions or on whether Part 5 should treat the various concerns that the provisions address.** On many aspects of the draft's treatment of consumer protection there remains a wide range of views among the Drafting Committee members and the Consumer Financing Task Force members. In general, readers may assume that the draft's consumer protection provisions are tentative and for discussion purposes only at this time.

Draft Part 5 includes the following consumer-protection provisions:

Section 9-501 -- The draft expands the nonwaivable debtor-protection provisions to include various new consumer-protection rules. It also includes a bracketed alternative "unreasonable" standard in place of the "manifestly unreasonable" standard applicable to agreed standards of compliance in consumer secured transactions.

Section 9-504 -- The draft specifies the information that must be contained in a notification of disposition of collateral in a consumer secured transaction and provides a "plain English" sample notification. It also adds a requirement that a secured party notify consumer debtors and consumer obligors of the method by which a surplus or deficiency has been calculated.

Section 9-504A -- This bracketed section is new. It would bar a deficiency in consumer secured transactions in which the secured obligations are less than a specified dollar amount (the amount has not been determined, but it would be relatively small).

Section 9-505 -- Although the draft generally would permit partial strict foreclosure (i.e., retention of collateral in satisfaction of a portion of the debt

secured), it would prohibit partial strict foreclosure in consumer secured transactions.

Section 9-506 -- In addition to the right to redeem collateral which exists under the current Article 9, for consumer secured transactions the draft gives a debtor or consumer obligor a right to reinstate a secured obligation after default by tendering to the secured party all past due payments (without acceleration), expenses of enforcement (e.g., costs of repossession and attorney's fees), and a security deposit.

Section 9-507 -- For most transactions the draft rejects the "absolute bar" test that has been judicially imposed in some jurisdictions; that approach bars a noncomplying secured party from recovering any deficiency. For most consumer secured transactions, however, the draft provides that the absolute bar rule applies, although the secured party could recover a portion of a deficiency that exceeds a specified (but as yet undetermined) dollar amount. The draft also provides that a prevailing consumer will receive attorney's fees in cases in which a prevailing secured party would have been entitled to recover its attorney's fees.

Several other default-related consumer protection proposals and issues have been considered by the Drafting Committee, the Drafting Committee's Consumer Task Force, or both. Some of these are mentioned in the Notes following particular sections of draft Part 5. The Drafting Committee and the Task Force will continue to pursue these proposals and issues.

SECTION 9-501. DEFAULT; JUDICIAL ENFORCEMENT; WAIVER AND VARIANCE OF RIGHTS AND DUTIES; PROCEDURE IF SECURITY AGREEMENT COVERS BOTH REAL AND PERSONAL PROPERTY.

(a) After default, a secured party has the rights and remedies provided in this part and, except as otherwise provided in subsection (c), those provided in the security agreement. A secured party may reduce the claim to judgment, foreclose, or otherwise enforce the claim or security interest by any available judicial procedure. If the collateral is documents, a secured party may proceed either as to the documents or as to the goods they cover. A secured party in possession has the rights, remedies, and duties provided in Section 9-207. The rights and remedies referred to in this subsection are cumulative and may be exercised simultaneously.

(b) Except as otherwise provided in subsection (i), after default, a debtor and an obligor have the rights and remedies provided in this part, in the security agreement, and in Section 9-207.

(c) To the extent that they give rights to a debtor or an obligor and impose duties on a secured party, the rules stated in the sections referred to below may not be waived or varied by a debtor or by a consumer obligor, except as specifically provided in this part:

(1) Section 9-502(c), which deals with collection and enforcement of collateral;

(2) Section 9-504(f), (g), (h), (i), (k), and (l), which deal with disposition of collateral;

(3) Section 9-503 insofar as it imposes upon a secured party that takes possession of collateral without judicial process the duty to do so without breach of the peace;

(4) Sections 9-502(d) and 9-504(c) insofar as they deal with application or payment of noncash proceeds of collection, enforcement, or disposition;

(5) Sections 9-502(d) and (f) and 9-504(d) insofar as they require accounting for or payment of surplus proceeds of collateral;

(6) Section 9-505, which deals with acceptance of collateral in satisfaction of obligation;

(7) Section 9-506, which deals with redemption of collateral and reinstatement of obligations;

(8) Section 9-507(a), (b), (c), (g), and (h), which deal with the secured party's liability for failure to comply with this part;

(9) Section 9-318(d), which deals with notification to an account debtor [who is a consumer debtor or consumer obligor]; and

(10) Section 9-504A, which deals with limitation of deficiency claims.

(d) Notwithstanding Section 1-102(3), an obligor other than a consumer obligor may waive or vary the rules referred to in subsection (c) to the extent and in the manner provided by other law.

(e) The parties may determine by agreement the standards by which the fulfillment of the debtor's or obligor's rights and the secured party's duties, other than duties concerning taking possession of collateral without breach of the peace under Section 9-503, is to be measured if[, in a consumer secured transaction, the standards are not unreasonable, and if, in any other transaction,] the standards are not manifestly unreasonable.

(f) If a security agreement covers both real and personal property, a secured party may proceed:

(1) under this part as to the personal property without prejudicing any rights and remedies with respect to the real property; or

(2) as to both the real and the personal property in accordance with the rights and remedies with respect to the real property, in which case the other provisions of this part do not apply.

(g) If a security agreement covers goods that are or become fixtures, a secured party, subject to Section 9-313(X-R), may proceed under this part or in accordance with the rights and remedies with respect to real property, in which case the other provisions of this part do not apply.

(h) If a secured party has reduced its claim to judgment, the lien of any levy which may be made upon the collateral by virtue of an execution based upon

the judgment relates back to the earlier of the date of perfection of the security interest in the collateral and the date of filing a financing statement covering the collateral. A sale pursuant to the execution is a foreclosure of the security interest by judicial procedure within the meaning of this section. A secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this article.

(i) Unless a secured party knows that a person is a debtor or an affected obligor, knows the identity of the person, and knows how to communicate with the person, the secured party owes no duty under this article to the person or to a secured party or lien holder that has filed a financing statement against the person.

Reporters' Explanatory Notes

1. For the most part, the draft follows existing Section 9-501. The important changes are noted below.

2. **When Remedies Arise.** Under subsection (a) the secured party's remedies arise "[a]fter default." As under current law, the draft leaves the circumstances that give rise to a default to the agreement of the parties. A number of questions concerning whether a default has occurred have been litigated in the Article 9 context. Chief among these is whether a secured party's post-default conduct can constitute a waiver of default in the face of a security agreement stating that such conduct shall not constitute a waiver. Although the cases are not consistent, the draft does not adopt a special rule on this point. It continues to leave to the parties' agreement, as supplemented by non-UCC law, the determination whether a default has occurred. See Section 1-103.

3. **Cumulative Remedies.** Current Section 9-501(1) provides that the secured party's remedies are cumulative. Some courts and commentators are of the opinion that the remedies may not be exercised simultaneously, lest the secured party harass the debtor. Others think that the obligation of good faith, the liability scheme of Section 9-507, and non-UCC law (including the law of tort and statutes regulating collection of debts) protect debtors adequately. The last sentence of subsection (a) adopts the latter view. It provides that the remedies are cumulative and may be exercised simultaneously. However, the Drafting Committee believes that the Official Comments should make clear that subsection (a) is not intended to override non-UCC law that would render a creditor liable for abusive behavior or harassment.

4. **Waiver by Debtors and Consumer Obligors.** Subsection (c) contains restrictions on waivers by debtors and consumer obligors. As to waivers by

other parties, see Note 5 below. Subsection (c) also revises current Section 9-501(3) by restricting the ability to waive or modify additional rights and duties: (i) the duty to collect collateral in a commercially reasonable manner (Section 9-502), (ii) the duty to apply noncash proceeds of collection or disposition in a commercially reasonable manner (Sections 9-502 and 9-504), (iii) the implicit duty to refrain from a breach of the peace in taking possession of collateral under Section 9-503, (iv) the right to reinstatement (Section 9-506), (v) notifications to account debtors (Section 9-318), and (vi) limitations of deficiency claims in consumer secured transactions (Section 9-504A).

Subsection (c) provides generally that the specified rights and duties "may not be waived or varied." However, it is not intended to 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." The Official Comments should be revised to make this point clear.

5. **Waiver by Others.** The restrictions on waiver imposed in subsection (c) relate only to waivers by a debtor (defined in Section 9-105 as a person with a property interest, other than a security interest or other lien, in the collateral) or by a consumer obligor. Subsection (d) provides explicitly that a waiver by any other party, such as a junior lien claimant, a former debtor that has sold the collateral and retains only a security interest in it at the time of the waiver, or a non-consumer obligor, would be governed by non-UCC law. This is so notwithstanding the first sentence of current Section 1-102(3), which generally prohibits disclaimers of the "obligations of good faith, diligence, reasonableness and care prescribed by this Act."

The draft gives affected obligors (defined in Section 9-105 as secondary obligors -- sureties) many of the same rights as debtors. One of the most important issues on which the Study Committee was divided was the extent to which a surety's purported waiver of rights under Part 5 would be effective. Following the majority (but not unanimous) view of the Drafting Committee, subsection (d) reflects the "pro-waiver" position described in Section 31.C of the Report: A non-debtor obligor, other than a consumer obligor, may waive all of its rights and all of the secured party's duties under Part 5 in accordance with other law.

The Official Comments should recognize explicitly that the waiver of rights or duties by an affected obligor would not prejudice the rights of a debtor. For example, the debtor could assert its claims and defenses arising out of a secured party's noncompliance with Part 5 in an action brought by the surety based on either reimbursement or subrogation. See Restatement (3d) Suretyship, Tentative Draft No. 2, §§ 20(1)(c); 24(1)(a) (April 2, 1993).

6. **Standards for Fulfillment of Duties.** Subsection (e) deals with agreements concerning standards for fulfillment of rights and duties. It retains "manifestly unreasonable" as the test for non-consumer transactions. In brackets, it substitutes "reasonable" for the "manifestly unreasonable" test for agreed standards of compliance in consumer secured transactions. Some are of the view that the more stringent "reasonable" test is appropriate for all transactions. Others believe that the "manifestly unreasonable" test is preferable. Subsection

(e) also excludes the implicit duty to refrain from a breach of the peace under Section 9-503 from those as to which the parties may by agreement determine the standards applicable to compliance.

