

**UNIFORM COMMERCIAL CODE  
REVISED ARTICLE 9  
SECURED TRANSACTIONS; SALES OF  
ACCOUNTS, CHATTEL PAPER, AND PAYMENT INTANGIBLES**

Reporters' Prefatory Notes	1
PART 1. SHORT TITLE AND GENERAL MATTERS	
Section 9-101. Short Title. [Minor Style Changes Only]	3
Section 9-102. Policy and Scope of Article.	3
Section 9-103. Perfection and Priority of Security Interest and Agricultural Lien in Multiple State Transactions.	5
Section 9-104. Transactions Excluded From Article.	24
Section 9-105. Definitions and Index of Definitions.	27
Section 9-106. Definitions: "Account"; "General Intangibles"; Payment Intangible."	39
Section 9-107. Definitions: "Purchase Money Security Interest"; "Purchase Money Collateral"; Purchase Money Obligation"; "Inventory Purchase Money Security Interest"; Burden of Establishing Purchase Money security Interest.	40
Section 9-107A. Definitions: "Production Money Security Interest"; "Production Money Crops"; "Production Money Obligation"; ["Production of Crops"]; Burden of Establishing Production Money Security Interest.	46
Section 9-108. When After-Acquired Collateral Not Security for Antecedent Debt. [Deleted]	47

Section 9-109.	Classification of Goods: "Consumer Goods"; "Equipment"; "Farm Products"; "Inventory."	47
Section 9-110.	Sufficiency of Description.	48
Section 9-111.	Applicability of Bulk Transfer Laws. [Minor Style Changes Only]	49
Section 9-112.	Where Collateral Is Not Owned by Debtor. [Deleted]	50
Section 9-113.	Security Interests Arising Under Article on Sales or Under Article on Leases. [Minor Style Changes Only]	50
Section 9-114.	<del>Consignment. [Minor Style Changes Only]</del> <u>Rights and Title of Consignee with Respect to Creditors and Purchasers.</u>	51
Section 9-115.	Investment Property. <del>[Minor Style Changes Only]</del>	53
Section 9-116.	Security Interest Arising in Purchase or Delivery of Financial Asset. [Minor Style Changes Only]	58
Section 9-117.	"Control" Over a Deposit Account.	59
Section 9-118.	<u>"Control" Over Investment Property.</u>	61
Section 9-119.	<u>"Control" Over Letter of Credit and Proceeds of Letter of Credit.</u>	62

## PART 2. VALIDITY OF SECURITY AGREEMENT

### AND RIGHTS OF PARTIES TO SECURITY AGREEMENT

Section 9-201.	General Validity of Security Agreement.	63
Section 9-202.	Title to Collateral Immaterial.	64

Section 9-203.	Attachment and Enforceability of Security Interest; Proceeds; <u>Support Obligations</u> ; _____ Formal Requisites.	64
Section 9-204.	After-Acquired Property; Future Advances.	67
Section 9-205.	Use or Disposition of Collateral Without Accounting Permissible.	68
Section 9-206.	Agreement Not to Assert Defenses Against Assignee; Modification of Sales Warranties Where Security Agreement Exists.	68
Section 9-207.	Rights and Duties if Collateral Is in Secured Party's Possession.	70
Section 9-208.	Request for Statement of Account or List of Collateral.	73
Section 9-209.	Effect of Security Interest on Depository Institution's Right of Set-Off.	74

PART 3. RIGHTS OF THIRD PARTIES; PERFECTED AND UNPERFECTED SECURITY INTERESTS; RULES OF PRIORITY

Section 9-301.	Persons That Take Priority Over Unperfected Security Interest or Agricultural Lien; Rights of "Lien Creditor."	75
Section 9-302.	When Filing <del>Is</del> Required to Perfect Security Interest or Agricultural Lien; Security Interests and Agricultural Liens to Which Filing Provisions <del>of This Article</del> Do Not Apply.	77
Section 9-303.	When Security Interest or Agricultural Lien	

	Is Perfected; Continuity of Perfection.	85
Section 9-304.	Perfection of Security Interest in Instruments, <del>Deposit Accounts,</del> Chattel Paper, Documents, <u>Money, Deposit Accounts, Letters of Credit,</u> and Goods Covered by Documents; Perfection by Permissive Filing; Temporary Perfection Without Filing or Transfer of Possession.	86
Section 9-305.	When Possession by Secured Party Perfects Security Interest Without Filing.	89
Section 9-305A.	Perfection by Control.	92
Section 9-306.	"Proceeds"; Secured Party's Rights on Disposition of Collateral; Secured Party's Rights in Proceeds.	92
Section 9-307.	Protection of Buyers of Goods.	96
Section 9-308.	Purchase of Chattel Paper and Instruments.	97
[Section 9-308A.	Transfer of <u>Money; Transfer of</u> Funds From Deposit Account.]	98
Section 9-309.	Protection of Purchasers of Instruments, Documents, and Securities. [Minor Style Changes Only]	100
Section 9-310.	Priority of Certain Liens Arising by Operation by Law. [Minor Style Changes Only]	100
Section 9-311.	Alienability of Debtor's Rights.	101
Section 9-312.	Priorities Among Conflicting Security Interests and Agricultural Liens in the Same Collateral.	101
[Section 9-312A.	Effectiveness of Right of Recoupment or	

	Set-Off Against Deposit Account.]	111
Section 9-313.	Priority of Security Interests in Fixtures. [Minor Style Changes Only]	111
Section 9-314.	Accessions. [Minor Style Changes Only]	115
Section 9-315.	Priority If Goods Are Commingled or Processed. [Minor Style Changes Only]	116
Section 9-316.	Priority Subject to Subordination. [Minor Style Changes Only]	117
Section 9-317.	Secured Party Not Obligated on Contract of Debtor. [Minor Style Changes Only]	117
Section 9-318.	Rights Acquired by Assignee; Defenses Against Assignee; Modification of Contract; <u>Discharge of Account Debtor</u> ; <del>After</del> Notification of Assignment; <del>Term Prohibiting Assignment Ineffective</del> ; Identification and Proof of Assignment; <u>Term Prohibiting Assignment Ineffective</u> .	118
[Section 9-318A.	Depository Institution's Right to Dispose of Funds in Deposit Account.]	123
<u>Section 9-318B.</u>	<u>Restrictions on Assignment of Certain General Intangibles Ineffective.</u>	124

#### PART 4. FILING

Section 9-401.	Place of Filing.	127
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.	128
Section 9-402A.	Effectiveness of Financing Statement If New Debtor Becomes Bound by Security Agreement.	135
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.	136
Section 9-404.	Termination Statement.	145
Section 9-405.	Assignment of Rights Under Financing Statement; Duties of Filing Office.	147
Section 9-406.	Multiple Secured Parties of Record.	148
<u>Section 9-406A.</u>	<u>Successor of Secured Party.</u>	149
Section 9-407.	Information From Filing Office; Sale or License of Records.	150
Section 9-408.	Filing and Compliance with Other Statutes and Treaties for Consignments, Leases, Bailments, and Other Transactions.	151
Section 9-409.	Registered Agent.	152
Section 9-410.	Assignment of Functions to Private Contractor.	152
Section 9-411.	Delay by Filing Office.	153
Section 9-412.	Fees.	153
Section 9-413.	Administrative Rules.	154
Section 9-414.	Duty to Report.	155

Section 9-415.	<u>Claim Concerning Inaccurate or Wrongfully Filed Record; Failure to Send or File Termination Statement; Correction Statement; Termination Request; Objection Statement; Filing Office Statement.</u>	158
----------------	--	-----

PART 5. DEFAULT

Section 9-501.	Default; Judicial Enforcement; Waiver and Variance of Rights and Duties; Procedure If Security Agreement Covers Both Real and Personal Property.	162
Section 9-502.	Collection and Enforcement by Secured Party.	166
Section 9-503.	Secured Party's Right to Take Possession After Default. [Minor Style Changes Only]	171
Section 9-504.	Disposition of Collateral After Default.	172
[Section 9-504A.	Limitation on Deficiency Claims in Consumer Goods Transaction.]	186
Section 9-505.	Acceptance of Collateral in Full or Partial Satisfaction of Obligation; Compulsory Disposition of Collateral.	186
Section 9-506.	Right to Redeem Collateral; Reinstatement of Obligation Secured Without Acceleration.	191
Section 9-507.	Secured Party's Failure to Comply With This Part.	194

APPENDIX

Section 1-201(9)	Definition of "buyer in ordinary course of business."	200
Section 1-201(32)	Definition of "purchase."	201
Section 1-201(37)	Definition of "security interest."	201
<u>Section [2-102].</u>	<u>Definitions of "consignee," "consignment," and "consignor."</u>	<u>202</u>
<u>Section [2-406].</u>	<u>Sale on Approval and Sale or Return; Special Incidents.</u>	<u>203</u>
<del>Section [2-407].</del>	<del>Consignment Sales and Rights of Creditors.</del>	<del>204</del>
<u>Section 5-118.</u>	<u>Security Interest in Documents, Instruments, and Certificated Securities Accompanying Presentation and Proceeds.</u>	<u>205</u>



**UNIFORM COMMERCIAL CODE  
REVISED ARTICLE 9  
SECURED TRANSACTIONS; SALES OF  
ACCOUNTS, CHATTEL PAPER, AND PAYMENT INTANGIBLES**

**Reporters' Prefatory Notes**

1. General.

With a few exceptions, noted below, this draft is marked to show changes from the November 15, 1995, Draft, which the Drafting Committee discussed at its December meeting in Miami. The Notes cover only the changes made in this draft; they do not explain past changes.

The draft reflects the Drafting Committee's deliberations on such topics as assignments of receivables, possessory security interests, purchase money security interests, and consignments. The draft also contains provisions addressing topics that the Drafting Committee has yet to consider in any detail. These include security interests in letters of credit and suretyship obligations, and security interests in non-transferrable rights. The draft also addresses a few new topics with respect to filing and enforcement. In addition, the draft corrects errors and makes a number of stylistic and other minor changes that are not noted in the Notes.

Several provisions of the draft address issues of consumer protection. These provisions were added by the Reporters last year for purposes of discussion. The Drafting Committee has not reached a consensus on the substance of most of these provisions or on whether Article 9 should treat the various concerns that the provisions address. Pending the recommendations of the Subcommittee on Consumer Transactions and the responses of the Drafting Committee and Executive Committee, this draft makes no changes, other than correction of errors, with respect to consumer-protection provisions.

2. Goods Covered by a Certificate of Title and Federal-State Interface.

The 1995 Annual Meeting Draft contained several revisions dealing with security interests in goods covered by a certificate of title (primarily motor vehicles) and the interface between the UCC and federal statutes that deal with perfection of security interests in specialized types of collateral, e.g., intellectual property and civil aircraft. The Drafting Committee considered those revisions during its June, 1995, meeting. The November 15, 1995, Draft contained further revisions to the statutory text, but the Drafting Committee did not discuss them at its December, 1995, meeting. Those revisions have been reproduced in this draft as they appeared in the prior draft; i.e., they have been

marked to show changes from the 1995 Annual Meeting Draft. The principal affected provisions are §§ 9-103(c); 9-302(b) and (c); 9-305(b); and 9-504(q). To aid in comprehension, the relevant Notes from both the 1995 Annual Meeting Draft and the November 15, 1995, Draft have been reproduced (but renumbered).

UNIFORM COMMERCIAL CODE  
REVISED ARTICLE 9  
SECURED TRANSACTIONS; SALES OF  
ACCOUNTS, CHATTEL PAPER, AND PAYMENT INTANGIBLES

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 to:

(1) ~~to any transaction, (regardless of its form), that creates a security interest in personal property or fixtures by contract [including accounts, chattel paper, deposit accounts, documents, financial assets, general intangibles, goods, instruments, [insurance policies,] investment property, or letters of credit];~~

(2) ~~to any agricultural lien; and~~

(3) ~~to any sale of an accounts, chattel paper, or payment intangibles; and~~

(4) any consignment.

~~(b) 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 for security]. [This article does not apply~~

~~to statutory liens other than agricultural liens except as otherwise provided in Section 9-310].~~

(~~b~~c) 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. This draft deletes the "including . . ." phrase in subsection (a) and combines subsection (b) of the preceding draft (existing § 9-102(2)) into subsection (a). No change in meaning is intended.

2. New subsection (a)(4) reflects this draft's treatment of consignments. Under common law, a (true) consignment is a bailment. Normally, creditors of a bailee would be unable to reach the interest of the bailor (in the consignment case, the consignor-owner). However, existing § 2-326 overrides that rule and apparently provides that consigned goods are subject to the claims of the consignee's creditors while in the consignee's possession, unless the consignor gives public notice of its interest in the goods. One method by which public notice may be given is by "compl[ying] with the filing provisions" of Article 9.

The 1972 amendments to Article added § 9-114, which contains priority rules that, to a considerable extent, analogize the (ownership) interest of the consignor to a purchase money security interest in inventory; however, these rules are incomplete and, to some extent, confused. See Study Committee Report § 25.E.

Working from the basic idea that the failure to afford public notice would leave the consignor's interest vulnerable to claims of the consignee's creditors, we saw two approaches to dealing with consignments in revised Article 9. One approach is to follow doctrines of property law strictly. Under this approach the rights of creditors of the consignee would depend, from time to time, on whether the consignor filed a financing statement. During the time that a filed financing statement is effective, the rule in § 2-326 would not apply, and the consignee's creditors would enjoy the same rights that they would have against any other bailee; they could not reach the ownership interest of the bailor, but they might be able to reach the interest (often called a "special property") of the bailee-consignee. Reaching this interest would be of little practical value, however, because the consignee's interest is subject to

defeat by the consignor. On the other hand, during the time that no effective financing statement was on file, the consignee's creditors could reach the interest of the owner-consignor.