7. **Real-estate-related Collateral.** Subsection (f) alters existing subsection (4) to make clear that a secured party that exercises rights under Part 5 does not prejudice any rights under real property law.

Subsection (g) is new. It is intended to make clear that a security interest in fixtures may be enforced under any of the applicable provisions of Part 5, including sale or other disposition either before or after removal of the fixtures (see existing Section 9-313(8)). The Official Comments should explain that subsection (g) also serves to overrule cases holding that a secured party's only remedy after default is the removal of the fixtures from the real estate. See, e.g., Maplewood Bank & Trust v. Sears, Roebuck & Co., 625 A.2d 537 (N.J. Super. Ct. App. Div. 1993).

The draft does not address certain other real estate-related problems. In a number of States, the exercise of remedies by a creditor that is secured by both real estate and non-real estate 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 estate. Under a "one-form-of-action" rule (or rule against splitting a cause of action), a creditor that judicially enforces a real estate 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's discussion of real-estate-related collateral was preliminary and will be continued and expanded during 1995-96, after the Drafting Committee receives the input it has requested from several committees of the American Bar Association.

8. **Judicial Enforcement.** Subsection (h) generally follows current Section 9-501(5). The principal change provides that a levy relates back to the earlier of the date of filing and 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 existing Section 9-312(5)(a) (draft Section 9-312(h)(1)).

9. **Duties to Unknown Persons.** Subsection (i) is new. It relieves a secured party from duties to a debtor or affected obligor if the secured party does not know about the debtor or affected 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 now is the debtor. This subsection should be read in conjunction with the exculpatory provisions in draft Section 9-507(i), (j), and (k).

SECTION 9-502. COLLECTION AND ENFORCEMENT BY SECURED PARTY.

(a) If so agreed, and in any event on default, a secured party may:

(1) notify an account debtor to make payment or otherwise render performance to or for the benefit of the secured party, whether or not a debtor had been making collections on the collateral;

(2) take control of any proceeds to which the secured party is entitled under Section 9-306; and

(3) enforce the obligations of an account debtor, including by exercising the rights and remedies of the debtor in respect of (i) the account debtor's obligation to make payment or otherwise render performance to the debtor, (ii) any property that secures the account debtor's obligations, and (iii) any guarantor or other surety for the account debtor's obligations.

[(b) Before exercising under subsection (a)(3) the rights of a debtor to enforce nonjudicially any [mortgage/deed of trust] covering real property a secured party shall [file/record] in the office in which the [mortgage/deed of trust] is [filed/recorded] (x) a copy of the security agreement that entitles the secured party to exercise those rights and (y) an affidavit signed by the secured party stating that a default has occurred and that the secured party is entitled to enforce nonjudicially the [mortgage/deed of trust].]

(c) A secured party that by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or against an affected obligor and that undertakes to collect from or enforce an obligation of an account debtor shall proceed in a commercially reasonable manner. The secured party may deduct from the collections reasonable expenses

of collection and enforcement, including reasonable attorney's fees and legal expenses incurred by the secured party.

(d) If a security interest secures payment or performance of an obligation the following rules apply:

(1) A secured party shall apply or pay over for application the cash proceeds (Section 9-306) of collection or enforcement under this section in the following order to:

(i) the reasonable expenses of collection and enforcement and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(ii) the satisfaction of obligations secured by the security interest under which the collection or enforcement is made; and

(iii) the satisfaction of obligations secured by any subordinate security interest in or other lien on the collateral subject to the security interest under which the collection or enforcement is made if the secured party receives a written notification of demand for proceeds before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest within a reasonable time. Unless the holder does so, the secured party need not comply with the demand.

(2) A secured party need not apply or pay over for application the noncash proceeds (Section 9-306) of collection and enforcement under this section. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(3) A secured party shall account to and pay a debtor for any surplus notwithstanding any agreement to the contrary, and, unless otherwise

agreed, the obligor is liable for any deficiency. Recovery of any deficiency under this subsection is subject to Section 9-507.

[(e) A secured party that receives cash proceeds of collection or enforcement in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest under which the collection or enforcement is made:

(1) takes the cash proceeds free of the security interest or other lien;

(2) is not obligated to apply the proceeds of collection or enforcement to the satisfaction of obligations secured by the security interest or other lien; and

(3) is not obligated to account to or pay the holder of the security interest or other lien for any surplus.]

(f) If the underlying transaction was a sale of accounts, chattel paper, or general intangibles, the debtor is entitled to any surplus, and the obligor is liable for any deficiency, only if its agreement so provides. Recovery of any deficiency under this subsection is subject to Section 9-507.

Reporters' Explanatory Notes

1. **Scope of Draft Section 9-502.** As a general matter Part 5 deals with the rights and duties of debtors and secured parties following default. However, Section 9-502 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.

2. **Primary Changes.** The primary substantive changes to this section are: (i) explicit provision for the secured party's enforcement of the debtor's rights in respect of the account debtor's obligations and any security or suretyship obligations that support the account debtor's obligations; (ii) explicit provision for the application of proceeds recovered by the secured party in substantially the same manner as provided in draft Section 9-504(b) and (c) for dispositions of collateral; and (iii) reference to the applicability of Section 9-507 in the event of the secured party's failure to comply with the commercial reasonableness requirement.

3. **Rights Against Third Parties.** The rights of a secured party against an account debtor 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 draft Section 9-306(a).

4. **Rights Against Real Estate Mortgagor.** Subsection (b) is a new, bracketed subsection that would permit the secured party whose collateral consists of a mortgage note to proceed after the debtor's (mortgagor's) default with a nonjudicial foreclosure of the real estate mortgage securing the note. Exercise of this right is conditioned upon the secured party recording the security agreement and an affidavit certifying default in the applicable real estate records. Of course, the secured party's rights derive from those of its debtor. The bracketed paragraph 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. Subsection (b) is one of several provisions concerning which the Reporters and the Drafting Committee will continue to consult with representatives of the real estate bar.

5. **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, unless the underlying transaction is a sale of accounts, chattel paper, or general intangibles for the payment of money and the secured party (buyer) has no right of recourse against the debtor or an affected obligor. The secured party's rights to collect and enforce 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 draft Section 9-507 and the secured party's recovery of a deficiency also would be subject to draft Section 9-507.

6. **Attorney's Fees and Legal Expenses.** The phrase "reasonable attorneys' fees and legal expenses," which appears in subsection (c), includes only those fees and expenses incurred in proceeding against account debtors. The secured party's right to recover these expenses arises automatically under this section. The secured party also may incur other attorneys' 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 attorneys' fees and legal expenses under draft Section 9-505(d)(1)(i) and Section 9-504(b)(1)(i). The parties also may agree to allocate a portion of the secured party's overhead to collection and enforcement under subsection (c) or (d).

7. **Noncash Proceeds.** Subsection (d)(2) is new. It addresses the situation in which an enforcing secured party receives noncash proceeds, such as the account debtor's promissory note. 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 (d)(2) a secured party whose collection or disposition yields noncash proceeds (e.g., a promissory note) is under no duty to apply the note or its value to the outstanding

obligation. If a 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 draft Section 9-501(e).

8. **Collections by Junior Secured Party.** Subsection (e) is in brackets. The Drafting Committee has not reached a consensus on whether to delete or retain this subsection. Subsection (e) would relieve a junior secured party from any responsibility to apply or pay over collections to senior claimants under certain circumstances. It provides that receipt of cash proceeds by a qualifying junior secured party terminates the interest, if any, of a senior secured party or lienholder. But it does not protect a junior secured party that does not act in good faith or that acts with knowledge that it is violating the rights of senior claimants. Subsection (e) is similar to draft Section 9-504(e), which applies to proceeds of a disposition by a junior secured party. In the case of a disposition, there is a possibility that the senior claimant can follow the collateral in the hands of the purchaser. In the case of collections, however, the account debtor normally will be discharged (see Section 9-318), leaving nothing for the senior party. Some Drafting Committee members believe that this potential for a harsher result in the case of collections warrants treatment different from that given to proceeds of dispositions.

SECTION 9-503. SECURED PARTY'S RIGHT TO TAKE POSSESSION AFTER DEFAULT.

[MINOR STYLE CHANGES ONLY] Unless otherwise agreed, a secured party has the right on default to take possession of the collateral. In taking possession, a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If a security agreement so provides, a secured party may require a debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal, a secured party may render equipment unusable, and may dispose of collateral on a debtor's premises under Section 9-504.

Reporters' Explanatory Notes

1. The draft is virtually identical to existing Section 9-503. The Study Committee did not recommend revision of Section 9-503. The only significant issue raised in the case law concerns the meaning of "breach of the peace." The Drafting Committee does not favor an attempt to define the term in the statute.

2. The Official Comments should explain that conversion liability of a junior party in possession of collateral is governed by non-UCC law and that Section 9-504 governs a junior secured party's rights to recover its expenses from the collateral. The Official Comments also should explain that a senior secured party is entitled to possession as against a junior claimant. Alternatively, there is some sentiment on the Drafting Committee for adding to Section 9-503 a statement such as: "Conflicting rights to possession among parties are resolved by the priority rules of this Article or, as applicable, other law."

SECTION 9-504. DISPOSITION OF COLLATERAL AFTER DEFAULT.

(a) A secured party after default may sell, lease, license, or otherwise dispose of any or all of the collateral [in its then condition or following any commercially reasonable preparation or processing]. Unless effectively excluded or modified, a contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract. Warranties under this section may be excluded or modified in the contract for disposition by giving a purchaser a written statement that contains specific language excluding or modifying the warranties. Language in a written statement is sufficient to exclude warranties under this section if it states "There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition," or words of similar effect.

(b) A secured party shall apply or pay over for application the cash proceeds (Section 9-306) of disposition in the following order to:

(1) the reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing, and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(2) the satisfaction of obligations secured by the security interest under which the disposition is made;

(3) the satisfaction of obligations secured by any subordinate security interest in or other lien on the collateral if the secured party receives a written notification of demand for proceeds before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest within a reasonable time, and unless the holder does so, the secured party need not comply with the demand.

(c) A secured party need not apply or pay over for application noncash proceeds (Section 9-306) of disposition under this section. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(d) If the security interest under which a disposition is made secures payment or performance of an obligation, (i) the secured party shall account to and pay a debtor for any surplus and (ii) unless otherwise agreed and except as otherwise provided in Section 9-504A, the obligor is liable for any deficiency. But if the underlying transaction was a sale of accounts, chattel paper, or general intangibles, the debtor is entitled to any surplus, and the obligor is liable for any deficiency, only if its agreement so provides. Recovery of any deficiency under this subsection is subject to Section 9-507.

(e) A secured party that receives cash proceeds of disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest under which the collection or enforcement is made:

(1) takes the cash proceeds free of the security interest or other lien;

(2) is not obligated to apply the proceeds of disposition to the satisfaction of obligations secured by the a security interest or other lien; and

(3) is not obligated to account to or pay the holder of the security interest or other lien for any surplus.

(f) Every aspect of a disposition of collateral, including the method, manner, time, place, and terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral (i) by public or private proceedings, (ii) by one or more contracts, (iii) as a unit or in parcels, [and] (iv) [in its then condition or following preparation or processing, and (v)] at any time and place and on any terms. A secured party may buy at a public sale. A secured party may buy at a private sale only if the collateral is of a kind customarily sold on a recognized market or is of a kind that is the subject of widely distributed standard price quotations.

(g) In this subsection and subsection (h), the "notification date" is the earlier of the date on which a secured party sends to the debtor and any affected obligor written notification of a disposition and the date on which the debtor and any affected obligor waive the right to notification. A secured party shall send to a debtor and any affected obligor reasonable written notification of the time and place of a public sale or reasonable written notification of the time after which any private sale or other intended disposition is to be made, unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market. In the case of consumer goods, another notification need not be sent. In other cases a secured party shall send written notification

[(1)] to any other person from whom the secured party has received, before the notification date, written notification of a claim of an interest in the collateral[;

(2) to any other secured party that, [20] days before the notification date held a security interest in the collateral perfected by the filing of a financing

statement that (i) identified the collateral, (ii) was indexed under the debtor's name as of that date, and (iii) was filed in the proper office or offices in which to file a financing statement against the debtor covering the collateral as of that date (Sections 9-103 and 9-401); and

(3) to any other secured party that, [20] days before the notification date held a security interest in the collateral perfected by compliance with a statute or treaty described in Section 9-302(c)].

[(h) A secured party has complied with the notification requirement specified in subsection (g)(2) if not later than [30] days before the notification date, the secured party requested, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the in the office or offices indicated in subsection (g)(2)(iii), and before the notification date, either (i) the secured party did not receive a response to the request for information or (ii) the secured party received a response to the request for information and the secured party sent written notification to each secured party named in that response and whose financing statement covered the collateral.]

(i) A debtor or a consumer obligor may waive the right to notification of disposition (subsection (g)) only by signing a statement to that effect after default. [In a consumer secured transaction, a] [A] signed statement is ineffective as a waiver unless the secured party proves that the signer expressly agreed to its terms.

(j) Unless otherwise agreed, a notification of disposition sent after default and, in a consumer secured transaction, [21] days or more, and, in other transactions, 10 days or more, before the earliest time of disposition set forth in the notification is sent within a reasonable time before the disposition. Whether a

notification sent less than [21] or 10 days, as applicable, before the earliest time of disposition set forth in the notification nevertheless is sent within a reasonable time is a question of fact to be determined in each case.

(k) This subsection does not apply to a consumer secured transaction.

(1) Unless otherwise agreed, the contents of a notification of disposition are sufficient if the notification (i) describes the debtor and the secured party, (ii) describes the collateral that is the subject of the intended disposition, (iii) states the method of intended disposition, and (iv) states the time and place of a public sale or the time after which any other disposition is to be made, whether or not the notification contains additional information.

(2) Whether a notification that lacks any of the information set forth in paragraph (1) nevertheless is sufficient is a question of fact to be determined in each case.

(3) A particular phrasing of the notification is not required. A notification substantially complying with the requirements of this subsection is sufficient even though it contains minor errors that are not seriously misleading.

(4) The following form of notification, when completed, contains sufficient information:

NOTIFICATION OF DISPOSITION OF COLLATERAL

To: [Name of debtor or obligor to whom the notification is sent]

From: [Name, address, and telephone number of secured party]

Name of Debtor(s): [Include only if debtor(s) are not an addressee]

[For a public disposition:]

We will sell [or lease or license, **as applicable**] the [describe collateral] [to the highest qualified bidder] in public as follows:

Day and Date: _____

Time: _____

Place: _____

[For a private disposition:]

We will sell [or lease or license, **as applicable**] the _____[describe collateral]_____ privately sometime after _____[day and date]_____ .

[End of Form]

(l) This subsection applies to a consumer secured transaction.

(1) A notification of disposition must contain the following information:

(i) the information specified in subsection (k)(1);

(ii) a description of any liability for a deficiency of the person to which the notification is sent;

(iii) the amount that must be paid to the secured party to redeem (Section 9-506) the obligation secured;

(iv) the amount that must be paid to the secured party to reinstate (Section 9-506) the obligation secured; and

(v) a telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

(2) A particular phrasing of the notification is not required. A notification substantially complying with the requirements of this subsection is sufficient even if it contains minor errors that are not seriously misleading.

(3) The following form of notification, when completed, contains sufficient information:

NOTICE OF OUR PLAN TO SELL PROPERTY

To: [Name of debtor or obligor to whom the notification is sent]

From: [Name, address, and telephone number of secured party]

Name of Debtor(s): [Include only if debtor(s) are not an addressee]

[You] [name of obligor, if different] owe(s) us money on a debt and [you have] [has] not paid it to us on time. We have [your] [the debtor's] [describe collateral] because we took it from [you] [the debtor] or [you] [the debtor] voluntarily gave it to us. [You] [name of obligor, if different] agreed to let us do that when [You] [name of debtor, if different] created the debt.

[For a public disposition:]

We plan to sell [or lease or license, **as applicable**] the [describe collateral] [to the highest qualified bidder] in public. The sale [or lease or license, **as applicable**] will be held as follows:

Day and Date: _____

Time: _____

Place: _____

You can bring bidders to the sale if you want.

[For a private disposition:]

We will sell [or lease or license, **as applicable**] the [describe collateral] privately sometime after [day and date] .

The money that we get from the sale [or lease or license, as applicable] (after paying our costs) will be paid on the debt that [you] [name of obligor, if different] owe(s) to us. **[Include the following sentence only if the addressee is obligated on the secured debt.]** IF WE GET LESS MONEY THAN YOU OWE, YOU WILL STILL OWE US THE DIFFERENCE, and we may sue you and take part of your wages or other property. **[Include the following sentence**

only if the addressee is a debtor.] If we get more money than ___[you] [name of obligor, if different]___ owe(s) to us, ___[you] [name of obligor, if different]___ will get the extra money.

You can stop the sale [and get] [and the debtor will get] the property back. To do this, ___[you] [name of obligor, if different]___ must:

[Alternative A]

Pay us $ _____ before the sale. That will pay off the debt plus our costs and ___[You] [name of obligor, if different]___ will not owe us any more money;

[add the following paragraph if applicable] OR

Pay us our costs of retaking the property, all regular payments that are overdue, all late charges, and a security deposit. That amount is now about $ _____ , but that amount may change. To learn the exact amount, call us at ___[telephone number]___ . You would have to make this payment by _____[date]_____ . If you make the payment, ___[You] [name of obligor, if different]___ will have to keep on making the rest of the regular [monthly] payments. When ___[you] [name of obligor, if different]___ make[s] the rest of the regular payments ___[you] [name of obligor, if different]___ will get back the security deposit of $ _____ .

[Alternative B]

Pay us the full amount of the debt plus our costs before the sale. Then ___[You] [name of obligor, if different]___ will not owe us any more money. To learn the exact amount you must pay, call us at ___[telephone number]___ ;

[add the following paragraph if applicable] OR

Pay us our costs of retaking the property, all regular payments that are overdue, all late charges, and a security deposit. To learn the exact amount

you must pay, call us at ___[telephone number]___ . You would have to make this payment by _____[date]_____ . If you make the payment, ___[You] [name of obligor, if different]___ will have to keep on making the rest of the regular [monthly] payments. When ___[you] [name of obligor, if different]___ make[s] the rest of the regular payments ___[you] [name of obligor, if different]___ will get back the security deposit.

[End of Form]

(m) [This subsection applies to a consumer secured transaction.]

(1) If the debtor is entitled to a surplus or a [consumer] obligor is liable for a deficiency under subsection (b)(3), before or when the secured party accounts to the debtor and pays any surplus or first makes demand on the consumer obligor for payment of the deficiency [or commences an action to collect the deficiency] the secured party shall send to the debtor or consumer obligor a written notification containing:

(i) the amount of the surplus or deficiency, and

(ii) a reasonable description of how the secured party calculated the surplus or deficiency, including

(A) the amount of the obligation secured and its components, such as the unpaid balance of principal or purchase price, interest or other finance charges, additional charges, such as for delinquency, default, or deferral, and reasonable expenses and attorney's fees of the type described in Section 9-504(b)(1), and

(B) the amount of credits on the obligation secured and their components, such as payments, rebates, and proceeds of the disposition of collateral.

(2) A particular phrasing of the notification is not required. A notification complying substantially with the requirements of this subsection is sufficient even if it contains minor errors that are not seriously misleading.

(n) A secured party's disposition of collateral after default transfers to a transferee for value all of a debtor's rights in the collateral and discharges the security interest under which the disposition is made and any subordinate security interest or other lien [other than liens created under] [here should be listed acts or statutes providing for liens, if any, that are not to be discharged]. The transferee takes free of those rights and interests even if the secured party fails to comply with the requirements of this part or of any judicial proceedings:

(1) in the case of a public sale, if the transferee (i) has no knowledge of any defects in the sale, (ii) does not buy in collusion with the secured party, other bidders, or the person conducting the sale, and (iii) acts in good faith; or

(2) in any other case, if the transferee acts in good faith.

(o) If a transferee does not take free of the rights and interests described in subsection (m), the transferee takes the collateral subject to the debtor's rights in the collateral and subject to any security interest under which the disposition is made and any subordinate security interest or other lien. Except as otherwise provided in this subsection or elsewhere in this article, the disposition does not discharge any security interest or other lien.

(p) A person that is liable to a secured party under a guaranty, indorsement, repurchase agreement, or the like and that (i) receives an assignment of a secured obligation from a secured party, (ii) receives a transfer of collateral from a secured party and agrees to accept the rights and assume the duties of the secured party, or (iii) is subrogated to the rights of a secured party, has thereafter the rights and the duties of the secured party. This subrogation,

assignment, or transfer is not a disposition of collateral under this article and does not relieve the secured party of its duties under this article.