The draft opts for a less analytically pure but (we think) considerably less cumbersome approach. Draft § [2-102] defines the terms "consignment," "consignor," and "consignee." For purposes of determining the rights and interests of third-party creditors of, and purchasers of the goods from, the consignee, but not for other purposes, such as remedies of the consignor, the consignee acquires whatever rights and title the consignor had or had power to transfer. Draft § 9-114. The interest of a consignor is defined to be a security interest, see draft § 1-201(37), more specifically, a purchase money security interest in the consignee's inventory. See draft § 9-107(c). Thus, the rules pertaining to lien creditors (draft § 9-301), buyers (draft §§ 9-301, 9-307), and attachment and priority of competing security interests (draft §§ 9-203, 9-312) apply to consigned goods. Accordingly, draft § 9-102(a) provides that Article 9 applies to consignments.

**SECTION 9-103. PERFECTION AND PRIORITY OF SECURITY INTEREST AND AGRICULTURAL LIEN IN MULTIPLE STATE TRANSACTIONS.**

(a) Nonpossessory ~~Non-possessory~~ security interest.

(1) This subsection applies to a nonpossessory ~~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~~ a debtor is located in a jurisdiction, perfection, the effect of perfection or nonperfection, ~~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~~ While 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~~ a 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 nonperfection ~~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 subsections (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~~ occurs 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 previous times ~~prior thereto~~.

(7) Insofar as it affects the priority of a security interest over a buyer of consumer goods (Section 9-307(c)), 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 and agricultural lien.

(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), and to an agricultural lien on collateral.

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

(3) Perfection of an agricultural lien on the collateral is governed by the local law of the jurisdiction in which the debtor is located. Subsections (a) (4), (5), and (6) apply to an agricultural lien.

(4) Except as otherwise provided in this subsection, ~~during the time that~~ while collateral is located in a jurisdiction, the effect of perfection or nonperfection ~~non-perfection~~ and the priority of an agricultural lien on the collateral are governed by the local law of that jurisdiction.

(5) 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 local law of the jurisdiction under whose certificate the goods are covered from ~~when~~ the time the goods become covered by the certificate until the earlier of

[clause (i)--Alternative A]

(i) ~~when~~ the time the certificate is surrendered [and canceled by the issuing authority] or

[clause (i)--Alternative B]

(i) when the time the certificate becomes ineffective under the law of that jurisdiction or

(ii) when the time 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.

[Subsection (5)--Alternative A]

(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 time 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 had 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 as against a purchaser of the goods for value prior thereto.

[Subsection (5)--Alternative B]

(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 security interest would have become unperfected by the law of the other jurisdiction had the goods not become so covered. However, if the applicable steps required for perfection under Section 9-302(d) [or ~~Section 9-305~~] are not taken before the earlier of (i) ~~when~~ the time 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 had become so covered, as against a purchaser of the goods for value the security interest becomes unperfected and is deemed to have been unperfected at all times.

(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, other than a person that is in the business of selling goods of that kind, 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~~ under Section 9-302(d), after issuance of the certificate and without knowledge of the security interest. [However, if the security interest was perfected by compliance with a certificate of title statute of another jurisdiction and the applicable steps required for perfection under Section 9-302(d) [or 9-305] are taken within four months after the goods become covered by the certificate from this jurisdiction, then the security interest takes priority over the conflicting security interest.]

[(7) Perfection of a security interest by filing is governed by the local law of the jurisdiction in which the debtor is located, as determined by the provisions of subsections (a) (4) and (5). Subsection (a) (6) applies to 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 nonperfection, ~~nonperfection~~, 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 subsection: ~~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~~ occurs 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 previous 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. Subsections (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~~ while a security certificate is located in a jurisdiction, perfection, the effect of perfection or nonperfection, ~~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 nonperfection ~~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. Subsections (a)(4), (5), and (6) apply to a security interest perfected by any of ~~these~~ those methods.

**Reporters' Explanatory Notes - November 15, 1995 Draft**

1. Subsection (c)(4) is the basic choice-of-law rule for goods covered by a certificate of title. Perfection is governed by the law of the jurisdiction under whose certificate the goods are covered. Subsection (c)(4) explains when that law ceases to apply.

Alternative A of clause (i) follows existing § 9-103(2)(b) and provides that the law of the jurisdiction issuing the certificate ceases to apply upon "surrender" of the certificate. In the case of automobiles, certificate of title statutes generally require tender of any outstanding certificate as a condition for issuance of a new certificate. See, e.g., Uniform C/T Act § 6(c)(1). This tender is the "surrender" to which existing subsection (2)(b) refers. This rule reflects the idea that notation of a security interest on a certificate of title affords notice to third parties only so long as the certificate is outstanding. Official Comment 4(c) indicates that "[s]ince the secured party ordinarily holds the certificate, surrender thereof could not occur without his action in the matter in some respect." In some states, however, the debtor holds the certificate and has the power to surrender it and thereby render the secured party unperfected. And when more than one security interest is noted on a single certificate, the certificate may be surrendered with the consent of one, but not the other, secured party.

One might respond that, inasmuch as a security interest noted on a certificate of title that has been removed from circulation no longer serve any public notice function, the secured party should bear the risk of becoming unperfected as a consequence of the debtor's (or competing secured party's) wrongdoing.

However, in response to discussions at the June, 1995, meeting, the draft proposes two alternative ways to address this situation. In considering these alternatives, note that under clause (ii), the governing law changes when the goods become

covered by a certificate of title from another jurisdiction. If certificates of title normally are not surrendered except in conjunction with the issuance of a new certificate (which seems to be the case), then it may not make much difference which alternative clause (i) the Drafting Committee chooses. And if the Drafting Committee decides to permit perfection by filing (see Note 5 below), then the precise contours of a "surrender" rule may have less importance.

One approach to reducing the secured party's risk would be to provide, as Alternative A does in brackets, that the law of the issuing jurisdiction applies until the occurrence of both surrender of the certificate and its cancellation by the issuing jurisdiction. This section might be accompanied by a Note recommending that legislatures amend their certificate of title statutes to provide that certificates will not be canceled without the consent of secured parties of record. In determining whether to include the bracketed reference to cancellation, the Drafting Committee should note that the Uniform C/T Act refers to cancellation of a certificate only with respect to vehicles that are scrapped, dismantled, or destroyed; other statutes may not use the term at all. If the Drafting Committee concludes that perfection should continue even after the certificate is surrendered until it is canceled, the Committee should consider subordinating the security interest noted on the out-of-circulation certificate to subsequent good-faith purchasers for value, who would have no convenient means of discovering the security interest. On the other hand, unless a new certificate of title has been issued that affords the purchaser priority under subsection (c)(6), it might be more appropriate to subordinate the rights of one who purchases following a surrender.

Alternative B reflects a slightly different solution that, like the bracketed language in Alternative A, is designed to keep the law of the original jurisdiction in effect as the governing law in the event of a wrongful surrender of the certificate. It would provide that the law of the original jurisdiction governs until the certificate becomes ineffective under that law. Given the diversity in certificate of title statutes, the draft makes no effort to define "ineffective." There seemed to be substantial support for this approach among members of the Drafting Committee and others at the June, 1995, meeting.

2. Subsection (c)(5) maintains the perfection of a security interest perfected under the law of one jurisdiction even though the goods become covered by a certificate of title from another jurisdiction. Under existing law, as long as the certificate has not been surrendered, the security interest remains perfected for at least four months following removal of the goods from the issuing jurisdiction. Alternative A, which appeared in the 1995 Annual Meeting Draft, contains a similar four-month rule. The revisions to Alternative A are discussed below in Note 3.

In accordance with the discussion at the June, 1995, Drafting Committee meeting, we have included Alternative B, under which a security interest perfected by any method under the law of another jurisdiction (State A) remains perfected, notwithstanding that the goods have become covered by a (perhaps, another) certificate of title under the law of State B. The chief effect of Alternative B is to enable a secured party who does not reperfect (perhaps because the secured party is holding a State A certificate of title that notes the security interest) to remain perfected as against a lien creditor or donee. The second sentence of Alternative B affords protection to buyers and secured parties by providing that if the secured party fails to reperfect with respect to the State B certificate within four months, the security interest will be deemed unperfected as against purchasers for value.

3. If the Drafting Committee adopts the approach of Alternative A, it must also determine the effect of becoming unperfected. Existing law does not explain the effect of becoming unperfected when the collateral is covered by a certificate of title; however, existing § 9-103(1)(d), which applies to "ordinary goods," provides that, upon becoming unperfected, the security interest is "deemed to have been unperfected as against a person who became a purchaser after removal." To eliminate the possibility of circular priorities, and to grant repose to a broader group of persons who acquire an interest in the collateral, the Study Committee recommended, in that context, that unperfection be made retroactive against non-purchasers (e.g., lien creditors) as well as purchasers. See Recommendation 9.E The 1995 Annual Meeting Draft reflected and expanded upon that approach.

At the June, 1995, meeting, Professor Shupack observed that the approach of the Annual Meeting Draft could cause problems if the debtor entered bankruptcy during the four-month period and the secured party did not continue perfection. A court might hold (erroneously, in our view) that the lapse of perfection and the "deemed" past unperfection subjected the security interest to avoidance under Bankruptcy Code § 544(a)(1). Also, a secured party who receives a prebankruptcy payment of the secured obligation while the security interest is perfected might (but in our view, should not) run a preference risk if the security interest subsequently becomes unperfected before under the four-month rule following bankruptcy. To take account of these potential problems, the draft makes the retroactive unperfection effective only against purchasers for value.

Alternative B of subsection (c)(5) follows a similar approach. Under that alternative, the fact that the goods are covered by State B's certificate does not affect the perfection of a security interest perfected under the law of State A. However, if the secured party fails to reperfect under the law of State B within four months, then--as against purchasers of the goods for

value--the security interest is treated as unperfected both prospectively and retroactively.

The "deemed to have been unperfected" rule in subsection (c) (5), like the rule in existing § 9-103, has the potential to create circular priorities. We hope to develop a new statutory provision that will prevent these and similar rules from creating circular priorities. Such a new provision would be designed to insure that a special priority rule affects only the two parties referred to in the special rule; otherwise, the special rule would not affect third parties. To accomplish this result, it may be desirable to articulate the "deemed unperfected" rule as a rule of subordination. For an example of a subordination rule designed not to affect third parties, see Bankruptcy Code § 724(b).

4. Subsection (c) (6) affords protection to certain good faith purchasers for value who rely on a "clean" certificate of title. Under that subsection, the protected purchasers can take free of a security interest that is perfected under the law of another jurisdiction. At the direction of the Drafting Committee, we have revised paragraph (6) (i) to exclude used car dealers and the like from the class of buyers who are entitled to rely on a clean certificate. Paragraph (6) (ii) protects secured parties who rely on a clean certificate.

Except as provided in the new, bracketed sentence (discussed in the paragraph immediately following), the persons who rely on a clean certificate of title would take priority over a security interest no matter how perfected. The draft would protect a qualifying secured party, even if the competing secured party has perfected by taking possession of the goods; however, the Drafting Committee may wish to consider the issue.

At the June, 1995, meeting, the following hypothetical was posed with respect to draft subsection (c) (6) (ii): SP-1 perfects on a certificate issued by State A. State B issues a clean certificate, and SP-2 perfects under the law of State B. The Annual Meeting Draft suggested that if SP-B qualified under subsection (c) (6) (ii), SP-1 would be junior, even if SP-1 perfected under the law of State B within the four-month period. The Drafting Committee did not reach any conclusion as to whether the Annual Meeting Draft gave the desired result. In the event that the Drafting Committee concludes that SP-2 should be subordinated under these circumstances, the new, bracketed sentence would afford priority to SP-1. Note that the bracketed sentence would not afford priority to SP-1 if SP-1 perfected under State A's law by a method other than compliance with a certificate of title law.

5. At its June, 1995, meeting, the Drafting Committee instructed us to pursue the option of permitting perfection by filing with respect to collateral covered by a certificate of

title. The availability of this option would be particularly helpful to secured parties in two circumstances: (i) when only a few states have certificate of title statutes pertaining to the goods in question (in that case, a secured party might have no reason to suspect that the goods are covered by a certificate of title), and (ii) when a secured party perfects under a certificate of title law but the governing law changes under subsection (c) (4).

Under new subsection (c) (7), which is bracketed to reflect the split on the Drafting Committee, perfection of security interests by filing (but not the priority of the perfected security interests) would be governed by the law of the debtor's location, as determined by the rules generally applicable to non-possessory security interests. The new subsection also incorporates the four-month rule generally applicable to changes in the debtor's location. In governing perfection by the law of one jurisdiction and priority by the law of another, we have followed existing § 9-103(6), dealing with investment property.

Given the lack of consensus among the members of the Drafting Committee, we have not attempted at this time to produce a complete draft of provisions that would be needed to implement filing as a perfection alternative for some or all goods covered by a certificate of title. Rather, we think it more useful to describe some of the changes that probably would be necessary, so that the Drafting Committee can revisit the issue.

First, if filing is an available method of perfection, there may be no practical need for a perfection-by-possession option. Accordingly, draft § 9-305(b) could be deleted. In addition, all references to § 9-305 in § 9-103(c) could be replaced by references to perfection by filing.