Reporters' Explanatory Notes

1. **Existing Subsection (1) Reorganized.** Subsections (a), (b), and (d) include the substance of current subsection (1), with several changes. Subsection (a) states the secured party's basic right to dispose of collateral after default. It deletes as unnecessary a sentence in current subsection (1) indicating that a foreclosure sale of goods is subject to Article 2. Subsections (b), (c), and (d) cover the application of the proceeds of a disposition.

2. **Warranties.** Another change in subsection (a) follows Recommendation 30.F. It affords the transferee at a disposition under Section 9-504 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 ordinary circumstances. For example, the Section 2-312 warranty of title would apply to a sale of goods, the analogous warranties of Section 2A-211 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).

The draft'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." The draft rejects the baseline assumption that commercially reasonable dispositions under this section are "out of the ordinary commercial course" or "peculiar." If the draft is adopted, then Section 2-312 and the related Official Comments should be conformed accordingly.

The draft explicitly contemplates that these warranties can be disclaimed. It follows the current draft of revised Article 2 by providing a sample of wording that will provide an effective exclusion of 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 (a) are those relating to "title, possession, quiet enjoyment, and the like." Whether other statutory or implied warranties apply to a disposition under this section turns on non-Article 9 law. For example, a foreclosure sale of a car by a car dealer would give rise to a warranty of merchantability (Section 2-314) unless effectively disclaimed (Section 2-316). The Official Comment to this section should explain clearly the limited nature of the warranties that it incorporates.

3. **Pre-disposition Preparation and Processing.** Current 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." Many courts have held that the "commercially

reasonable" standard of 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 has not reach a consensus on whether a secured party is entitled to sell collateral without preparation or processing in all cases or whether preparation or processing is required if it would not be commercially reasonable to forego it. Accordingly, the draft places brackets around the language that appears to give a secured party the freedom to forego preparation or processing even if the omission would not commercially reasonable. If the bracketed language is deleted from subsection (a), new language in subsection (d), also in brackets in this draft, should be added to make clear that preparation and processing are required if necessary to the commercial reasonableness of a disposition. Alternatively, the issue could be clarified in an Official Comment along the following lines:

> A secured party is not entitled to 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 its then condition.

4. **Application of Proceeds.** Subsections (b), (c), and (d) contain the rules governing application of proceeds and the debtor's liability for a deficiency. Current Section 9-504 splits these rules between subsections (1) and (2). Subsection (b) provides a "safe harbor" for a secured party that complies with its terms. However, a secured party that does not comply with subsection (b) is liable only as provided in Section 9-507.

5. **Noncash Proceeds.** Subsection (c) addresses the application of noncash proceeds of a disposition, such as a note or lease. The explanation in Note 7 to draft Section 9-502 generally applies to Section 9-504(c). 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 the security agreement or in an agreement entered into after default. The parties may provide for the method of application of noncash proceeds in the security agreement, if the method is not manifestly unreasonable. See draft Section 9-501(e). The draft rejects a statutory formula for applying noncash proceeds. A formula would impose unwanted complication and unnecessary rigidity. The draft leaves the matter to a standard of reasonableness as fleshed out in the parties' agreement.

6. **Surplus and Deficiency.** Subsection (d) deals with surplus and deficiency. In setting the debtor's liability for a deficiency following a disposition that complies with the requirements of Part 5, the draft follows the prevailing view under current law: the deficiency is measured by the amount of the secured obligation remaining unpaid after the proceeds of disposition have been applied in accordance with the statute. Any challenge to the claimed deficiency should be based on the alleged failure to conduct a commercially reasonable disposition. Although some members of the Drafting Committee would prefer a different approach, such as calculating the deficiency and surplus

on the "value" of the collateral, a majority of the Drafting Committee are opposed to changing the calculation rule. A related issue -- the role that the amount of the proceeds may play in the determination of whether a disposition was commercially reasonable -- is discussed in Note 7 to draft Section 9-507.

Clause (i) of subsection (d) revises current 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 intangibles have been sold likewise has been revised to take into account the new distinction between debtor and obligor.

When debtor sells collateral subject to a security interest, the original debtor (grantor 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 9-105 and Notes 4 and 5. 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. The draft 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, the draft 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 the draft would exonerate the secured party from liability to the new debtor. See draft Sections 9-501(e) and 9-507(i) and (j). Obviously, if a debtor sells collateral **free** of a security interest, such as a sale to a buyer in ordinary course of business (see current Section 9-307(1)), the property is no longer collateral and the buyer is not a debtor.

7. **Disposition by Junior Secured Party.** Some have questioned whether a secured party holding a junior lien has the right to dispose of the collateral under this section. See Recommendation 30.G. Some of the issues arising from the enforcement of a junior security interest might be addressed in an Official Comment along the following lines:

> 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, and, as subsection (b) makes clear, the junior secured party owes no obligation under Article 9 to apply the proceeds of disposition to the satisfaction of the obligations secured by the senior security interest. Subsection (e) 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, subsection (e) would protect a junior that acts in good faith and without knowledge that its actions violate the rights of a senior party. Moreover, because the disposition by a junior would not cut off a senior's security interest or lien (discussed below), in

many (probably most) cases the junior's receipt of the cash proceeds would not violate the rights of the senior.

The senior's priority status affords the senior the right 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 9-503. Accordingly, a junior may convert tangible collateral by refusing to relinquish possession upon the demand of a secured party having a superior possessory right thereto.

This Article protects a senior that does not prevent the junior from disposing of the collateral. Under subsection (n), the junior's disposition does not of itself discharge the senior's security interest; unless the senior secured party has authorized the disposition free and clear of its security interest, the senior's security interest ordinarily will continue under [draft] Section 9-306(c). Thus, 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.

Note what is implicit in the third paragraph of the proposed Comment: disposition coupled with some other facts **may** constitute a conversion. Arguably, the Official Comment should defer explicitly to non-Article 9 law on the question whether a disposition that has the practical effect of putting the collateral out of the senior's reach constitutes a conversion. Alternatively, the Official Comment could attempt to be even more protective of an enforcing junior secured party. Several other questions have arisen concerning the obligation to apply proceeds when there are multiple security interests in the same collateral. The Drafting Committee is inclined to address these issues in the Official Comments as well.

8. **Security Interests of Equal Rank.** In assessing subsections (b), (c), and (d) as they apply to cases of multiple security interests in the same collateral, special consideration may be warranted for cases in which 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. To date,

equal-priority problems have arisen with insufficient frequency to justify treating them in either the statute or the Official Comments. However, Revised Article 8 establishes a rule of equal priority for certain security interests in investment property, see Section 9-115(5)(b), (e), and draft Section 9-312(g)(2) proposes the same rule for certain security interests in deposit accounts. In addition, the Study Committee recommended that Section 9-312 be revised to provide that qualifying purchase money security interests in the same collateral be afforded equal priority. See Recommendation 14.H. Explicit treatment of equal-priority cases in Part 5 may now be appropriate. The Study Committee acknowledged that "a rule of equal priority may create complications when one secured party tries to enforce its security interest."

The draft treats a security interest having equal priority like a senior security interest. 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 (1) SP-W's and SP-Y's security interests survive the disposition but SP-Z's does not, and (2) neither SP-W nor SP-Y is entitled to receive a distribution of proceeds but SP-Z is.

The analogy fails when one considers the ability to obtain possession of the collateral. As the senior secured party, SP-W should enjoy the right to possession as against SP-X. See Section 9-503, Note 2. SP-Y, however, should not have such a right; 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 may best be left to the parties and, if necessary, the courts.

Some may conclude that this difference between seniors and equals suggests that equals should not be treated as seniors in other respects, as well. Under the draft, if junior repossesses, senior has the right to take over the sale and claim the proceeds off the top. If senior fails to do so, senior keeps its security interest but does not share in the proceeds of junior's disposition. To the extent that SP-Y can neither take over the sale from SP-X nor claim the proceeds off the top, SP-Y is more like SP-Z (a junior) than like SP-W (a senior). This argument proves only so much. Draft Section 9-504 does not treat SP-Y like a junior in all respects; specifically, it does not provide that SP-X's disposition discharges SP-Y's security interest. Arguably, the section should provide that SP-Y should be entitled to claim a share of the proceeds of SP-X's disposition. However, there seems to be little interest among Drafting Committee members for affording those holding equal-priority security interests the right to demand a distribution of proceeds.

9. **Existing Subsection (3) Reorganized.** The draft divides current subsection (3) into three new subsections: Subsection (f) deals with the method of disposition, subsections (g) and (h) deal with the notification requirement, and subsection (i) deals with waiver. Subsections (j), (k), and (l), which create "safe harbors" for the timeliness and contents of notification, are new.

10. **Public vs. Private Dispositions.** Subsection (f) maintains two distinctions made in current subsection (3) between "public" and other dispositions: (i) The secured party may buy at the former, but not at the latter, and (ii) the debtor is entitled to notification of "the time and place of any public

sale" and notification of "the time after which" any private sale or other intended disposition is to be made. (The draft also maintains the third distinction, which concerns the rights of transferees of a noncomplying disposition. See subsection (n).) The existing statute does not define "public sale," but the Comments seem to equate the term with a public auction. See Section 9-504, Comment 1; Section 2-706, Comment 4. The Drafting Committee is not inclined to add a statutory definition. Rather, it contemplates an expansion of the Official Comments to reflect the concept: 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 must have access to the sale.

11. **Commercial Reasonableness.** Subsection (f) states directly the overarching principle that all aspects of a disposition must be commercially reasonable. Concerning the bracketed reference to dispositions of collateral in "its then condition or following . . . preparation or processing," see Note 3 above.

12. **Investment Securities.** Some lawyers who have foreclosed on investment securities have expressed concern that the "public sale" of their collateral pursuant to Section 9-504 would implicate the registration requirements of the Securities Act of 1933, and that the "commercially reasonable" requirements of Section 9-504 might prevent a secured party from conducting a foreclosure sale without first complying with federal registration requirements. To meet this concern in part, the Official Comments should contain a statement to the effect that a Section 9-504 disposition that qualifies for deviations from the rules for "private placement" exemptions under the Securities Act of 1933 in connection with public advertising may constitute a "public sale" within the meaning of Section 9-504. The Official Comment also might include a useful reference to the common practice of including in security agreements covering unregistered securities a requirement that the debtor cause the securities to be registered under the 1933 Act if requested by the secured party. 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 draft Section 9-501(e).

13. **Wholesale vs. Retail Dispositions.** Official Comment 2 to Section 9-507 suggests that a disposition at wholesale is not per se commercially unreasonable: "One recognized method of disposing of repossessed collateral is for the secured party to sell the collateral to or through a dealer." Cases conflict, however, over whether disposition at wholesale is commercially reasonable when retail facilities are readily available. The draft does not address this issue. It leaves the courts free to resolve each case on its own facts.

14. **Relevance of Price.** Note 7 to draft Section 9-507 discusses the relationship between the requirement in draft Section 9-504(f) that "every aspect of the disposition, including the . . . terms, must be commercially reasonable" and the statement in draft Section 9-507(d) that "[t]he fact that a greater amount could have been obtained by a . . . disposition at a different time or in a different method from that selected by the secured party is not of itself sufficient to

preclude the secured party from establishing that the . . . disposition was made in a commercially reasonable manner."

15. **Notification: Who Is Entitled.** Subsection (g) provides that the duty to send notification of a disposition runs not only to the debtor but also to an affected obligor. This resolves an uncertainty under existing law by providing that secondary obligors (sureties) will be 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 an affected obligor. (The draft also resolves the question of the secondary party's ability to waive the right to notification. See Note 20 below.) Draft Section 9-501(i) relieves a secured party from any duty to send notification to a debtor or affected obligor unknown to the secured party.

The rules in subsection (g) also might differ from existing law in another ways. The principal obligor (borrower) would not be entitled to notification of disposition in all cases. Suppose that Mooney borrows on an unsecured basis and Harris grants a security interest in his car to secure the debt. Mooney would be a primary obligor, not an affected obligor. As such, he would not be entitled to notification of disposition under the draft.

16. **Notification: Writing Requirement.** The draft also makes some minor changes to the notification requirement as it appears in existing Section 9-504. One of these is particularly worthy of note. Subsection (g) explicitly provides that notification of disposition must be "written." (For the time being, the draft uses the defined term "written." The Drafting Committee plans to consider all references to "written" in light of the widespread use of fax machines, e-mail, and other substitutes for traditional writings. In appropriate cases, the new defined term "record" will be used.) In adding the word "written," the draft resolves a conflict in the reported cases.

17. **Notification: Unresolved Issues.** The draft does not address several conflicts that have arisen in the cases concerning notification. One conflict relates to the meaning of the term "recognized market," as used in existing Section 9-504(4). The Drafting Committee prefers that this issue be addressed in an Official Comment, explaining that a "recognized market" is one, like the New York Stock Exchange, in which the items sold are fungible and prices are not subject to individual negotiation. The Comment also might address specifically the markets that have proven most troublesome: used automobiles and livestock (neither of which, in the Reporters' view, qualifies).

Another conflict that the draft does not address has arisen over whether the requirement of "reasonable notification" requires a "second try." That is, must a secured party that sends notification and learns that the debtor did not receive it attempt to locate the debtor and send another notification? The trend seems to be in favor of requiring a second try when a notification sent by certified mail is returned unclaimed. The draft would leave this issue to the courts.

The draft also would leave to the courts the resolution of questions that might arise concerning a secured party that sends a notification and then decides not to proceed with the intended disposition. Nothing in the draft prevents a

secured party from sending a revised notification if its plans for disposition change; provided, however, that the revised notification is reasonable and the revised plan for disposition and any attendant delay are commercially reasonable. The Official Comments should be sufficient to address this question, the answer to which follows from the text of the statute.

18. **Notification: When Not Required.** Subsection (g) follows current Section 9-504(3) in providing that no notification need be given when the collateral is of a type customarily sold on a recognized market. The Reporters have heard two conflicting reactions to this rule. First, some have questioned the need for the rule. They believe that the only reason to dispense with notification is when the attendant delay would be likely to cause a reduction in the price obtained, e.g., when, as in subsection (g), the collateral is perishable or threatens to decline speedily in value. The presence of a recognized market for the collateral is irrelevant to this concern. Another view is that the presence of a recognized market provides an independent check on the price received upon disposition, thereby eliminating the need to notify the debtor of an intended disposition. Under this view, notification probably also should be excused if the collateral is "of a type which is the subject of widely distributed standard price quotations." This phrase is found in subsection (g) as a circumstance under which the secured party may buy at a private sale. The draft proposes no changes in the current formulations.

19. **Notification of Other Secured Parties.** In accordance with Recommendation 30.A, bracketed language in subsection (g) would expand 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.

Prior to the 1972 amendments, 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.

To comply with the pre-1972 text, a foreclosing secured party not only had to search the UCC filings for financing statements showing a competing security interest but also had to review its own records to discover whether some communication, perhaps informal, had given the secured party knowledge of another security interest.

Although the Study Committee enthusiastically concurred with the Review Committee's decision to eliminate the knowledge test, some Study Committee members thought that many of the problems arising from dispositions of collateral encumbered by multiple security interests could be ameliorated or solved by informing all secured parties of an intended disposition and affording them the opportunity to work with one another. Section 30.A of the Report encourages the Drafting Committee to consider whether to restore the requirement that an enforcing secured party notify other secured parties of record. But inasmuch as a substantial majority of the Study Committee favored

retention of the current notification requirements, the Study Committee did not recommend that the requirements be revised.

The Drafting Committee has not reached a consensus on this point, but there is substantial support for an expansion of the notification requirements. Some of this support is a consequence of the rules in draft subsection (e), under which a junior secured party takes proceeds of a disposition free from the claims of seniors. The bracketed language in subsection (g)(2) 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. Under the draft, to determine who is entitled to notification, the foreclosing secured party must determine what the proper office for filing a financing statement was as of a particular date and see whether any financing statements covering the collateral in fact were filed there and were indexed under the debtor's name (as the name existed as of that date). 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 collateral or the debtor, proceeds rules, or changes in the debtor's name.

Bracketed subsection (h) 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 clause (ii) if it requests search(es) from the proper office(s) at least 30 days before sending notification to the debtor and it also sends a notification to all secured parties reflected on the search report(s). The secured party's duties under clause (ii) also will be satisfied if the secured party does not receive any search report(s) 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: the aggrieved secured party has the burden of establishing its loss. See draft Section 9-507. Also relevant are draft subsection (e), under which senior secured parties ordinarily are not entitled to share in proceeds of a junior's disposition, and subsection (b), under which a disposition cuts off junior security interests and junior secured parties are not entitled to receive excess proceeds from the disposing secured party unless they demand them.

20. **Notification: Waiver.** The waiver rules in subsection (i) follow Recommendation 31.B. See also Notes 4 and 5 to draft Section 9-501. In an effort at clarification, the draft uses the term "waive" instead of "renouncing or modifying," which appears in current Section 9-504(3). To see the operation of this subsection, consider the following examples:

> **Example 1:** Corporation grants a security interest in its equipment to secure a loan. President issues an unsecured guarantee of Corporation's debt. Corporation is the debtor, and President is the affected obligor. Under draft Section 9-501(d), President is entitled to waive notification of disposition to the extent and in the manner prescribed by non-UCC law.

Example 2: Corporation is obligated to creditor. The debt is secured only by equipment owned by Parent. Here, although Parent is an affected obligor, it also is the debtor. Corporation, the principal obligor, is neither the debtor nor an affected obligor. Although Corporation is entitled under the language of draft Section 9-501(d) to waive rights and the secured party's duties to the extent and in the manner prescribed by non-UCC law, the secured party has no duty to notify Corporation of a disposition. However, a purported waiver of notification by Parent would be effective only if in writing after default under draft Section 9-504(i).

The draft adds further requirements for waivers in consumer transactions. First, the ability of a consumer obligor to waive the right to notification is restricted in the same manner as that of debtors. See draft Section 9-501(c). Second, under draft Section 9-504(i), the secured party bears the burden of proving that a consumer debtor or consumer obligor expressly agreed to the terms of a purported waiver. The brackets in this provision indicate division among members of the Drafting Committee as to whether this rule should apply only in consumer secured transactions or in all transactions.

The draft makes no provision for waiving 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 draft Section 9-505.

The Drafting Committee has not yet considered whether an Official Comment should address the relationship between the limitations on waiver in subsection (i) (as well as similar limitations in draft Sections 9-505(m) and 9-506(f)) and the non-UCC principles of estoppel. For example, should a debtor who has actual knowledge of the information that a written notification would contain and who orally assures the secured party that no further notice is necessary be estopped from recovering damages on the basis of the secured party's failure to send written notification?

21. **Notification: Timing.** Subsection (j) is new and reflects Recommendation 32.A. The 10-day notice period (for non-consumer secured transactions) is intended to be a "safe harbor" and not a minimum requirement. In order 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 draft subsection (g) (written notification must be reasonable). 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.

Although a majority of Drafting Committee appear to favor application of the safe harbor in consumer secured transactions, there is substantial opposition as well. The Drafting Committee has not reached a consensus on the appropriate number of days for the safe harbor in a consumer secured transaction, as indicated by the brackets in subsection (j).

22. **Notification: Contents.** Subsection (k) is new and reflects Recommendation 32.B. It does not apply to a consumer secured transaction. To comply with the "reasonable written notification" requirement of subsection (g), the contents of a notification must be reasonable. The contents of a notification

that includes the information set forth in subsection (k)(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 current Section 9-504(3) and draft Section 9-504(g), 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. A properly completed sample form of notification in paragraph (4) is one example of a notification that would contain the information set forth in paragraph (1). No particular phrasing of the notification is required, however.

Subsection (l) also is new. It applies only in a consumer secured transaction. Unlike subsection (k)(1), paragraph (1) of subsection (l) is mandatory: the notification "must contain" the specified information. Like subsection (k)(4), paragraph (3) of subsection (l) provides a sample form of notification that, when properly completed, would contain the information required by paragraph (1). The sample form is written in "plain English" intended to be suitable for a debtor or affected obligor in a consumer secured transaction.

23. **Calculation of Deficiency and Surplus.** Subsection (m) is another new provision. It requires a secured party to give a debtor or consumer obligor notification of relevant information concerning the calculation of a surplus or deficiency claim at the time the secured party accounts for a surplus or first makes demand for payment of a deficiency. Brackets around the first sentence indicate that the Drafting Committee has not reached consensus as to whether this rule should apply only in consumer secured transactions or in all transactions.