Second, § 9-302(c) and (d), which now indicate that filing is ineffective to perfect, would need to be adjusted to provide that filing is an alternative method of perfection.

Third, § 9-302(a) (4) [renumbered as (a) (7)], dealing with purchase money security interests in consumer goods, would need to be revised to require either filing or perfection under the certificate of title law for goods covered by a certificate of title.

Fourth, adjustments in the priority rules probably would be needed. Section 9-301(a) might be revised to provide that a qualifying non-ordinary-course buyer takes free of a security interest perfected only by filing, and § 9-312 presumably would need to subordinate security interests perfected by filing to those perfected by compliance with the certificate of title law.

**Reporters' Explanatory Notes - 1995 Annual Meeting Draft**

1. 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 § 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 § 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 § 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 § 9-103) may be relocated elsewhere in the Article.

2. 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.

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

[Subsection (~~1a~~)--Alternative A]

[Delete subsection (1) (~~a~~).]

[Subsection (~~1a~~)--Alternative B]

(~~1a~~) ~~to~~ a security interest subject to any statute or treaty of the United States, to the extent that ~~such~~ the statute or treaty preempts this article;

(~~2b~~) ~~to~~ a landlord's lien;

(~~3c~~) ~~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 the lien ~~such liens~~;

(~~4d~~) ~~to~~ a transfer of a claim for wages, salary, or other compensation of an employee;

(~~5e~~) ~~to~~ a transfer by a government or governmental subdivision or agency;

(~~6f~~) ~~to~~ a sale of accounts, chattel paper, or payment intangibles as part of a sale of the business out of which they arose, or an assignment of accounts, chattel paper, or payment intangibles which is for the purpose of collection only, or an assignment of a right to payment under a contract to an assignee

that is also obliged to perform ~~to do the performance~~ under the contract, or an assignment of a single account or payment intangible to an assignee in whole or partial satisfaction of a preexisting indebtedness;†

(7g) ~~to~~ a transfer by an individual of an interest in or claim under any policy of insurance ~~which~~ that 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;

(8h) ~~to~~ a right represented by a judgment, ~~†~~ (other than a judgment taken on a right to payment that was collateral);

(9i) ~~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(b));

(10j) ~~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, except to the extent that provision is made for fixtures in Section 9-313;

(11k) ~~to~~ a transfer by an individual of any tort claim for damages resulting from an injury to an individual;

Subsection (12)--Alternative A

(12) a transfer of an interest in a deposit account, except as provided with respect to proceeds (Section 9-306), priorities in proceeds (Section 9-312) [, transfer of funds (Section 9-



308A),] [rights of recoupment and set-off (Section 9-312A),]  
[disposition of funds (Section 9-318A),] [and enforcement  
(Section 9-502(qqq))].

Subsections (12) and (13)--Alternative B

(~~12~~) 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

(~~13~~) to a transfer of an interest in a deposit account in a consumer secured transaction.~~;~~ or

**Reporters' Explanatory Notes**

1. The Study Committee recommended that "the Drafting Committee . . . revise § 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 § 9-302(3) and the official comment to clarify the applicability of the subsection." Recommendation 2.A., Report at 50. Existing § 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 § 9-104(1) respond to that concern. The first alternative deletes subsection (1) from § 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 (1) 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 § 9-104(a) might prove useful in providing a section number under which research tools such as case digests might index relevant cases.

2. Brackets have been removed from the exclusion in subsection (6), reflecting the Drafting Committee's decision not to move that provision to § 9-302(a). The exclusion retains the added language concerning transactions in payment intangibles.

3. This draft adds an alternative subsection (12) to reflect the view of some members of the Drafting Committee that Article 9 should not allow for security interests in deposit accounts as original collateral. If Alternative A is adopted, certain provisions of this draft should be deleted. These include § 9-103(d) (choice of law), § 9-117 (definition of "control"), and all other provisions referring to "control" of a deposit account. In addition, if it adopts Alternative A, the Drafting Committee should consider whether to retain draft §§ 9-308A (cutting off security interests in funds transferred from a deposit account), 9-312A (regulating rights of recoupment and set-off against a deposit account), 9-318A (protecting a depository institution's right to dispose of funds), and § 9-502(c) (enforcement of security interest against depository institution). Inasmuch as the problems addressed by those sections have arisen under existing Article 9, we recommend retaining them.

**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.

(2) "Agricultural lien" means an interest in farm products or proceeds of farm products (i) ~~that~~ which secures payment or performance of an obligation, (ii) ~~that~~ which is created by statute in favor of a person that in the ordinary course of its business furnishes goods or services to a debtor engaged in a farming operation, and (iii) the effectiveness of which does not depend on the person's possession of the farm products or proceeds of farm products. An agricultural lien is not a security interest.

(3) "Agricultural lienholder" means a person in favor of which an agricultural lien is created.

~~(4) "Bank" means a person that (i) is regulated and supervised by the government of the United States or a State and~~

~~(ii) is engaged in the business of banking. The term includes a savings bank, savings and loan association, credit union, or trust company.~~

(45) A person "becomes bound" as debtor by a security agreement entered into by another person if, ~~when~~, by operation of other law or by contract~~[,]~~ [:

(i) ] the security agreement becomes effective to create a security interest in the person's property~~];~~ or

(ii) the person (x) becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and (y) acquires or succeeds to all or substantially all of the assets of the other person~~]~~.

(56) "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~~ The term does not include 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.

(67) "Collateral" means the property subject to a security interest or an agricultural lien. The term includes proceeds to which a security interest attaches under ~~pursuant to~~ Section 9-306(b), proceeds as to which an agricultural lien becomes effective, and accounts, chattel paper, and payment intangibles that have been sold.

(~~78~~) "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.

(~~89~~) "Consumer debtor" means a debtor in a consumer secured transaction.

(~~910~~) "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.

(~~1011~~) "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.

(~~11~~<sup>12</sup>) "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 payment intangibles; and

(iii) a consignee.

(~~12~~<sup>13</sup>) "Deposit account" means a demand, time, savings, passbook, or like account maintained with a depository institution. The term does not include investment property or an account evidenced by an instrument.

(~~13~~<sup>14</sup>) "Depository 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.

(~~14~~<sup>15</sup>) "Document" means a document of title ~~as defined in Section 1-201(15), and~~ or a receipt of the kind described in Section 7-201(2).

(~~15~~<sup>16</sup>) "Encumbrance" includes a real estate mortgages, ~~and other liens on real estate,~~ and ~~all~~ other rights in real estate that ~~are~~ is not an ownership interests.

(~~16~~<sup>17</sup>) "Filing office" means an office designated in Section 9-401 as the proper place to file a financing statement.

~~(18) "Financial institution" means a person that (i) is engaged in the business of making loans and (ii) is a bank or is regulated and supervised by the government of the United States or a State as a securities broker or dealer or insurance company.~~

(17~~19~~) "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.

†(18~~20~~) "Good faith," for purposes including 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.†

(19~~21~~) "Goods" includes all things that are movable at the time a security interest attaches, or that are fixtures (Section 9-313), standing timber that is to be cut and removed under a conveyance or contract for sale, the unborn young of animals, and crops grown, growing, or to be grown, including crops produced on trees, vines, and bushes. The term 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 crops grown, growing, or to be grown, including crops produced on trees, vines, and bushes.~~

(~~20~~<sup>22</sup>) "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.

(~~21~~<sup>23</sup>) "Jurisdiction of organization" of a registered entity means the jurisdiction under whose law the entity is organized.

(~~22~~<sup>24</sup>) "Mortgage" means a consensual interest created by a real estate mortgage, a trust deed on real estate, or the like.

(~~23~~<sup>27</sup>) "New debtor" means a person that becomes bound as debtor by a security agreement previously entered into by another person.

(~~24~~<sup>28</sup>) "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. The term, ~~but~~ does not include an obligation substituted for another obligation.

(~~25~~<sup>25</sup>) "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 or agricultural lien ~~in~~ on the collateral.

(~~2626~~) "Original debtor" means a person that, as debtor, entered into a security agreement to which a new debtor has become bound.

(~~2729~~) 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.

(~~2830~~) "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.

[(~~2931~~) "Registered agent" means a registered agent of a debtor designated under Section 9-409.]

(~~3032~~) "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.

(~~3133~~) "Rule" means a rule adopted by [] pursuant to Section 9-413.

(~~3234~~) "Secondary obligor" means an obligor any portion of whose obligation is secondary.

(~~3335~~) "Secured party" means a ~~[lender, seller, or other]~~ person that has a security interest and an agricultural lienholder. The term includes a consignor and a person to whom accounts, chattel paper, or general intangibles have been sold. If a security interest [or agricultural lien] is created in favor



of a trustee, indenture trustee, agent, collateral agent, or other representative, the representative is the secured party.

(~~3436~~) "Security agreement" means an agreement that creates or provides for a security interest.

(~~3537~~) "Sign" means to identify a record by means of a signature, mark, or other symbol with intent to authenticate it.

(~~3638~~) "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.

(~~3739~~) "Support obligation" means a suretyship obligation or letter of credit that supports the payment or performance of an account, chattel paper, general intangible, document, [insurance policy,] instrument, or security.

(~~3839~~) "Transmitting utility" means ~~any~~ a 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 <del>9-115</del> <u>9-118</u> .
<u>"Control" (letter of credit)</u>	Section 9-119.
"Equipment"	Section 9-109.
"Farm products"	Section 9-109.
"Fixture"	Section 9-313.
"Fixture filing"	Section 9-313.
"General intangibles"	Section 9-106.
"Inventory"	Section 9-109.
<del>"Inventory purchase money</del>	
<del>security interest"</del>	<del>Section 9-107.</del>
"Investment property"	Section 9-115.
"Lien creditor"	Section 9-301.
"Payment intangible"	Section 9-106.
"Proceeds"	Section 9-306.
"Production money crops"	Section 9-107A.
"Production money obligation"	Section 9-107A.
"Production money security	
interest"	Section 9-107A.
["Production of crops"	Section 9-107A.]
"Purchase money security	
interest"	Section 9-107.
"Purchase money collateral"	Section 9-107.
"Purchase money obligation"	Section 9-107.

"Successor" Section 9-406A.

"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.

"Consignee" Section [2-102].

"Consignment" Section [2-102].

"Consignee" Section [2-102].

"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.

"Lessee in ordinary course  
of business" Section 2A-103.

"Letter of credit" Section 5-102.

"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. The references to instruments and letters of credit have been deleted from the definition of "account debtor." This revision restores the scope of the definition to that of current law.

2. The definition of "becomes bound" has been revised to place brackets around clause (ii) in order to reflect the Drafting Committee's even split over whether that clause should be included.

3. The definitions of "debtor" and "secured party" have been revised to include a "consignee" and "consignor," as newly defined. References to those definitions and to the new definition of "consignment" have been added to subsection (c). The definition of "secured party" also has been made more concise.

4. The definitions of "bank" and "financial institution" were added as part of an effort to limit the types of sales of general intangibles covered by Article 9. Given the Drafting Committee's decision to include all sales of payment intangibles (other than those excluded by § 9-104(6)), these definitions no longer are necessary.

5. The brackets have been removed from the definition of "good faith" pursuant to the instructions of the Drafting Committee during the June, 1995, meeting. In addition, the word "including" now replaces the word "of" in the definition. The term "good faith" appears in the following sections of this draft of Article 9: 9-206(a), 9-208(b), 9-308(a), 9-318(c), 9-415(a) and (b), 9-502(f), and 9-504(e) and (n). The revision makes it clear that the definition also applies to the term when used in those provisions.

5. References to the definitions of "inventory purchase money security interest," "purchase money collateral," and "purchase money obligation" have been deleted. See the Notes to draft § 9-107.

6. The revised definition of "secondary obligor" addresses an ambiguity in the previous version. An obligor is a secondary obligor if any portion of the obligor's obligation is secondary.

7. A new subsection adds a definition of "support obligation." This term covers the most common types of credit enhancements-- suretyship obligations (including guarantees) and letters of credit that support any one of the specified types of collateral. The phrase "insurance policy" is bracketed to indicate that whether an insurance policy can be original collateral remains an open issue.

Questions have arisen under existing Article 9 as to the relationship between a right to payment taken as collateral and any related support obligation. This draft contains rules explicitly governing attachment and perfection of security interests in support obligations. See draft §§ 9-203, 9-303, and 9-306. These provisions reflect the principle that a support obligation is an incident of the collateral it supports. The Drafting Committee should consider whether statutory provisions of this kind are needed.

The draft does not contain special priority provisions governing security interests in support obligations. For suretyship obligations, which are now included in the definition of "account," the first-to-file-or-perfect rule normally will apply to both secured parties and buyers, regardless of whether the obligations are taken as independent collateral or as support obligations. Under the special rule governing security interests in letters of credit, an account financier's failure to take a direct interest in the supporting letter of credit may leave its security interest exposed to a priming interest of a party who does take a direct interest. See draft § 9-312(p) (security interest in letter of credit perfected by control has priority over a conflicting security interest).

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

**SECTION 9-106. DEFINITIONS: "ACCOUNT"; "GENERAL INTANGIBLES"; "PAYMENT INTANGIBLE."**

(a) "Account" means ~~any~~ a right to payment, whether or not earned by performance, for ~~personal~~ property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, ~~or~~ for services rendered or to be rendered, for a policy of insurance issued or to be issued, for a suretyship obligation incurred or to be incurred, for energy consumed or to

~~be consumed, or for the use or hire of a vessel under a charter or other contract 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. A right to payment evidenced by an instrument[,] [or] chattel paper[, or a deposit account] is not an account.~~

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

(c) "Payment intangible" means a general intangible under which the account debtor's principal obligation is to pay money.