24. **Title Taken by Transferee.** Subsections (n) and (o), which address the title taken by a transferee of property disposed of after default, derive from current Section 9-504(4). They change the term "purchaser" to "transferee," inasmuch as a buyer at a foreclosure sale does not meet the definition of "purchaser" in Section 1-201. Subsection (n) sets forth the rights acquired by persons that qualify under paragraphs (1) or (2). By virtue of the expanded definition of the term "debtor" in draft Section 9-105, subsection (n) 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 the draft. Under current law, the result arguably is the same, but the statute is not clear.

Subsection (o) specifies the consequences for a transferee that does not qualify for protection (e.g., a transferee with knowledge of defects in a public sale). The subsection also adds a sentence intended to make clear that a disposition does not discharge senior interests or interests of equal rank unless they would be discharged under other provisions of Article 9.

Secured parties may utilize the services of third persons to dispose of repossessed collateral. Assume that a secured party takes possession of goods collateral after default and entrusts the goods to a merchant, and further that the merchant then wrongfully sells the collateral to a buyer in ordinary course of business. That disposition would transfer to the buyer all of the secured party's rights and the rights that the secured party had the power to transfer (including

those of the debtor). Section 2-403(1); draft Section 9-504(n). The sale would constitute a disposition under Section 9-504 and as such would give rise to the consequences specified in Part 5. The secured party would have a conversion claim against the merchant, and the debtor could assert its rights under Part 5 arising out the secured party's (probably) noncomplying disposition.

25. **Assignments and Repurchase Agreements.** Subsection (p) is an effort to clarify existing subsection (5) along the lines suggested by Recommendation 33.A. The draft reflects the view that assignments of secured obligations and other transactions (regardless of form) that function like assignments of secured obligations are not dispositions to which this section applies. Rather, such transactions constitute assignments of rights and (occasionally) delegations of duties. Admittedly, application of the rule 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). Subsection (p), like current subsection (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 recourse situations. Whether the assignee of a secured obligation acquires the rights and duties of the secured party in other contexts is determined by other law.

One observer has suggested to the Reporters that in a consumer transaction subsection (p) could exacerbate the perceived problem of "churning" automobiles. The churning is said to involve numerous financings and resales of the same collateral and the repeated generation of inflated deficiency claims. Subsection (p) applies to transfers of collateral by a secured party to a guarantor or the like only if the transferee assumes the secured party's duties. The observer is concerned that the draft would create opportunities for potentially collusive calculations of deficiencies based on dispositions to guarantors. The Reporters believe that any problem in this context is best addressed by an Official Comment pointing out the potential for collusion and warning the courts to exercise care in examining these transactions for their commercial reasonableness. The Drafting Committee has not yet considered fully the concerns expressed by the observer.

[**SECTION 9-504A. LIMITATION ON DEFICIENCY CLAIMS IN CONSUMER GOODS TRANSACTION.** If, after default, a secured party [in a consumer secured transaction] takes possession of collateral consisting of consumer goods and the amount owing on the obligation secured by the collateral does not exceed $ [XX] at the time of default, a consumer obligor is not liable to the secured party for the unpaid balance of the obligation secured.]

Reporters' Explanatory Note

This section is new. It eliminates any deficiency claim if a secured party takes possession of consumer goods and the debt at the time of default does not exceed an amount to be specified. The Reporters contemplate that the amount would be a relatively small (e.g., substantially less than amount of a typical new automobile financing). The brackets around the section reflect the absence of a consensus among the members of the Drafting Committee.

SECTION 9-505. ACCEPTANCE OF COLLATERAL IN FULL OR PARTIAL SATISFACTION OF OBLIGATION; COMPULSORY DISPOSITION OF COLLATERAL.

(a) In this section, "proposal" means a written statement by a secured party containing the terms on which the secured party is willing to accept collateral in full or partial satisfaction of the obligation it secures.

(b) A secured party may accept collateral in full or partial satisfaction of the obligation it secures only if:

(1) the debtor consents to the acceptance under subsection (d);

(2) the secured party does not receive, within the time set forth in subsection (e), a written notification of objection to the proposal from a person to whom the secured party was required to send a proposal under subsection (f) or (g) from any other person holding an interest in the collateral subordinate to the security interest that is the subject of the proposal; and

(3) in a consumer secured transaction in which collateral is of a type in which a security interest can be perfected by possession under Section 9-305, the collateral is in the possession of the secured party at the time the debtor consents to the acceptance.

(c) A purported or apparent acceptance of collateral under this section is ineffective unless the secured party consents to the acceptance in a signed writing or sends [written notification of] a proposal to the debtor and the conditions of subsection (b) are met.

(d) For purposes of this section:

(1) a debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees in a writing signed after default; and

(2) a debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees in a writing signed after default or

the secured party:

(i) sends to the debtor after default a proposal that is unconditional or subject only to a condition that collateral not in the possession of the secured party be preserved or maintained;

(ii) in the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and

(iii) does not receive a written notification of objection from the debtor within 21 days after the proposal is sent.

(e) To be effective under subsection (b)(2), a notification of objection must be received by the secured party:

(1) in the case of a person to whom the proposal has been sent pursuant to subsection (f) or (g), within 21 days after notification is sent to that person; and

(2) in other cases, within 21 days after the last notification is sent pursuant to subsection (f) or (g) or, if a notification is not sent, before the debtor consents to the acceptance under subsection (d).

(f) Except in a consumer secured transaction, a secured party that wishes to accept collateral in partial satisfaction of the obligation it secures shall send written notification of its proposal to any affected obligor, and a secured

party that wishes to accept collateral in full or partial satisfaction of the obligation it secures shall send written notification of its proposal in addition to:

(1) any person from whom the secured party has received, before the debtor consented to the acceptance, written notification of a claim of an interest in the collateral;

(2) any other secured party or lien holder that, [21] days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected [or evidenced] by the filing of a financing statement that (i) identified the collateral, (ii) was indexed under the debtor's name as of that date, and (iii) was filed in the proper office or offices in which to file a financing statement against the debtor covering the collateral as of that date (Sections 9-103 and 9-401); and

(3) to any other secured party [or lien holder] that, [21] days before the debtor consented to the acceptance, held a security interest in [or other lien on] the collateral perfected [or evidenced] by compliance with a statute or treaty described in Section 9-302(c).

(g) In a consumer secured transaction, a secured party that wishes to accept collateral in satisfaction of the obligation it secures shall send written notification of its proposal to any person from whom the secured party has received, before the debtor consented to the acceptance, written notification of a claim of an interest in the collateral.

(h) A secured party's acceptance of collateral in full or partial satisfaction of the obligation it secures:

(1) discharges the obligation to the extent consented to by the debtor;

(2) transfers to the secured party all of a debtor's rights in the collateral;

(3) discharges the security interest that is the subject of the debtor's consent and any subordinate security interest or other lien; and

(4) terminates any other subordinate interest.

(i) A subordinate interest is discharged or terminated under subsection (h) whether or not the secured party is required to send or does send notification to the holder thereof. However, any person to whom the secured party was required to send, but did not send, notification has the remedy provided by Section 9-507(b).

(j) A consumer obligor may waive the obligor's rights and the secured party's duties under this section only by signing a statement to that effect after default.

(k) If 60 percent of the cash price has been paid in the case of a purchase money security interest in consumer goods or 60 percent of the principal amount of the obligation secured has been paid in the case of another security interest in consumer goods, and the debtor has not consented to an acceptance, a secured party that has taken possession of collateral shall dispose of the collateral under Section 9-504 within 90 days after taking possession or within any extended period to which all affected obligors have agreed by signing a statement to that effect after default.

(l) In a consumer secured transaction, a secured party may accept collateral only in full satisfaction, and not in partial satisfaction, of the obligation is secures.

(m) In a consumer secured transaction, a statement signed by the debtor or a consumer obligor is ineffective as the agreement of the debtor or consumer

obligor under subsection (d)(2)(i), (j), or (k) unless the secured party proves that the debtor or consumer obligor expressly agreed to its terms.

Reporters' Explanatory Notes

1. **Overview and Organization.** This section deals 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 9-504. The section has been entirely reorganized and substantially rewritten. The more straightforward approach taken in the draft eliminates the fiction that the secured party always will present a "proposal" for the retention of collateral to which the debtor will have a fixed period to respond. By eliminating the need (but preserving the possibility) for proceeding in this fashion, the draft eliminates much of the awkwardness of existing Section 9-505. The draft reflects the Drafting Committee's belief that strict foreclosures should be encouraged and often will produce better results than a disposition for all concerned. This Note explains how the draft section is organized. The following Notes contain a subsection-by-subsection analysis of the text.

Subsection (b) sets forth the conditions necessary to an effective acceptance (formerly, retention) of collateral in full or partial satisfaction of the secured obligation. The first of these conditions is that the debtor must consent to the acceptance. Subsection (d) provides that this consent must be manifested either by the debtor's post-default, signed, written agreement to the acceptance or, in the case of an acceptance in full satisfaction, by the debtor's 21-day silence after receipt of a written "proposal" (as defined in subsection (a)). Subsection (c) conditions the effectiveness of an apparent acceptance on the secured party's written 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 (e) indicates when an objection is timely. The third condition applies only in the case of consumer goods: at the time of the debtor's consent (whether by signed writing or by silence) the secured party must be in possession of collateral that is of a type that can be possessed. If any of these three conditions is not met, any purported or apparent acceptance in satisfaction is ineffective.

In addition to the conditions described above, subsections (g) (for consumer secured transactions) and (f) (for other transactions) require that a secured party that wishes to proceed under this section notify certain other persons that have or that claim an interest in the collateral. Unlike the failure to meet the conditions in subsection (b), under subsection (i) the failure to comply with the notification requirement of subsection (f) or (g) does not render the acceptance of collateral ineffective. Rather, the acceptance can take effect notwithstanding the secured party's noncompliance. Subsection (i) indicates that a person to which the required notice was not sent has the right to recover damages under draft Section 9-507(b). Subsection (h) sets forth the effect of an acceptance of collateral under draft Section 9-505.

Subsections (j), (k), (l), and (m) deal with consumer secured transactions. See Note 12 below.