#### **Reporters' Explanatory Note**

1. The definition of "account" has been expanded and reformulated to remove as many categories of receivables as practicable from the automatic perfection rules applicable to payment intangibles. The Drafting Committee should consider whether the expansion makes the bracketed language in the last sentence necessary.

2. Under the revision to subsection (b), a letter of credit would be a separate type of collateral and not a general intangible. Accordingly, filing would not work to perfect a security interest, and the issuer would not be an "account debtor."

**SECTION 9-107. DEFINITIONS: "PURCHASE MONEY SECURITY INTEREST"; "PURCHASE MONEY COLLATERAL"; PURCHASE MONEY OBLIGATION"; "INVENTORY PURCHASE MONEY SECURITY INTEREST"; BURDEN OF ESTABLISHING PURCHASE MONEY SECURITY INTEREST.**

~~(a) A security interest in goods[, including fixtures,] purchase money collateral is a "purchase money security interest" to the extent that ~~(i) the purchase money collateral secures a purchase money~~ the collateral ("purchase money collateral") secures an obligation incurred by an obligor as the price of the collateral or for value given to enable the debtor to acquire rights in the collateral ("purchase money obligation") if the value is in fact so used ~~with respect to that collateral or (ii) the security interest is an inventory purchase money security interest.~~~~

~~(b) A purchase money security interest (subsection (a)) in inventory is a "purchase money security interest" also to the extent that the security interest secures a purchase money obligation incurred with respect to other inventory in which the secured party holds or held a purchase money security interest (subsection (a)).~~

~~(b) An obligation is a "purchase money obligation" if it is incurred by an obligor as the price of collateral or for value given to enable the debtor to acquire rights in [or the use of] collateral if the value is in fact so used. [Purchase money obligations include obligations for expenses incurred in connection with acquiring rights in purchase money collateral, sales taxes, finance charges, interest, [time-price differential,] administrative charges, expenses of collection and enforcement, attorney's fees, and other obligations arising out of purchase money obligations.]~~

~~(c) Collateral is "purchase money collateral" if [it is goods and] an obligor incurred a purchase money obligation as the price for or in order to enable the debtor to acquire rights in the collateral.~~

~~(d) A security interest in inventory is an "inventory purchase money security interest" to the extent that the inventory is purchase money collateral and the inventory secures a purchase money obligation.~~

(c) The interest of a consignor in goods that are the subject of a consignment is a purchase money security interest in inventory.

(d) The parties may determine by agreement the method for [determining] [calculating] When the extent to which a security interest is a purchase money security interest depends on the application of a payment to a particular obligation, the payment is to be applied: if the method is not manifestly unreasonable.

(1) in accordance with any reasonable method of application to which the parties agree,

(2) in the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment, or

(3) in the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, first to obligations that are not secured and then, if more than one obligation is secured, to obligations secured by purchase money security interests in the order in which those obligations were incurred.



(e) A purchase money security interest does not lose its status as such even though

(1) the purchase money collateral also secures an obligation that is not a purchase money obligation;

(2) collateral that is not purchase money collateral also secures the purchase money obligation; or

(3) the purchase money obligation has been renewed, refinanced, or restructured.

(fg) If the status of a security interest as a purchase money security interest or the extent to which it is a purchase money security interest is placed in issue, the secured party claiming a purchase money security interest has the burden of establishing the extent to which the security interest is a purchase money security interest.

#### **Reporters' Explanatory Notes**

1. This section has been made more concise by eliminating the freestanding definitions of "purchase money obligation," "purchase money collateral," and "purchase money inventory security interest" and capturing the concepts in the definition of "purchase money security interest" in subsection (a).

2. Subsection (a) has been revised so that it more closely resembles the definition in existing § 9-107. Pending further investigation as to the need for purchase money priority with respect to paper collateral and intangibles, we have limited purchase money security interests to goods, including fixtures.

3. Subsection (b) deals with the problem of cross-collateralized purchase money security interests in inventory. As we explained in the Notes to the November, 1995, Draft:

Consider a simple example.

Seller (S) sells an item of inventory (Item-1) to Debtor (D), retaining a security interest in Item-1 to secure Item-1's price and all other obligations, existing and future, of D to S. S then sells another item to D (Item-2), again retaining a security

interest in Item-2 to secure Item-2's price as well as all other obligations of D to S. D then pays to S Item-1's price. D then sells Item-2 to a buyer in ordinary course of business, who takes Item-2 free of S's security interest.

Is S's security interest in Item-1 securing Item-2's unpaid price a PMSI? The answer is unclear under current law. In the case of inventory, the Study Committee concluded that it should be a PMSI. The Study Committee was influenced in part by its understanding that when financiers such as S obtain subordination agreements from secured parties with earlier-filed financing statements, the subordination agreements virtually always extend to all inventory financed, without limitation.

Under draft subsection (b), S's security interest would be a purchase money security interest. This is so because S has a purchase money security interest in Item-1, Item-1 secures the price of (a "purchase money obligation with respect to") Item-2 ("other inventory"), and Item-2 itself is subject to a PMSI. Note that, to the extent Item-1 secures the price of Item-2, S's security interest in Item-1 would not be a purchase money security interest under the general definition in subsection (a). The security interest in Item-1 is only a PMSI under that subsection to the extent that "the collateral" (i.e., Item-1) secures an obligation incurred as the price of "the collateral" (i.e., Item-1) or for value given to enable the debtor to acquire rights in "the collateral" (again, Item-1).

4. At the December, 1995, meeting, the Drafting Committee discussed circumstances under which a "refinancing" would or would not destroy purchase money status. Among the circumstances discussed were (i) another lender purchases and takes an assignment of the loan; (ii) the debtor uses funds advanced by another lender, secured by the collateral, to pay off the original loan; (iii) funds "advanced" by the original lender, secured by the collateral, are used to pay off the original loan. Short of deleting the term "refinancing" from subsection (e), we see no practical way of dealing with these distinctions in the statute. Some clarification may be possible in the official comments.

5. The draft continues to approve the "dual-status" rule, under which a security interest may be a purchase money security interest to some extent and a non-PMSI to some extent. Consider what happens when a \$10,000 loan secured by a PMSI is refinanced by the original lender, and, as part of the transaction, the debtor borrows an additional \$2,000 secured by the collateral. Under draft subsection (e), the security interest remains a PMSI, but under subsection (a) it is a PMSI only to the extent of \$10,000. Suppose the debtor makes a \$1000 payment. To what

extent does the security interest remain a PMSI--\$9,000 or \$10,000?

Under the November, 1995, Draft: an agreement of the parties governs this question unless the agreed-upon method is "manifestly unreasonable"; in the absence of an agreement, the parties are free to use to an allocation formula or method that other law provides; and if neither agreement nor other law provides a method of allocation, the secured party would have been unable to meet its burden of establishing PMSI status.

At the Drafting Committee's request, this draft expands upon the method for determining the extent to which a security interest is a PMSI. The overriding principle, expressed in subsection (d)(1), is freedom of contract, as limited by principles of reasonableness (at the Drafting Committee's instruction, the draft eliminates the notion of manifest unreasonableness) and unconscionability. In the absence of agreement, subsection (d)(2) would permit the obligor to determine how payments should be allocated. If the obligor fails to manifest its intention, obligations that are not secured will be paid first. The obligor may prefer this approach, because unsecured debt is likely to carry a higher interest rate than secured debt. A creditor who would prefer to be secured rather than unsecured also would prefer this approach. (Please note: As used in the draft, the concept of "obligations that are not secured" means obligations for which the debtor has not created a security interest. This concept is different from and should not be confused with the concept of an "unsecured claim" as it appears in Bankruptcy Code § 506(a).)

After the unsecured debt is paid, draft subsection (d)(3) provides that payments are to be applied first toward the obligations secured by PMSI's. In the event that there is more than one such obligation, payments first received are to be applied to obligations first incurred. Once these obligations are paid, there are no PMSI's, and so there is no need for additional allocation rules.

The Study Committee expressed reservations about including a statutory allocation formula for these purposes. Upon further reflection, and after having reviewed various statutory allocation formulas and drafted subsection (d), we advise the Drafting Committee against including an allocation formula. Any scheme has potential for mischief, such a forcing a prepayment of low interest debt while leaving outstanding high interest debt. A FIFO approach, such as that taken by subsection (c)(3), requires one to determine when a debt was "incurred." Experience under the 45-day rule of original Bankruptcy Code § 547(c)(2) suggests that this determination is not so simple, particularly when it comes to interest. Moreover, the Article 9 allocation formula may differ from that required by other law under other circumstances.

6. Under existing § 9-114, the priority of the consignor's interest is similar to that of a purchase money security interest. Subsection (c) achieves this result more directly, by defining the interest of a consignor to be a purchase money security interest in inventory. Under this approach, there is no need to set forth special priority rules applicable to the interest of a consignor. Rather, the priority of the consignor's interest as against the rights of lien creditors of the consignee, competing secured parties, and purchasers of the goods from the consignee can be determined by reference to the generally applicable priority rules, such as §§ 9-301, 9-307, and 9-312.

7. The revision to subsection (f) is for clarification.

**SECTION 9-107A. DEFINITIONS: "PRODUCTION MONEY SECURITY INTEREST"; "PRODUCTION MONEY CROPS"; "PRODUCTION MONEY OBLIGATION"; ["PRODUCTION OF CROPS"]; BURDEN OF ESTABLISHING PRODUCTION MONEY SECURITY INTEREST."**

(a) "Production money security interest" means a security interest in production money crops to the extent that the production money crops secure a production money obligation incurred with respect to those crops.

(b) "Production money obligation" means an obligation incurred by an obligor for new value given to enable the debtor to produce the crops if the value is in fact used for the production of crops. [Production money obligations include related obligations for expenses incurred in connection with incurring production money obligations, sales taxes, finance charges, interest, [time-price differential,] administrative charges, expenses of collection and enforcement, attorney's fees, and other obligations arising out of production money obligations.]

(c) Crops are "production money crops" if an obligor incurred a production money obligation in order to enable the debtor to produce the crops.

[(d) The "production of crops" includes tilling and otherwise preparing land for growing, planting, cultivating, fertilizing, protecting from damage or disease, irrigating, harvesting, and gathering crops.]

(e) A production money security interest does not lose its status as such even though

(1) the production money crops secure an obligation that is not a production money obligation;

(2) collateral other than production money crops secures the production money obligation; or

(3) the production money obligation has been renewed, refinanced, or restructured.

(f) The parties may determine by agreement the method for [determining] [calculating] the extent to which a security interest is a production money security interest if the method is not manifestly unreasonable.

(g) If the status of a security interest as a production money security interest or the extent to which it is a production money security interest is placed in issue, the secured party has the burden of establishing the extent to which the security interest is a production money security interest.

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

[Deleted]

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

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

(b) Goods are "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) Goods are "farm products" if

(1) they are (i) crops grown, growing, or to be grown, including crops produced on trees, vines, and bushes, (ii) livestock, born or unborn, (iii) supplies used or produced in farming, livestock, or aquacultural operations, or (iv) products of crops or livestock in their unmanufactured states and

(2) the debtor is engaged in raising, cultivating, propagating, fattening, grazing or other farming, livestock, or aquacultural operations. If goods are farm products they are neither equipment nor inventory. The terms "crops" and "livestock" include aquatic goods produced in aquacultural operations.

(d) Goods are "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.

**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.

**[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]

**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.

**Reporters' Explanatory Note**

This section will be reconsidered after the Article 2 Drafting Committee determines which rights arising under Article 2 will be characterized as security interests.



**SECTION 9-114. RIGHTS AND TITLE OF CONSIGNEE WITH RESPECT TO CREDITORS AND PURCHASERS. CONSIGNMENT.** ~~[MINOR STYLE CHANGES~~

~~ONLY]~~ For purposes of determining the rights of creditors of, and purchasers of goods from, a consignee, while goods are in the possession of a consignee the consignee has rights and title identical to those the consignor had or had power to transfer.

~~(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.~~

### **Reporter's Explanatory Notes**

1. The priority rules applicable to consignments are the same as those applicable to purchase money security interests in inventory. See draft § 9-107(c). Accordingly, a special section containing those priority rules no longer is needed.

2. Existing Article 2 seems to provide that, absent public notice of the consignment, the consigned goods are subject to the claims of the consignee's creditors while in the consignee's possession. See § 2-326. The applicable provisions are not completely clear. Presumably, they mean not only that a lien creditor of the consignee has a better claim to the goods than the consignor, but also that the consignee has "rights in the collateral" sufficient to enable the consignee to create a security interest in them. Moreover, neither existing Article 2 nor existing Article 9 specifically addresses the rights of non-ordinary course buyers from the consignee.

New draft § 9-114 provides that, for purposes of determining the rights of third parties, the consignee acquires all rights and title that the consignor had or had power to transfer. The consignee would acquire these rights even though, as between the parties, it purchased a limited interest in the goods (as would be the case, e.g., in a true consignment, under which the consignee acquires only the interest of a bailee). This makes clear that creditors of the consignee can acquire judicial liens and security interests in the goods. Other sections of the Article, e.g., draft §§ 9-301 and 9-312, determine whether those interests are senior to the interest of the consignor. Draft §§ 9-301, 9-306, and 9-307 determine whether a buyer takes free of the consignor's interest.

**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.~~

(56) "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(m), (n), and (o). ~~[Section 9-312(e) 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 Notes**

1. The definition in § 9-115(a)(5) has been moved to new § 9-118.

2. The draft limits purchase money security interests to goods. Accordingly, the second sentence of subsection (e)(6) has been deleted.

#### **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 depository institution with which the deposit account is maintained;

(2) the depository institution with which the deposit account is maintained agrees in writing that, without further consent by the debtor, the depository 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 depository 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 depository institution to enter into an agreement of the type described in subsection (a) (2) even though its customer so requests or directs. A depository 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~~ If 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~~ after written demand by the debtor, shall send the depository institution with which the deposit account is maintained a written statement that releases the depository 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~~

after written demand by the debtor, shall 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 Note**

1. As of the December, 1995, meeting, the Drafting Committee remained divided over the appropriate treatment for deposit accounts as original collateral. This draft proposes that, if the Drafting Committee decides to include deposit accounts as original collateral, filing not be a means of perfection; the only means of perfection would be by control. See draft § 9-304(a). Also, under draft § 9-203(a)(1), the parties could substitute "control by agreement" for a security agreement as an element of attachment.

2. Subsection (a) derives from § 8-106(d) and (e). A question has arisen in connection with § 8-106(d)(2): Has "the securities intermediary . . . agreed that it will comply with instructions" originated by a secured party if the securities intermediary agrees to comply only if certain conditions are met? For example, the secured party and debtor may agree that the former is not to issue any instructions to the securities intermediary unless the debtor is in default. The debtor may insist that the securities intermediary agree not to comply with the secured party's instructions unless they are accompanied by a notice or certification of default (or, in a badly drafted control agreement, unless the debtor in fact is in default).

We think that an agreement to comply with the secured party's instructions should suffice for "control" under § 8-106(d)(2) or under the analogous provision in this section. Surely, an agreement conditioning compliance on the submission of written instructions would not defeat "control." We see no statutory basis or other justification for distinguishing among conditions. (Of course, if the condition is the debtor's further consent, the statute explicitly provides that the agreement would not confer control.)

Official Comment 1 to § 8-106 can be read to support the opposite result. It includes the following statement:

Obtaining "control" means that the purchaser has taken whatever steps are necessary[] . . . to place itself in a position where it can have the securities sold, without further action by the owner.

The Drafting Committee should consider whether the draft, perhaps accompanied by a change to the official comments, is clear enough to reach the desired result or whether a minor amendment is necessary.

**SECTION 9-118. "CONTROL" OVER INVESTMENT PROPERTY.**

(a) "Control" with respect to a certificated security, uncertificated security, or security entitlement has the meaning specified in Section 8-106.

(b) 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.

(c) 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.

**Reporters' Explanatory Note**

The provisions of new § 9-118 have been moved from § 9-115(a)(5).

**SECTION 9-119. "CONTROL" OVER LETTER OF CREDIT AND PROCEEDS OF LETTER OF CREDIT.**

A secured party has control over a letter of credit and proceeds of the letter of credit if:

(1) the issuer (Section 5-102(a)(9)) and any nominated person (Section 5-102(a)(11)) have consented to an assignment of proceeds of the letter of credit (Section 5-114(c)), or

(2) the secured party is a transferee beneficiary of the letter of credit [and the issuer has no right to refuse to recognize or carry out the transfer (Section 5-112(b))].

### **Reporters' Explanatory Notes**

1. Whether a secured party has control over a letter of credit and the method by which the secured party takes control determine the secured party's rights as against competing secured parties. See draft § 9-312(p). This section provides that a secured party acquires control over a letter of credit in one of two ways. Under paragraph (1), which typically will apply when the letter of credit or the proceeds of the letter of credit have been assigned, the secured party may acquire control by obtaining the consent of the issuer and any nominated person. The details of the issuer's or nominated person's duties to pay or otherwise render performance to the secured party are left to the agreement of the parties. Under subsection (2), the secured party may acquire control by becoming the transferee beneficiary of the letter of credit. As such, the secured party would acquire the right to draw or otherwise demand payment under the letter of credit.

2. Section 5-114 follows traditional banking terminology by referring to a letter of credit beneficiary's assignment of its right to receive payment thereunder as an assignment of the "proceeds of a letter of credit." Just as the seller of goods can assign its right to receive payment (an "account") before the goods have been delivered to the buyer, so the beneficiary of a letter of credit can assign its contingent right to payment before the time that the letter of credit is honored. See § 5-114(b). If the assignment creates a security interest, the security interest can be perfected at the time it is created. An assignment of, including the creation of a security interest in, proceeds of a letter of credit is identical in effect and legal contemplation to an assignment of or the creation of a security interest in the letter of credit itself.

Banking usage distinguishes the "transfer" of a letter of credit from an "assignment." Under a transfer, the transferee itself becomes the beneficiary and acquires the right to draw. Section 5-114(e) provides that the rights of a transferee beneficiary are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

PART 2

VALIDITY OF SECURITY AGREEMENT AND  
RIGHTS OF PARTIES TO SECURITY AGREEMENT

**SECTION 9-201. GENERAL VALIDITY OF SECURITY AGREEMENT.**

(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.

(b) Nothing in this article 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.

**SECTION 9-202. TITLE TO COLLATERAL IMMATERIAL.** Except as otherwise provided with respect to consignments that do not secure an obligation or sales of accounts, chattel paper, and payment intangibles, 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.

**Reporters' Explanatory Note**

The added language signifies that the remedies of a consignor under a true consignment are determined by other law and not by part 5. As the Note to § 9-501 explains more fully, we have deferred drafting remedial provisions affecting a consignor under a true consignment.

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

(a) Subject to ~~the provisions of~~ Section 4-210 on the security interest of a collecting bank, Section 5-118 on the security interest of a letter of credit issuer or nominated person, 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 (Section 9-305) pursuant to the debtor's agreement, the collateral is investment property or a deposit account 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~~ if 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 ~~or the power to transfer rights in~~ the collateral or, if the collateral is an account or chattel paper that has been sold by the debtor, the buyer's security interest is unperfected.

(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 the property enforceable.

(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:

\_\_\_\_\_ (1) a security agreement gives the secured party the rights to proceeds provided by Section 9-306; and

\_\_\_\_\_ (2) a security interest in an account, chattel paper, a document, an instrument, [an insurance policy,] a general intangible, or a security also is a security interest in any support obligation with respect to the collateral.

(e) A transaction, although subject to this article, is also subject to \_\_\_\_\_ \*, ~~and in the~~ In case of conflict between ~~the provisions of this article and that statute, the provisions of that statute controls.~~ Failure to comply with any applicable statute has only the effect the statute specifies. ~~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 § 5-118, referred to in the change to subsection (a), is found in the Appendix.

2. The revision to subsection (a)(1) recognizes that control of a deposit account pursuant to agreement will suffice as a means of attachment. If the Drafting Committee decides not to expand Article 9 to cover deposit accounts as original collateral, this clause will not be necessary. The official comments should explain that "pursuant to agreement" in this section refers to the debtor's agreement to the secured party's possession or control for the purpose of creating a security interest. In the unlikely event that possession or control is obtained without the debtor's agreement, it would not suffice as a substitute for a written security agreement.

3. Subsection (a)(3) has been revised to make clear that if the buyer of an account or chattel paper fails to perfect its interest in the collateral, the debtor may create an enforceable security interest in the same collateral, in favor of another secured party, even though the debtor may have no rights in the property sold. The explicit statement in the provision supplements § 9-311, which deals with transfer of a "debtor's rights in collateral." If the buyer's security interest is perfected, on the other hand, the debtor normally has no remaining rights in the account or chattel paper that is sold. Neither Article 9 nor the definition of "security interest" in § 1-201(37) undertakes to delineate between assignments that are "sales" and those that "secure an obligation."

4. Under new subsection (d)(2) a security interest in a support obligation automatically follows from a security interest in the underlying, supported collateral. We believe this to be implicit in current law. The Drafting Committee should consider whether it should be made explicit.

**SECTION 9-204. AFTER-ACQUIRED PROPERTY; FUTURE ADVANCES.**

(a) Except as otherwise provided in subsection (b), a security agreement may create or provide for a security interest in 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) A security agreement may provide that collateral secures or that accounts, chattel paper, or payment intangibles are sold in connection with 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.** 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, compromise, or enforce, or otherwise deal with collateral, or to accept the return of collateral 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 attachment (Section 9-203), or perfection (Section 9-305), or enforcement of a security interest depends upon possession of the collateral by the secured party.

**SECTION 9-206. AGREEMENT NOT TO ASSERT DEFENSES AGAINST ASSIGNEE; MODIFICATION OF SALES WARRANTIES WHERE SECURITY AGREEMENT EXISTS.**

(a) Subject to any other law ~~statute or decision~~ that establishes a different rule for consumer account debtors ~~buyers or lessees of consumer goods~~, an agreement by an account debtor not to assert against an assignee any claim or defense that the account debtor may have against the assignor is enforceable by an assignee that takes an assignment for value (Section 3-303(a)),

in good faith (Section 3-103(a)(4)) and without notice of a claim, of a property or possessory right to the property assigned or of a defense, or claim in recoupment of the type that may be asserted against a person entitled to enforce a negotiable instrument (Section 3-305(a)), except as to defenses ~~or claims in recoupment~~ of a type that may be asserted against a holder in due course of a negotiable instrument (Section 3-305**(b)**). [A buyer of goods which as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.]

[(b) Subsection (a) does not displace Section 1-107.

(c) If other law gives effect to an agreement by an account debtor not to assert against an assignee any claim or defense that the account debtor may have against the assignor, subsection (a) does not displace it.]

[~~(d)~~ 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.]

### **Reporters' Explanatory Notes**

1. The first clause of subsection (a) has been revised to reflect that the subsection extends to all account debtors, not just those who buy or lease goods. The reference to "other law" encompasses Federal Trade Commission Rule 433 concerning holders in due course; the reference it replaces ("statute or decision") arguably would not. The term "consumer account debtor" is left undefined. We will seek the advice of the Subcommittee on Consumer Transactions before drafting a definition.

2. The operative rule of subsection (a) has been reformulated to track more closely the rules of §§ 3-302 (concerning who is a holder in due course), 3-305 and 3-306 (concerning claims and defenses available against a holder in due course).

3. The last sentence of subsection (a) has been bracketed to indicate the Reporters' uncertainty about whether it is necessary. If the Drafting Committee thinks it necessary, it may

wish to consider whether the rule should be limited to buyers of goods.

4. New subsections (b) and (c) make clear that this section does not displace § 1-107 (concerning waiver) or any non-UCC law that may give broader effect to waiver of defense clauses. The Drafting Committee should consider whether these new subsections should be moved to the official comments.

5. Subsection (d) has been bracketed to indicate the Reporters' uncertainty about whether it is necessary. The official comments could make clear that Article 9 does not regulate an account debtor's obligation to the original obligee, except where it does do directly.

Related to this issue is how the draft deals with an account debtor's undertaking not to assert any defenses or claims against an assignor. If other law gives effect to this undertaking, then, under principles of nemo dat (see draft § 9-318(a)) it would be effective against the assignee. But other law may prevent the assignor from enforcing the undertaking. We are not inclined to create a special rule governing this case; rather, we would resolve the issue by determining whether, under the facts, the account debtor's undertaking fairly could be construed as an agreement that falls within the scope of draft § 9-206(a). We suspect that, normally, subsection (a) would apply.

**SECTION 9-207. RIGHTS AND DUTIES IF COLLATERAL IS IN SECURED PARTY'S POSSESSION.**

(a) If a security interest secures an obligation or a buyer of accounts, chattel paper, or payment intangibles is entitled by agreement to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or against a secondary obligor ~~has recourse against the debtor, a~~ the secured party must shall 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 and notwithstanding any contrary provision in Section 9-501, if a security interest secures an obligation and 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~~ a 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~~ to reduce the secured obligation;

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

(5) the secured party may create a security interest in the collateral ~~but the debtor retains its right to redeem the collateral (Section 9-506)~~.

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

(d) If a security interest secures an obligation, 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.

### **Reporters' Explanatory Notes**

1. At the request of the Drafting Committee, subsection (a) has been conformed to draft § 9-502(d).

2. We have removed from subsection (b)(5) the reference to redemption rights, because we believe that any such reference would tend to more harmful than helpful. There is no basis on which to draw from subsection (b)(5) any inference concerning the debtor's right to redeem the collateral. The debtor enjoys that right under § 9-506(a), and nothing in this section addresses it. For example, if the collateral is a negotiable note that the secured party (SP-1) repledges to SP-2, nothing in this section suggests that the debtor (D) does not retain the right to redeem the note upon payment to SP-1 of all obligations secured by the note.

In resolving questions that arise from the creation of a security interest by SP-1, one must take care to distinguish the rights of the debtor against SP-1 from the rights of the debtor against SP-2. Once D discharges the secured obligation, under § 9-506(a) or otherwise, D becomes entitled to the note; SP-1 has no legal basis upon which to withhold it. If, as a practical matter, SP-1 is unable to return the note because SP-2 holds it as collateral for SP-1's unpaid debt, then SP-1 is liable to D under the law of conversion.

Whether SP-2 would be liable to D depends on the priority of SP-2's security interest. Normally, the nemo dat principle will apply, and SP-2's security interest, which is a security interest in SP-1's security interest, will be defeated if the debtor discharges its secured obligations under § 9-506(a) or otherwise. If so, D will have a right to replevy the note from SP-2 or recover damages from SP-2 in conversion. In some circumstances, however, SP-2's security interest will survive discharge of SP-1's security interest. This will be the case, for example, if SP-2 is a holder in due course. See §§ 9-309, 3-306. Under these circumstances, D has no right to recover the note or recover damages from SP-2. Nevertheless, D will have a damage claim against SP-1.