2. **Proposals.** Subsection (a) is new. It defines the term "proposal." Under the draft, a "proposal" is necessary only if the debtor does not agree to an acceptance in a signed writing as described in subsection (d)(1) or (d)(2)(i). A proposal under subsection (a) 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.

3. **Conditions to Effective Acceptance.** Subsection (b) contains the conditions necessary to the effectiveness of an acceptance of collateral. Subsection (b)(1) requires the debtor's consent. Under subsections (d)(1) and (d)(2)(i), the debtor may consent by agreeing to the acceptance in writing after default. Subsection (d)(2) contains an alternative method by which to satisfy the debtor's-consent condition in subsection (b)(1). It follows the proposal-and-objection model found in existing Section 9-505: The debtor consents if the secured party sends a proposal to the debtor and does not receive an objection within 21 days. Subsection (d)(1) provides 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 written agreement. In all other respects, in non-consumer secured transactions, 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 Section 9-505. See draft Section 9-505(b)(1), (b)(3), (c)(1), (d)(2), and (e)(1), (2), and (3). The Official Comments should explain that, for purposes of determining the time of consent under this section, a debtor's conditional consent constitutes consent.

Subsection (b)(2) contains the second condition to the effectiveness of an acceptance under draft Section 9-505 -- the absence of an objection from a person holding a junior interest in the collateral or from an obligor having a right of recourse against the debtor. Any junior party -- secured party or lien holder -- is entitled to lodge an objection to a proposal, even if that person was not entitled to notification under subsection (f) or (g). Subsection (e), discussed in the Note 7 below, indicates when an objection is timely.

4. **When Acceptance Occurs.** The draft does not impose any formalities or identify any steps that a secured party must take in order to accept collateral once the conditions of subsection (b) have been met. Absent facts or circumstances indicating a contrary intention, the fact that the conditions have been met should provide a sufficient indication that the secured party has accepted the collateral on the terms to which the debtor has agreed or failed to object. 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 Official Comments should state expressly (i) that the secured party is bound

by its agreement to accept collateral and by any proposal to which the debtor consents and (ii) that acceptance of the collateral is automatic upon the secured party becoming bound and the time for objection passing (i.e., that the secured party's agreement to accept collateral is self-executing and cannot be breached).

5. **No Possession Requirement.** The draft eliminates the requirement that the secured party be "in possession" of collateral except for collateral of a type that can be possessed in consumer secured transactions. See draft subsection (b)(3).

6. **No Constructive Strict Foreclosure.** Subsection (c) is intended to make clear that a 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 9-502 or 9-504. The Official Comments should explain that 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.

7. **When Objection Timely.** Subsection (e) 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 subsection (f) or (g) is effective if it is received by the secured party within 21 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 21 days after the last notification is sent under subsection (f) or (g). 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 21-day waiting period.

8. **Notification.** For non-consumer secured transactions subsection (f) 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 statute. The Study Committee recommended that the Drafting Committee add the first class and give serious consideration to adding the second group. See Recommendation 34.B. Subsection (f) also requires notification to any affected obligor if the proposal is one for partial satisfaction.

Subsection (g) provides that the secured party must send notification of a proposal in a consumer secured transaction to those that notify the secured party that they claim an interest in the collateral.

9. **Effect of Acceptance.** Subsection (h) 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. Paragraphs (2) though (4) indicate the effects of an acceptance on various

property rights and interests. Paragraph (2) follows draft Section 9-504(n) in providing that the secured party acquires "all of a debtor's rights in the collateral." Paragraph (3) reflects Recommendation 34.D concerning the effect of strict foreclosure on holders of junior security interests and liens. The effect 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 (i) makes clear that this is the effect regardless of whether a notification was required or, if required, sent. Paragraph (4) provides for the termination of other subordinate interests. Given the breadth of the definition of the term debtor, however, paragraph (2) may render paragraph (4) superfluous.

10. **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. (In that connection, the Official Comments should urge the legislatures to conform those laws so that they mesh well with this section and Section 9-504 and should urge judges to 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.

11. **Accounts, Chattel Paper, and General Intangibles.** If the collateral is accounts, chattel paper, or general intangibles, 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 current Sections 1-201(37) and 9-102. The new security interest would remain perfected by a filing that was effective to perfect the secured party's original security interest. However, the Official Comments to Section 9-203 and this section should explain that the procedures for acceptance of collateral under this section satisfy all necessary formalities and that a new security agreement signed by the debtor would not be necessary.

12. **Consumer Secured Transactions.** Several provisions in draft Section 9-505 apply to consumer secured transactions. Subsection (j) prohibits an affected obligor that is a consumer obligor from waiving the obligor's rights and the secured party's duties under this section. Subsection (k) continues the mandatory-disposition requirement, derived from current Section 9-505(1). Subsection (l) provides that a secured party in a consumer secured transaction may accept collateral in full satisfaction but not in partial satisfaction of the secured obligation. When the effectiveness of a consumer debtor's or consumer obligor's written consent or agreement is at issue, subsection (m) imposes a burden on the secured party to prove that the that the debtor or obligor expressly agreed to its terms.

SECTION 9-506. DEBTOR'S RIGHT TO REDEEM COLLATERAL; REINSTATEMENT OF OBLIGATION SECURED WITHOUT ACCELERATION.

(a) At any time before a secured party has collected collateral under Section 9-502, disposed of collateral or entered into a contract for its disposition under Section 9-504, or accepted collateral in full or partial satisfaction of the obligation it secures under Section 9-505, the debtor, any affected obligor, or any other secured party or lien holder may redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the reasonable expenses and attorney's fees of the type described in Section 9-504(b)(1).

(b) In a consumer secured transaction, a debtor or an affected obligor that is a consumer obligor may cure a default consisting only of the failure to make a required payment and may reinstate the secured obligation without acceleration by tendering

(1) the unpaid amount of the secured obligation due at the time of tender, without acceleration, including charges for delinquency, default, or deferral, and reasonable expenses and attorney's fees of the type described in Section 9-504(b)(1), and

(2) a performance deposit in the amount of (i) [XX] regularly scheduled instalment payments (or minimum payments, if there are no regularly scheduled instalment payments), or (ii) [XX] percent of the total unpaid secured obligation, whichever is less.

(c) Tender of payment under subsection (b) is ineffective to cure a default or reinstate a secured obligation unless made before the later of

(1) 21 days after the secured party sends a notification of disposition under Section 9-504(g) to the debtor and any consumer obligor who is an affected obligor, and

(2) the time the secured party disposes of collateral or enters into a contract for its disposition under Section 9-504 or accepts collateral in full satisfaction of the obligation it secures under Section 9-505.

(d) Tender of payment under subsection (b) restores to the debtor and a consumer obligor who is an affected obligor their respective rights as if the default had not occurred and all payments had been made when scheduled, including the debtor's right, if any, to possess the collateral. Promptly upon the tender, the secured party shall take all steps necessary to cause any judicial process affecting the collateral to be vacated and any pending action based on the default to be dismissed.

(e) A secured obligation may be reinstated under subsection (b) only once during any [XX]-month period.

(f) A debtor or a consumer obligor may waive the right to redeem the collateral (subsection (a)) or reinstate a secured obligation (subsection (b)) only by signing a statement to that effect after default. In a consumer secured transaction, a signed statement is ineffective as a waiver unless the secured party proves that the signer expressly agreed to its terms.

Reporters' Explanatory Notes

1. **Redemption.** Subsection (a) follows existing Section 9-506 with a few changes, most of which are not substantive. In accordance with Recommendation 35, the draft extends the right of redemption to holders of nonconsensual liens.

The rules governing redemption of collateral are surprisingly sparse. For example, the statute is silent concerning the effect of redemption by a competing secured party, whether successive redemptions are possible, what happens if more than one person seeks to redeem, etc. Being unaware of any practical problems that have arisen under this section, however, the Drafting Committee is not inclined to add refinements.

2. **Reinstatement.** Subsection (b) is new and applies only to consumer secured transactions. It provides a right of reinstatement for consumer debtors and affected consumer obligors. The provision derives from several sources, including the Wisconsin Consumer Act (Wis. Stat. § 425.208) and UCC § 5.111.

Under subsection (b) the debtor or obligor may reinstate the debt and cure a payment default (but not other defaults) by tendering all past due amounts (including late charges) without acceleration plus a performance deposit in the amount of the lesser of a to-be-specified number of scheduled payments or a to-be-specified percentage of the secured obligation. The tender must be made within 21 days following a notice of disposition or before disposition (or contract for disposition) or retention under Section 9-505, whichever is later. A debtor or obligor may use this reinstatement right only one time during a specific period (to be determined). Although the Drafting Committee favors a reinstatement provision somewhat along the lines of subsection (b), it has reached no consensus on the specifics of the provision.

3. **Waiver.** Subsection (f) sets forth separately the rules governing waiver for both redemption and reinstatement.

SECTION 9-507. SECURED PARTY'S FAILURE TO COMPLY WITH THIS PART.

(a) If it is established that a secured party is not proceeding in accordance with this part, collection, enforcement, or disposition of collateral may be ordered or restrained on appropriate terms and conditions.

(b) A secured party is liable for damages in the amount of any loss caused by a failure to comply with this part. Except as otherwise provided in subsections (i), (j), and (k), any person that, at the time of the failure, was a debtor, was an affected obligor, or held a security interest or other lien in the collateral has a right to recover damages for its loss under this subsection. A debtor whose deficiency is eliminated pursuant to subsection (c)(3) may recover damages for the loss of any surplus, but a debtor or consumer obligor whose deficiency is eliminated or reduced pursuant to subsection (c)(3) may not otherwise recover under this subsection for noncompliance with Section 9-502, 9-504, or 9-505.

(c) In an action in which the amount of a deficiency or surplus is in issue the following rules apply.

(1) A secured party need not establish compliance with Section 9-502, 9-504, or 9-505 unless the debtor or an affected obligor places the secured party's compliance in issue, in which case the secured party has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with Section 9-502, 9-504, or 9-505, as applicable.

(2) Except as otherwise provided in subsections (i), (j), and (k), if a secured party fails to meet the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with Section 9-502, 9-504, or 9-505:

(i) in a consumer secured transaction for which no other collateral remains to secure the obligation, an affected obligor's liability for a deficiency is limited to any amount by which the sum of the secured obligation, expenses, and attorney's fees exceeds the sum of

(A) the greater of (I) the actual proceeds of the collection, enforcement, disposition, or acceptance and (II) the amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with Section 9-502, 9-504, or 9-505; and

(B) $ [XX].