We do not intend to change existing law in this regard, but rather to eliminate an existing ambiguity. Existing § 9-207(2)(e) permits the secured party to "repledge the collateral upon terms that do not impair the debtor's right to redeem it." This language could be read to override the rule of § 9-309, under which a qualifying SP-2 takes its security interest free of D's interest in the collateral. This language also could be read to prohibit SP-1 from creating a security interest to secure a

debt owed to SP-2 that is larger than the debt owed by D to SP-1. We think both readings are erroneous.

Simply put, subsection (b) (5) does no more than permit a secured party to create a security interest in collateral in its possession. It says nothing about the relative rights of the debtor and the second secured party or about the debtor's right to redeem.

**SECTION 9-208. REQUEST FOR STATEMENT OF ACCOUNT OR LIST OF COLLATERAL.**

(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) A secured party [other than a buyer of accounts, chattel paper, or payment intangibles] 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.

### PART 3

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

**SECTION 9-301. PERSONS THAT TAKE PRIORITY OVER UNPERFECTED SECURITY INTEREST OR AGRICULTURAL LIEN; RIGHTS OF \*LIEN CREDITOR.\***

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

(1) ~~a 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 a secured party files a financing statement with respect to a purchase money security interest before or within 20 days after the debtor receives possession of the ~~purchase money~~ collateral, the security interest takes priority over the rights of ~~[the buyer in a bulk sale] [or of] [a buyer not in ordinary course of business]~~ 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.



The term includes an assignee for benefit of creditors from the time of assignment, a trustee in bankruptcy from the date of the filing of the petition, and a receiver in equity from the time of appointment.

(d) If a security interest secures an obligation, 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.

#### **Reporters' Explanatory Note**

Subsections (a)(3) and (b) have been revised to delete the references to the transferee in bulk and the buyer in a bulk sale. Each of these persons is a "buyer not in ordinary course of business."

#### **SECTION 9-302. WHEN FILING IS REQUIRED TO PERFECT SECURITY INTEREST OR AGRICULTURAL LIEN; SECURITY INTERESTS AND AGRICULTURAL LIENS TO WHICH FILING PROVISIONS ~~OF THIS ARTICLE~~ DO NOT APPLY.**

(a) A financing statement must be filed to perfect all security interests and agricultural liens 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);

(3) a security interest ~~or~~ in instruments, certificated securities, chattel paper, or documents perfected without filing or possession ~~delivery~~ under Section 9-304(d) or (e); ~~17~~

(4) ~~or~~ a security interest in or agricultural lien on proceeds under Section 9-306(e);

(5) a security interest in a support obligation under § 9-303(d);

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

(74) 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);

(85) an assignment of accounts, ~~chattel paper,~~ or payment intangibles which ~~(i)~~ does not alone or in conjunction with other assignments to the same assignee transfer ~~more than XX~~ percent a significant part of the face amount of the assignor's outstanding accounts or ~~, chattel paper,~~ and payment intangibles ~~[or] [and] (ii) is not made in the ordinary course of the assignee's business or financial affairs;~~

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

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

(118) a security interest in investment property which is perfected without filing under Section 9-305A ~~9-115~~ or ~~9-116~~.

(12) a security interest in a letter of credit and proceeds of the letter of credit which is perfected without filing under Section 9-305A;

~~(13)~~ a security interest in property subject to a statute or treaty described in subsection (c);

~~(14)~~ a security interest in a deposit account ~~over which is perfected without filing under Section 9-305A; the secured party has control under Section 9-117;~~

~~[(11) a sale of accounts, chattel paper, or payment intangibles as part of a sale of the business out of which they arose, or an assignment of accounts, chattel paper, or payment intangibles which is for the purpose of collection only, or an assignment of a right to payment under a contract to an assignee that is also to do the performance under the contract or an assignment of a single account or payment intangible to an assignee in whole or partial satisfaction of a preexisting indebtedness;] and~~

~~(15)~~ a sale ~~an assignment of a payment intangible by a financial institution.~~

(b) If a secured party assigns a perfected security interest, no ~~action~~ filing 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 or certificate-of-title 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. Former subsection (a)(2) has been divided into three subsections.

2. New subsection (a)(5) reflects the rule in new draft § 9-303(d), which provides for automatic perfection of a security interest in a support obligation for collateral if the security interest in the collateral is perfected.

3. Subsection (a)(8) now follows existing subsection (1)(e), except that it has been expanded to cover assignments of payment intangibles as security. The Drafting Committee should consider whether that expansion is warranted. (To the extent that the exception covers outright sales of payment intangibles, which automatically are perfected under subsection (a)(15), the exception is redundant.) Note that the expanded definition of "account" in draft § 9-105 is likely to reduce the applicability of this subsection.

4. Former subsection (a)(11), which appeared in brackets, appears as § 9-104(6).

5. Revised subsection (a)(15) reflects the Drafting Committee's decision to afford automatic perfection to sales of payment intangibles.

**Reporters' Explanatory Notes - November 15, 1995 Draft**

In subsection (b), we have replaced "action" with "filing," which appears in the existing statutes. The official comments can explain the effect of an assignment on security interests perfected by other methods, including possession, control, and compliance with a statute or treaty under subsection (d).

The revision to subsection (c) is for stylistic purposes.

### **Reporters' Explanatory Notes - 1995 Annual Meeting Draft**

1. 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 § 9-302(3) be clarified. The language chosen is not perfect, in that § 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 § 9-302(c) and (d), "perfecting" means acquiring priority over a subsequent lien creditor. Cf. draft § 9-301(a)(2) (existing § 9-301(1)(b)).

2. 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 § 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 § 9-101(4)) contains a similar phrase, but omits any reference to goods that are "leased." Draft § 9-109(d) conforms the definition of inventory to draft § 9-302(c)(2) by including a reference to "leased" goods. (See also existing § 9-103(3)(a), which seems to distinguish goods "leased" and goods "held for lease.")

3. 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 § 9-103(c). However, paragraph (3) appears in brackets because draft § 9-103(c) apparently makes the paragraph unnecessary. Assume that a court is applying draft § 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 § 9-302(c)(2), will apply. Once State B issues a certificate, State B's law will apply, including State B's §§ 9-103(c)(3) [renumbered as (c)(4)] and 9-302(c)(5) [should be (c)(2)]. 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 9-103(c)(5) does terminate perfection if perfection would have lapsed under the law of State A.

4. 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 § 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.

5. Compliance with Other Statute as Equivalent of Filing. Both existing § 9-302(4) and draft § 9-302(d) provide that compliance with a statute or treaty described in § 9-302(c) (existing § 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 § 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 § 9-302(b), discussed in Note 3 above, and draft § 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 § 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 § 9-306. Similar Comments could be added to reflect the applicability of other "filing" provisions when perfection is accomplished under draft § 9-302(d), such as draft § 9-402(h) (concerning errors that are not seriously misleading). In the alternative, the official comments to § 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.

6. 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 § 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 § 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 § 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 §§ 9-103(c)(5), 9-302(d), and 9-305(b) to provide that a security interest that remains perfected solely by virtue of § 9-103(c)(5) can be (re)perfected by the secured party's taking possession of the collateral.

**SECTION 9-303. WHEN SECURITY INTEREST OR AGRICULTURAL LIEN IS PERFECTED; CONTINUITY OF PERFECTION.**

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

(b) An agricultural lien is perfected if it has become effective and all of the applicable steps required for perfection (Sections 9-302 and 9-306) have been taken. ~~The steps are specified in Sections 9-302 and 9-306.~~ If the steps are taken before the agricultural lien becomes effective, it is perfected when it becomes effective.

(c) If a security interest or agricultural lien is originally perfected in ~~any way~~ one manner permitted under this article and is ~~subsequently~~ later perfected in ~~some other way~~ another manner under this article, without an intermediate period when it was unperfected, the security interest or agricultural lien is perfected continuously. ~~for the purposes of this article.~~

(d) If a security interest in an account, chattel paper, a document, an instrument, [an insurance policy,] a general

intangible, or a security is perfected, a security interest in a support obligation for the collateral is perfected.

### Reporters' Explanatory Note

New subsection (d) provides for automatic perfection of a security interest in a support obligation for collateral if the security interest in the collateral is perfected. We believe this to be consistent with current law.

#### **SECTION 9-304. PERFECTION OF SECURITY INTERESTS IN INSTRUMENTS, ~~DEPOSIT ACCOUNTS,~~ CHATTEL PAPER, DOCUMENTS, MONEY, DEPOSIT ACCOUNTS, LETTERS OF CREDIT, 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. Except as otherwise provided in Section 9-306(e) for cash proceeds:

(1) a security interest in money can be perfected only by the secured party's taking possession (Section 9-305),

(2) a security interest in a deposit account can be perfected only by control (Section 9-305A), and

(3) except as otherwise provided in Section 9-303(d) for support obligations, a security interest in a letter of credit and proceeds of the letter of credit can be perfected only by control (Section 9-305A) ~~except as otherwise provided in Section 9-306(e) for cash proceeds.~~

(b) ~~During the period that~~ While goods are in the possession of a bailee (Section 7-102(1)) that has issued a negotiable document (Section 7-104(1)) covering 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 period is subject thereto.

(c) A security interest in goods in the possession of a bailee (Section 7-102(1)) that has issued a non-negotiable document (Section 7-104(2)) covering the goods is perfected by issuance of a document in the name of the secured party, 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, chattel paper, or negotiable documents is perfected without filing or the taking of possession for a period of ~~21~~ 20 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~~ 20 days without filing ~~where~~ if a secured party having a perfected security interest in an instrument, a certificated security, ~~[chattel paper,]~~ 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 (d); or

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

(f) After the ~~21-day~~ 20-day period in subsections (d) and (e) perfection depends upon compliance with the applicable provisions of this article.

### **Reporters' Explanatory Notes**

1. As of the December, 1995, meeting, the Drafting Committee remained divided over the appropriate treatment for deposit accounts as original collateral. Under revised subsection (a), filing would not be a means of perfection in these circumstances; the only means of perfection would be by control. As defined in § 9-117, "control" can arise as a result of an agreement among the secured party, debtor, and depository institution, whereby the last agrees to comply with instructions of the first with respect to disposition of the funds on deposit, even though the debtor retains the right to direct disposition of the funds. Thus, the draft takes an intermediate position between certain non-UCC law, which conditions the effectiveness of a security interest on the secured party's enjoyment of such dominion and control over the deposit account that the debtor is unable to dispose of the funds, and the previous draft, under which a secured party who is unable to reach the funds without resort to judicial process could perfect by filing. This approach may be acceptable to those who believe Article 9 should apply to creditors who take deposit accounts as original collateral. Compared to the previous draft, it is more compatible with the view that creditors who do not rely on particular deposit accounts (as evidenced by the failure to take control) are not deserving of protection as against lien creditors.

An alternative approach would be to make "control" a requirement for attachment. Absent control, a security interest in a deposit account as original collateral would be junior to the rights of perfected secured parties and lien creditors and would not be enforceable against the depository institution without resort to judicial process. However, a written security agreement suffices for all other types of collateral. We see no reason to create a special rule.

Another approach would impose a more stringent requirement for control. The problem with this approach, reflected in some of the cases addressing the dominion and control concept under common law, is one of line-drawing. To require, as a condition

of perfection, that the secured party achieve absolute dominion and control, to the exclusion of the debtor, would prevent perfection in transactions in which the secured party actually relies on the deposit account and maintains some meaningful control over it. We are at a loss to reduce the concept of "meaningful control" to statutory language.

2. Subsection (a)(3) makes clear that neither filing nor taking possession will perfect a security interest in a letter of credit or the proceeds of the letter of credit. If, however, the letter of credit is a support obligation, perfection as to the related account, chattel paper, or general intangible will perfect as to the letter of credit. See draft § 9-303(d).

3. In accordance with the Drafting Committee's decision, the bracketed references to chattel paper in subsection (e) have been removed, as have the brackets around subsection (d), thereby restoring existing law.

4. "Enforcement" has been added in subsection (e) as one of the special and limited purposes for which a secured party can release an instrument or certificated security to the debtor and still remain perfected.

5. The time periods in subsections (d), (e), and (f) have been reduced to 20 days. See Report § 16.C.

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

(a) Except as otherwise provided in subsection (b), 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. A security interest in certificated securities may be perfected by the secured party's taking possession of the security certificates.

(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).

~~{Subsection (c) - Alternative A }~~

~~(c) If a person other than the debtor or the secured party is in possession of collateral other than goods covered by a document, for purposes of subsection (a) the secured party takes possession when the person in possession acknowledges [in writing] that it holds possession for the secured party's benefit. A security interest is perfected by possession when the secured party takes possession, without a relation back, and continues only while the secured party retains possession, unless otherwise specified in this article.~~

~~{Subsection (c) - Alternative B }~~

(c) ~~If a person is in possession of collateral other than goods covered by a document, and if the person is a not is in the possession of a person other than the debtor, the secured party, or a lessee of the collateral from the debtor in the ordinary course of the debtor's business (Section 2A-103), the secured party takes possession when the person in possession acknowledges [in writing] that it has received notice of holds possession for the secured party's security interest benefit. A security interest is perfected by possession when the secured party takes possession, without a relation back, and continues only while the secured party retains possession, unless otherwise specified in this article.~~

(d) A person that is in possession of collateral is not required to acknowledge that it has received notice of holds possession of the collateral for a secured party's security interest benefit.