However, the amount referred to in clause (A)(II) is equal to the sum of the secured obligation, expenses, and attorney's fees unless the secured party meets the burden of establishing that the amount referred to in clause (A)(II) is less than that sum; and

(ii) in other cases, an affected obligor's liability for a deficiency is limited to any amount by which the sum of the secured obligation, expenses, and attorney's fees exceeds the greater of (A) the actual proceeds of the collection, enforcement, disposition, or acceptance and (B) the amount of

proceeds that would have been realized had the noncomplying secured party proceeded in accordance with Section 9-502, 9-504, or 9-505. However, the amount referred to in clause (B) is equal to the sum of the secured obligation, expenses, and attorney's fees unless the secured party meets the burden of establishing that the amount referred to in clause (B) is less than that sum; and, in a consumer secured transaction, any liability is not a personal liability of a consumer obligor but can be satisfied only by enforcing a security interest or other consensual lien against property securing the obligation.

(d) The fact that a greater amount could have been obtained by a collection, enforcement, disposition, or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition, or acceptance was made in a commercially reasonable manner.

(e) A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

(1) in the usual manner on any recognized market therefor,

(2) at the price current in any recognized market at the time of the disposition, or

(3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

(f) A collection, enforcement, disposition, or acceptance that has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors is commercially reasonable. But approval need not be obtained, and failure to obtain approval does not mean that the collection, enforcement, disposition, or acceptance is not commercially reasonable.

(g) Except as otherwise provided in subsections (i), (j), and (k), in a consumer secured transaction, a person that at the time that a secured party fails to comply with this part, is a debtor has a right to recover from the noncomplying secured party an amount equal to the interest or finance charges plus 10 percent of the principal amount of the obligation, less the sum of any amount by which any consumer obligor's personal liability for a deficiency is eliminated or reduced under subsection (c) and any amount for which the secured party is liable under subsection (b).

(h) In a consumer secured transaction, if the secured party's compliance with this part is placed in issue in an action, (i) if the secured party would have been entitled to attorney's fees had the secured party been the prevailing party, the court shall, and (ii) in other cases the court may, award to a consumer debtor or consumer obligor prevailing on that issue the costs of the action and reasonable attorney's fees. In determining the attorney's fees, the amount of the recovery on behalf of the prevailing consumer debtor or consumer obligor is not a controlling factor.

(i) Unless a secured party knows that a person is a debtor or an affected obligor, knows the identity of the person, and knows how to communicate with the person:

(1) the secured party is not liable to the person or to a secured party or lien holder that has filed a financing statement against the person for failure to comply with this part; and

(2) the secured party's failure to comply with this part does not affect the liability of the affected obligor for a deficiency.

(j) A secured party is not liable to any person because of any act or omission, other than the failure to send a notification required by Section

9-504(g)(2), that occurs before the secured party knows that the person is a debtor or an affected obligor or knows that the person has a security interest or other lien in the collateral.

(k) A secured party is not liable to any person because of any act or omission arising out of the secured party's reasonable belief that a transaction is not a consumer secured transaction [or that goods are not consumer goods] if the secured party's belief is based on its reasonable reliance on a debtor's representation concerning the purpose for which collateral was to be used, acquired, or held, or an obligor's representation concerning the purpose for which a secured obligation was incurred.

Reporters' Explanatory Notes

1. **Injunctions.** Subsection (a) is the first sentence of existing subsection (1), with the addition of the references to "collection" and "enforcement."

2. **Damages.** Subsection (b) derives from the second sentence of existing subsection (1) and sets forth the basic remedy for failure to comply with Part 5: a damage recovery in the amount of loss caused by the noncompliance. The draft expands upon the existing sentence by affording a remedy to any aggrieved person that is an affected obligor or that holds a competing security interest or lien, regardless of whether the aggrieved person is entitled to notification under Part 5. The remedy would be available even to holders of senior security interests and liens. The Official Comments should explain that exercise of this remedy is subject to the normal rules of pleading and proof and that 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 (b) makes it clear that a debtor whose deficiency is reduced or eliminated under subsection (c) can pursue a claim for a surplus. It also eliminates the possibility of double recovery or other over-compensation arising out of noncompliance with Section 9-502, 9-504, or 9-505.

3. **Rebuttable Presumption Rule.** The basic remedy under subsection (b) is subject to the special rules contained in subsection (c). This subsection 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. Subsection (c) contains special rules applicable to a determination of the amount of a deficiency or surplus. Under subsection (c)(1), the secured party need not prove compliance with Section 9-502, 9-504, or 9-505 as part of its prima facie case. If, however, the debtor 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

subsection (c)(2) explains how to calculate the deficiency. For most cases, a rule popularly known as the "rebuttable presumption rule" applies. As formulated in the draft, the rule means that the debtor or obligor is to be credited with the greater of the actual proceeds of the disposition and the proceeds that would have been realized had the secured party complied with Section 9-502, 9-504, or 9-505. If a deficiency remains, then the secured party is entitled to recover it. See subsection (c)(2)(ii). The references to "the secured obligation, expenses, and attorney's fees" in subsection (c) embrace the application rules in Section 9-502(d)(1)(i) and (ii) and Section 9-504(b)(1) and (2).

The second sentence of subsection (c)(2)(ii) provides that, unless the secured party proves that compliance with Part 5 would have yielded a smaller amount, 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 attorneys' fees. Thus, the secured party may not recover any deficiency unless it meets this burden of proof.

4. **Absolute Bar Rule.** Subsection (c)(2)(i) sets forth a variant of the "absolute bar rule" for consumer transactions in which no other collateral remains. Subsection (c)(2)(i)(B) in effect imposes a cap on the amount of a deficiency that is barred. The noncomplying secured party can recover the portion of a deficiency claim that exceeds the cap. The Drafting Committee has not reached a decision as to the amount of the cap. If other collateral remains in a consumer secured transaction, subsection (c)(2)(ii) applies, but the secured party may recover on its claim only by foreclosing on additional collateral.

5. **Scope of Subsection (c).** The rules in subsection (c) apply only to noncompliance under Section 9-502, 9-504, or 9-505. For other types of noncompliance with Part 5 the general rule for the recovery of actual damages under subsection (b) applies. Consider, for example, a repossession that does not comply with Section 9-503 for want of a default. The debtor's remedy is under subsection (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 9-504 at that time and subsection (c) would apply.

6. **Delay in Applying Subsection (c).** 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 5. During the interim, the secured party, believing that the secured debt 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 or the absolute bar rule, a reasonable application of Section 9-507 would impose liability on the secured party for the amount of the excess, unwarranted recoveries. The Official Comments should be revised to explain the appropriate result and analysis.

7. **Relationship of Price to Commercial Reasonableness.** Subsections (d), (e), and (f) contain rules addressing whether a disposition was commercially reasonable. They are borrowed from existing Section 9-507(2), with some slight modifications. Arguably, these would be more appropriately located in Section

9-504; however, the Drafting Committee is inclined to leave them where they are now found.

Some observers have found the notion contained in draft subsection (d) (the fact that a better price could have been obtained does not establish lack of commercial reasonableness) to be inconsistent with that found draft Section 9-504(d) (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. In most cases there is a range of commercially reasonable prices that collateral will fetch. Disposing of collateral for a price within that range may be commercially reasonable even though the particular price is not the best price. The draft does not define fully the relationship between the two sections. In particular, it leaves open the question of how courts are to evaluate a disposition that is procedurally commercially reasonable (e.g., advertising, preparation of collateral, etc.) but which yields an extremely low price.

One approach would begin from the premise that the price is one of the "terms" that, under Section 9-504(d), must be commercially reasonable. Under that approach, the trier of fact could predicate a finding that a procedurally sound disposition was noncomplying solely on the basis of a low price. Others assert that a low price is relevant to whether a disposition has been commercially reasonable only to the extent that a low price suggests the need for careful judicial scrutiny of other aspects of the disposition. Under the latter approach, commercial reasonableness is exclusively a question of process. Those who advocate the latter approach would acknowledge that where the price is extremely low, other aspects of the disposition (e.g., the time and manner) might well have been commercially unreasonable. But if they were not, then those who take the latter approach would not find fault with the disposition.

A third approach would recognize that a secured party may credit the obligor with an amount that is greater than the actual net proceeds that otherwise would be used to calculate a deficiency. A secured party might wish to do so, for example, if a procedurally commercially reasonable disposition yields a nominal price. Recognition of this alternative method of calculating a deficiency could be added to the statute or explained in the Official Comments. This approach has not yet been discussed by the Drafting Committee.

8. **Undefined Terms.** The Official Comments should explain that the concept of a "recognized market" in subsection (e)(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. Also, the Official Comments should explain "commercial practices among dealers" in subsection (e)(3). Some are of the view that the relevant commercial practices are those of dealers acting for their own account, not as enforcing secured parties.

9. **Waiver.** The Official Comments to Section 9-507 should explain that a waiver of rights or duties by a debtor, secured party, or other lien holder carries with it, by implication, a waiver of any right to a remedy or recovery under that section arising out of noncompliance with the right or duty that has been waived.

10. **Minimum Damages.** Subsection (g) derives from existing Section 9-507(1), which affords a "minimum damage" recovery (a/k/a "penalty") for noncompliance in the case of consumer goods. Subsection (g) clarifies the relationship among the statutory minimum recovery (subsection (g)), the general damage rules (subsection (b)), and the deficiency rules (subsection (c)). It provides that the amount by which the deficiency is reduced or eliminated under subsection (c) and the amount of any other damages recoverable under subsection (b) (e.g., any surplus to which the debtor would have been entitled had the secured party complied with Part 5) are both to be credited against the minimum statutory recovery.

11. **Attorney's Fees.** Subsection (h) provides that a prevailing consumer in an action is entitled to attorneys' fees if the secured party would have been entitled to attorney's fees had it prevailed. It leaves the question whether a secured party is entitled to attorney's fees to the parties' agreement and other law.

12. **Exculpatory Provisions.** Subsections (i), (j), and (k) are exculpatory provisions that should be read in conjunction with Section 9-501(i). 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.

APPENDIX

SECTION 1-201. GENERAL DEFINITIONS.

* * *

(37) "Security interest" means . . . The term also includes any interest of a buyer of accounts, chattel paper, or a general intangible in a transaction that is subject to Article 9.

* * *