(e) If a person acknowledges that it has received notice of holds possession of collateral for a secured party's security interest benefit, (i) the acknowledgment is effective under subsection (c) even ~~though~~ if the acknowledgment violates the rights of a debtor, and (ii) unless the person otherwise agrees or other law otherwise provides, the person owes no duties to the secured party and is not required to confirm the acknowledgment to another person.

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

#### **Reporters' Explanatory Notes**

1. Subsection (b) is necessary to effect changes to the choice-of-law rules governing goods covered by a certificate of title. These changes are described in Note 9 [renumbered as Note 6] to Annual Meeting Draft § 9-302. The official comments can make clear that subsection (b), like subsection (a), does not create a right to take possession. If the Drafting Committee decides to make filing an alternative method of perfection, subsection (b) can be deleted. See Note 5 to § 9-103.

2. Subsections (c), (d), and (e) have been revised to reflect what we understood to be the consensus emerging from the discussion at the December, 1995, meeting: when collateral is in the possession of a bailee, the secured party may perfect by obtaining the bailee's acknowledgment that the bailee has received notification of the secured party's security interest. This acknowledgment serves to reduce the likelihood that the debtor and secured party are colluding after the fact and falsely alleging that a security interest was created. Giving this acknowledgment also might increase the likelihood that a bailee, if asked whether the collateral is subject to a security interest, would recall that it had been notified of such a claim.

3. Subsection (c) reflects the Drafting Committee's decision that acknowledgment of notification by a lessee in ordinary course of business should not suffice for possession.

#### **SECTION 9-305A. PERFECTION BY CONTROL.**



(a) A security interest in a deposit account, ~~or~~ investment property, or a letter of credit and proceeds of the letter of credit (Section 5-114(a)) may be perfected by control of the collateral (Section 9-117, 9-118, or 9-119 ~~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**

The section provides a single statement of the rules for perfection of security interests by control. This draft provides for perfection by control with respect to letters of credit and proceeds of letters of credit, in addition to deposit accounts and investment property.

#### **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 [or on account of a support obligation with respect to 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~~ nonconformity 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~~ nonconformity 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. Other law determines whether an agricultural lien ~~continues in~~ on collateral continues notwithstanding disposition or becomes effective as to ~~the~~ proceeds.

(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, including application of equitable [tracing] principles, that is available under other law with respect to commingled property of the type involved.

(e) A security interest in or agricultural lien on proceeds is a perfected security interest or agricultural lien if the interest in or lien on the original collateral was perfected.

The security interest in or agricultural lien on proceeds ceases to be a perfected interest or lien and becomes unperfected on the 21st day after the security interest attaches to the proceeds or the agricultural lien becomes effective as 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~~ in which 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 or agricultural lien on the proceeds is perfected before the 21st day after the security interest attaches to the proceeds or the agricultural lien becomes effective as to the proceeds.

(f) Except as otherwise provided in subsection (e), a security interest in or agricultural lien on 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 or an agricultural lien on 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 or the agricultural lien becomes effective as to the proceeds.

#### **Reporters' Explanatory Note**

The bracketed language added to subsection (a)(2) would make explicit what is implicit under current law: Collections and distributions under various credit support arrangements for collateral consisting of a right to payment or other intangible are proceeds of the underlying rights to payment or intangibles and should be afforded treatment identical to proceeds collected from or distributed by the account debtor. However, in the special case of a letter of credit, the secured party's failure to take a direct interest in the support obligation may leave its security interest exposed to a priming interest of a party who does take a direct interest. See § 9-312(p) (security interest in letter of credit perfected by control has priority over a conflicting security interest).

Arguably, this change to § 9-306 is surplusage. Under § 9-203 the support obligation is itself collateral, and collections thereon are therefore proceeds. We have included the bracketed language because we think it nevertheless may be useful in clearing up any possible gap in coverage.

#### **SECTION 9-307. PROTECTION OF BUYERS OF GOODS.**

(a) This section does not affect ~~apply to a security interest in~~ goods in the possession of the a secured party (Section 9-305).

(b) 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 though the security interest is perfected and even though the buyer knows of its existence.

(c) A buyer of consumer goods takes free of a security interest, even though 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.

(d) A buyer of goods 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 occurs 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.

#### **Reporters' Explanatory Notes**

1. Subsection (a) has been revised to make more apparent the idea that the secured party referred in subsection (a) is the holder of the security interest referred to in one of the following subsections.

2. The Drafting Committee suggested that subsection (a) might also be revised to stipulate more precisely the time at which the secured party must be in possession. We propose to defer any changes in the text until the Article 2 Drafting Committee reconsiders the specifics of when a buyer acquires the right to recover goods from the seller.

#### **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(j), in the proceeds of either if the purchaser, [in good faith,] 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 Note**

In accordance with the Drafting Committee's instructions, the brackets have been removed from around "in good faith."

#### **[SECTION 9-308A. TRANSFER OF MONEY; TRANSFER OF FUNDS FROM DEPOSIT ACCOUNT.**

(a) A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.]

(b) A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.]

#### **Reporters' Explanatory Notes**

1. At the June, 1995, meeting, the Drafting Committee expressed a desire to afford broad protection to those who take funds from a deposit account. This approach is consistent with that of the Federal Reserve Bank of New York, whose concern about increasing the availability of security interests in deposit accounts stems in part from fear that the security interests might impair the free flow of funds. It also minimizes the likelihood that a secured party will enjoy a claim to whatever the transferee purchases with the funds. Accordingly, § 9-308A of the November, 1995, Draft, enabled every transferee of funds from a deposit account to take funds free of security interests, regardless of the transferee's knowledge or good faith. The term "transferee" is not defined; however, the official comments could make clear that the debtor itself is not a transferee.

The November draft gave rise to two principal objections. First, the draft appeared to make funds in a deposit account more negotiable than money. The second, and by no means unrelated, objection was that the draft seemed to immunize transferees who acted in bad faith or who had not given value for the funds.

This draft and the following Notes address these objections. We are indebted to Professors Neil Cohen, James Steven Rogers, Linda Rusch, Stephen Sepinuck, and Barry Zaretsky for having shared their views on this subject and, in the case of Professors Rusch and Cohen & Zaretsky, having offered drafting suggestions.

2. The current draft solves the apparent incongruity between the protection afforded to takers of money (currency) and that afforded to takers of funds from a deposit account by adding a new subsection (a). This subsection sets forth the rights of those who take money and affords protection identical to that afforded to takers of funds from a deposit account under subsection (b).

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

4. To deal with the question of the "bad actor," we have borrowed "collusion" language from Article 8. See, e.g., §§ 8-115, 8-503(e). This is the most protective (i.e., least stringent) of the various standards now found in the UCC. Compare, e.g., § 1-201(9) ("without knowledge that the sale . . . is in violation of the . . . security interest"); § 1-201(19) ("honesty in fact in the conduct or transaction concerned"); § 3-302(a)(2)(v) ("without notice of any claim"). Although some may think that the draft makes it too easy to launder funds, we think it incongruous to make currency or its equivalent (funds on deposit at a bank) less negotiable than investment property.

5. If the Drafting Committee approves the draft, it may wish to consider whether (and, if so, how) to address remedies that might be available to an aggrieved secured party, other than enforcement of its security interest. One approach might be to treat this issue in the statute itself. For example, the

protection that § 8-503 affords to certain purchasers extends to immunize them from any action based on the property interest, "whether framed in conversion, replevin, constructive trust, equitable lien, or other theory." Another approach would address the issue in the official comments, as is done in Official Comment 9 to § 9-115 (addressing the relation of Article 9's priority rules to other law that affords a remedy for wrongful conduct). A third possibility is to leave development of the law to the courts without additional guidance.

6. A question also was raised concerning the effect of a corporate merger on an encumbered deposit account. A merger normally would not result in a transfer of funds from a deposit account. Rather, it might result in a transfer of the deposit account itself. The normal rules applicable to transferred collateral would apply; this section would not.

7. Some members of the Drafting Committee think that Article 9 should not allow for security interests in deposit accounts as original collateral. If the Drafting Committee adopts that approach, it should consider whether to delete or retain this section. We recommend that the section be retained, because it addresses a problem that arises even in the proceeds context. The current statutory silence, coupled with the incomplete treatment of the issue in the official comments, is unsatisfactory. Cf. Report § 15.F.

**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~~ those 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~~ those holders or purchasers.

**SECTION 9-310. PRIORITY OF CERTAIN LIENS ARISING BY OPERATION OF LAW.** [MINOR STYLE CHANGES ONLY] ~~When~~ If 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~~ the 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.** A debtor's rights in collateral may be voluntarily or involuntarily transferred, (including 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 AND AGRICULTURAL LIENS 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~~ on security interests of collecting banks in items being collected, accompanying documents, and proceeds; Section 5-118 on security interests of issuers and nominated persons in collateral accompanying presentation under a letter of credit; Section 9-103 on security interests related to other jurisdictions; ~~Section 9-114 on consignments,~~ and Section 9-115 on security interests in investment property.

(b) Except as otherwise provided in subsection (1), a perfected production money security interest (Section 9-107A(a)) in production money crops (Section 9-107A(c)) has priority over a

conflicting security interest in the same crops and, except as otherwise provided in subsection (j), also has priority in their identifiable proceeds if:

(1) the production money security interest is perfected by filing at the time ~~that~~ the secured party first gives new value to enable the debtor to produce the crops;

[Paragraph (2)--Alternative A]

(2) the production money secured party gives written notification ~~in writing~~ to the holder of the conflicting security interest if the holder had filed a financing statement covering the crops before the date of the filing made by the production money secured party; and]

[Paragraph (2)--Alternative B]

(2) the production money secured party gives written notification ~~in writing~~ to the holder of the conflicting security interest not less than 10 nor more than 30 days before the secured party first gives new value to enable the debtor to produce the crops if the holder had filed a financing statement covering the crops before the date of the filing made by the production money secured party; and]

(3) the notification states that the production money secured party has or expects to acquire a production money security interest in the debtor's crops and contains a description of the crops.

(c) Except as otherwise provided in subsection (g), a perfected ~~inventory~~ purchase money security interest in inventory ~~(Section 9-107(d))~~ has priority over a conflicting security

interest in the same inventory and, except as otherwise provided in subsection (j), 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 written 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 a filing made by the purchase money secured party, or (ii) before the beginning of the 20 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) Except as otherwise provided in subsection (g), a perfected purchase money security interest in livestock that are farm products has priority over a conflicting security interest in the same livestock and, except as otherwise provided in subsection (j), also has priority in its identifiable proceeds [and identifiable products in their unmanufactured states] if:

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

(2) the purchase money secured party gives written notification ~~in writing~~ to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of livestock (i) before the date of a the filing made by the purchase money secured party, or (ii) before the beginning of the 20 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 six months before the debtor receives possession of the livestock; and

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

(e) Except as otherwise provided in subsection (g), a purchase money security interest in collateral other than inventory ~~for~~ livestock~~[, investment property, or a deposit account]~~ has priority over a conflicting security interest in the same collateral and, except as otherwise provided in subsection (j), 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.

[Subsection (f)--Alternative A]

(f) Except as otherwise provided in subsection (l), if more than one security interest qualifies for priority in the same collateral under subsection (b), the security interests rank equally.

[Subsection (f)--Alternative B]

(f) Except as otherwise provided in subsection (l), if more than one security interest qualifies for priority in the same collateral under subsection (b), the security interests rank according to priority in time of filing under subsection (m).

~~-----[Subsection (g) Alternative A]~~

~~----- (g) If more than one security interest qualifies for priority in the same collateral under subsection (c), (d), or (e), the security interests rank equally.~~

~~-----[Subsection (g) Alternative B]~~

(g) If more than one security interest qualifies for priority in the same collateral under subsection (c), (d), or (e):

(i) the a security interest securing the purchase money an obligation incurred [by an obligor] as the price of the collateral has priority over a security interest securing an obligation incurred [by an obligor] for value given to enable the debtor to acquire rights in collateral, and

(ii) in all other cases, subsection (m) applies to the qualifying security interests.

(h) If a debtor acquires property subject to a security interest created by another person the following rules apply:

(1) ~~if~~ 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~~ 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 (i)--Alternative A]

(i) 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 (i)--Alternative B]

(i) 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.

(j) 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.

(k) If a statute under which an agricultural lien in collateral is created provides that the agricultural lien has priority over a conflicting security interest or agricultural lien in the same collateral, the statute governs priority if the agricultural lien is perfected.

(l) To the extent that an agricultural lienholder holds both an agricultural lien and a production money security interest in the same collateral securing the same obligations, the rules of priority applicable to agricultural liens govern priority.

(m) In all cases not governed by other rules stated in this section, including cases of [production money security interests,] purchase money security interests[, and security interests in deposit accounts that do not qualify for the special priorities ~~set forth~~ in subsections (b), (c), (d), (e), (f), (g), (j), and (p), ~~(i),~~ priority among conflicting security interests

and agricultural liens 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.

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

(o) 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.

(p) Priority between conflicting security interests in the same letter of credit and proceeds of the letter of credit is governed by the following rules:



(1) A security interest held by a secured party that has control over the letter of credit and proceeds of the letter of credit has priority over a conflicting security interest held by a secured party that does not have control.

(2) Except as provided in paragraph (3), security interests perfected by control rank equally.

(3) A security interest held by a transferee beneficiary has priority over a conflicting security interest held by another secured party.

### **Reporters' Explanatory Notes**

1. Subsection (a) adds a reference to draft § 5-118. Inasmuch as draft § 9-107(c) deems the interest of a consignor to be a purchase money security interest for purposes of priority, the reference to § 9-114 has been deleted.

2. The revision to subsection (c) reflects the deletion of certain definitions in draft § 9-107.

3. Subsection (e) has been revised to reflect that a secured party may hold a "purchase money security interest" only in goods. See draft § 9-107(a).

4. The Drafting Committee asked us to choose the better alternative subsection (g), dealing with cases in which more than one PMSI is entitled to priority over a non-PMSI. Our choice reflects our aversion to security interests of equal rank. The specific rule, affording priority to a seller-retained security interest, is consistent with § 7.2(c) of the Restatement of the Law of Property (Mortgages), Tentative Draft No. 4 (February 28, 1995). Subsection (m), the first-to-file-or-perfect rule, applies to multiple PMSI's that secure enabling loans and that qualify for purchase money priority.

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

5. Subsection (p)(1) awards a secured party that perfects its security interest in a letter of credit and proceeds of the letter of credit (i.e., one that becomes a transferee beneficiary or that takes an assignment of proceeds and obtains consent of the issuer and any nominating bank under § 5-114(c)) with

priority over another conflicting security interest, such as a perfected security interest in an account supported by the letter of credit that is also a perfected security interest in collections under the letter of credit.

Subsection (p) (3), awarding priority to a transferee beneficiary, is consistent with § 5-114(e), which provides that the "[r]ights of a transferee beneficiary or nominated person are . . . superior to the assignee's right to the proceeds." Arguably the priority provision for a transferee beneficiary is unnecessary and the same result would obtain under Article 5, inasmuch as there is in effect a novation upon the transfer with the issuer becoming bound on a new, independent obligation to the transferee. We are inclined to make the priority explicit in Article 9, however, in the interest of clarity.

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

(a) Except as otherwise provided in subsection (b), the depository 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 depository 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 Note**

Some members of the Drafting Committee think that Article 9 should not allow for security interests in deposit accounts as original collateral. If the Drafting Committee adopts that approach, it should consider whether to delete or retain this section. We recommend that the section be retained, because it addresses a problem that arises even in the proceeds context.

**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 agricultural lien or of 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. RIGHTS ACQUIRED BY ASSIGNEE; DEFENSES AGAINST ASSIGNEE; MODIFICATION OF CONTRACT; DISCHARGE OF ACCOUNT DEBTOR; AFTER NOTIFICATION OF ASSIGNMENT; ~~TERM PROHIBITING ASSIGNMENT INEFFECTIVE~~; IDENTIFICATION AND PROOF OF ASSIGNMENT; TERM PROHIBITING ASSIGNMENT INEFFECTIVE.**

(a) Except as otherwise provided in this Article, an assignee of an account, chattel paper, or a payment intangible acquires rights identical to those ~~that~~ the assignor had or had power to transfer.



(b) 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), and subject to subsection (c), 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 in recoupment arising from the transaction that gave rise to the contract 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.

(c) The claim of an account debtor may be asserted against an assignee under subsection (b) only to reduce the amount owing at the time the action is brought.

~~(d)~~ So far as To the extent that 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~~ the modification or substitution is a breach by the assignor.

(e) This subsection is subject ~~Subject~~ to subsections ~~(e)~~, (f), (g), ~~and~~ (h), and (i). An an account debtor on an account, chattel paper, or a payment intangible may discharge its

obligation by is authorized to pay paying the assignor until but not after the account debtor receives an effective notification that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of an effective notification, the account debtor may discharge its obligation by paying the assignee.

~~(f)~~ A notification under subsection ~~(d)~~ (e) is ineffective if it does not reasonably identify the rights assigned.

(g) A notification under subsection (e) is ineffective to the extent that an agreement between an account debtor and a seller of a payment intangible limits the account debtor's duty to pay a person other than the seller and the limitation is effective under other law.

~~(g) This paragraph applies only to [an assignment] [a sale] of a payment intangible [by a financial institution]. To the extent that an agreement between an account debtor and an assignor limits the account debtor's duty to pay a person other than the assignor, a notification under subsection (d) is ineffective.~~

~~[Subsection (h)--Alternative A]~~

~~(h) 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 an effective notification under subsection (d), 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 (h) Alternative B]~~

(h) An assignee may not send a notification under subsection (e) ~~(d)~~ is ineffective if it that notifies 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)~~ (i) only a portion of the account, chattel paper, or general intangible has been assigned to that assignee, ~~(2)~~ (ii) a portion has been assigned to another assignee, and ~~(3)~~ (iii) the account debtor knows that the assignment to that assignee is limited. A notification sent in violation of this subsection is ineffective.

(if) If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made. ~~and unless~~ Unless the assignee does so, the account debtor may discharge its obligation by paying the assignor even though the account debtor has received an effective notification under subsection (e).

(j†) This subsection does not apply to the sale of a payment intangible. Except as otherwise provided in § Section 2A-303, a term in any contract between an account debtor and an assignor, ~~other than a contract between an account debtor and a financial institution that is a seller of an account, chattel paper, or a payment intangible,~~ is ineffective if it prohibits, or restricts, or requires the account debtor's consent to

assignment of an account, chattel paper, or a payment intangible.  
~~or requires the account debtor's consent to the assignment.~~

### **Reporters' Explanatory Notes**

1. Subsection (a) incorporates a nemo dat-like concept for assignments of receivables and other intangibles, subject to other provisions of Article 9.

2. Subsection (b) has been revised to reflect that waiver-of-defense clauses under § 9-206 are not limited to sales and leases and to track § 3-305(a)(3) more closely.

3. Subsection (c) tracks § 3-305(a)(3) and follows the rule of *Michelin Tires (Canada), Ltd. v. First National Bank*, 666 F.2d 673 (1st Cir. 1981).

4. Subsection (e) has been revised to make explicit that payment to the assignor before notification, or payment to the assignee after notification, discharges the obligation. It also has been revised to apply only to account debtors on accounts, chattel paper, and payment intangibles. (The term "account debtor" is defined in § 9-105(a)(1) to include those obligated on all general intangibles.) Although this revision renders subsection (e) more precise, we doubt that it changes current law. Existing § 9-318(3) refers to the account debtor's obligation to "pay," thus suggesting that the subsection is limited to account debtors on accounts, chattel paper, and other payment obligations.

5. The draft contains three special rules concerning the effectiveness of a notification under subsection (e). First, subsection (f) tracks existing law and makes ineffective a notification that does not reasonably identify the rights assigned. Second, subsection (g) makes a notification ineffective to the extent that other law gives effect to an agreement between an account debtor and a seller of a payment intangible that limits the account debtor's duty to pay a person other than the seller. Third, subsection (h) makes ineffective a notification to pay the assignee less than the full amount of any installment payment. In accordance with the Drafting Committee's instructions, the draft also prohibits an assignee from sending such a notification. The Drafting Committee may wish to consider whether any consequences other than the ineffectiveness of the notification should follow from a violation of subsection (h).

6. Subsection (i) has been revised to link payment with discharge, as in subsection (e). It follows existing law in referring to the right of the account debtor to pay the assignor if the requested proof of assignment is not seasonably forthcoming. Arguably, the notification of assignment would remain effective, so that, in the absence of reasonable proof of

the assignment, the account debtor could discharge the obligation by paying either the assignee or the assignor. We think this is a better approach than making the notification ineffective if the assignee fails seasonably to provide reasonable proof of the assignment. Of course, if no assignment was in fact made, the putative assignee has no right to payment under any circumstances, and the account debtor cannot discharge the obligation by paying the putative assignee. If no assignment was made, the quality of the notice or of the "proof" of assignment are irrelevant.

7. Subsection (j) essentially follows existing § 9-318(4). Like the prior draft, this draft renders ineffective certain restrictions on the assignment of chattel paper.

Existing § 9-318(4) does not apply to sales of payment intangibles but does apply to assignments for security. The draft likewise does not address anti-assignment clauses with respect to these sales; the clauses would continue to be governed by non-UCC law.

Like existing subsection (4), draft subsection (j) provides that anti-assignment clauses are "ineffective." Some have argued that the quoted term means that the clause is of no effect whatsoever; it does not prevent the assignment from taking effect between the parties, nor does the prohibited assignment constitute a default under the agreement between the account debtor and assignor. Others think that "ineffective" contemplates only that a prohibited assignment nevertheless takes effect between the parties. Under this interpretation, the making of the assignment might constitute a default that affords a remedy to the account debtor. The Drafting Committee should consider whether and, if so, how to clarify the meaning of "ineffective."

8. The draft remains silent concerning multiple assignments. The official comments might refer to applicable non-UCC rules.

9. Note that § 9-318 deals only with the rights and duties of account debtors--and for the most part only with account debtors on accounts, chattel paper, and payment intangibles. Neither this section, draft § 9-318B, nor any other provision of Article 9 provides analogous regulation of the rights and duties of other obligors on collateral, such as the maker of a negotiable instrument (governed by Article 3), the issuer of a letter of credit (governed by Article 5), the issuer of a security (governed by Article 8), or the obligor on a non-negotiable instrument (governed by common law).

**[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 depository institution otherwise agrees [in writing], a depository institution's rights and duties with respect to a deposit account maintained with the depository institution are not terminated, suspended, or modified by:

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

(2~~b~~) the depository institution's knowledge of the security interest; or

(3~~c~~) the depository institution's receipt of instructions from the secured party.]

#### **Reporters' Explanatory Notes**

1. In the course of discussions about the rights of transferees of funds from a deposit account (§ 9-308A), the question was raised whether draft § 9-318A is sufficient to insulate a depository institution from liability for paying out encumbered funds in accordance with the instructions of its customer. We are not inclined to include a special rule in Article 9. Rather, we think that a depository institution's liability to the holder of a security interest should be determined by whatever rule applies generally when a bank pays out funds in which a third party has an interest. Often, this rule is found in a non-UCC adverse claim statute. If a rule were to be introduced into the UCC, Article 4 would seem to be the proper location for it. Cf. § 8-115 (securities intermediary not liable to adverse claimant).

2. Some members of the Drafting Committee think that Article 9 should not allow for security interests in deposit accounts as original collateral. If the Drafting Committee adopts that approach, it should consider whether to delete or retain this section. We recommend that the section be retained, because it addresses a problem that arises even in the proceeds context.

#### **SECTION 9-318B. RESTRICTIONS ON ASSIGNMENT OF CERTAIN GENERAL INTANGIBLES INEFFECTIVE.**

(a) This section applies to a security interest in a payment intangible only if the security interest arises out of a sale of the payment intangible.

(b) A term in a general intangible, including a contract, permit, license, or franchise, between an account debtor and a debtor that prohibits, restricts, or requires the account debtor's consent to the assignment or transfer of or creation, attachment, or perfection of a security interest in the general intangible, is ineffective to the extent that (i) the term would impair the creation, attachment, or perfection of a security interest, or (ii) the creation, attachment, or perfection of the security interest would cause a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the general intangible.

(c) A term in a statute or governmental rule or regulation that prohibits, restricts, or requires the consent of a government or governmental body or official to the assignment or creation of a security interest in a general intangible, including a contract, permit, license, or franchise, between an account debtor and a debtor is ineffective to the extent that (i) the term would impair the creation, attachment, or perfection of a security interest, or (ii) the creation, attachment, or perfection of the security interest would cause a default, breach, claim, defense, termination, right of termination, or remedy under the general intangible.

(d) To the extent that a term in a general intangible, statute, rule, or regulation is ineffective under subsection (b)

or (c) but is effective under other law, the creation, attachment, or perfection of a security interest in the general intangible (i) is not enforceable against the account debtor, (ii) imposes no duties or obligations on the account debtor, and (iii) does not require the account debtor to recognize the security interest, pay or render performance to the secured party, or accept payment or performance from the secured party.

(e) This section controls over any inconsistent provisions of the following statutes, rules, and regulations:

[List here any statutes, rules, and regulations containing provisions inconsistent with this section.]

#### **Reporters' Explanatory Notes**

1. The Study Committee recommended that the Drafting Committee seriously consider whether Article 9 should render ineffective provisions in contracts, permits, and licenses that restrict the creation of security interests. Recommendation 23, Report at 178. This is the applicable rule for accounts, chattel paper, and payment intangibles (other than sales of payment intangibles) under draft § 9-318(j) and the rule under current law for accounts and payment intangibles.

2. Draft § 9-318B would make attempts to restrict assignments of general intangible ineffective whether they appear in the terms of a general intangible (subsection (b)) or in a statute, rule, or regulation (subsection (c)). The goal is to protect the creation, attachment, and perfection of a security interest (including a sale of a payment intangible) and to prevent the occurrence of a default, breach, or remedy of the account debtor based on the security interest. On the other hand, subsection (d) would protect the account debtor from any adverse effects of the security interest, leaving the account debtor's rights and obligations unaffected if a restriction rendered ineffective by subsection (b) or (c) would be effective under other law.

3. This section is likely to have its biggest effect if the assignor enters bankruptcy. Roughly speaking, Bankruptcy Code § 552 invalidates security interests in property acquired after a bankruptcy petition is filed, except to the extent that the post-petition property constitutes proceeds of pre-petition collateral. Consider the owner of a cable television franchise that, under applicable law, cannot be assigned without the



consent of the municipal franchisor. A lender wishes to extend credit to the franchise, secured by the debtor's "going business" value. To secure the loan, the debtor grants a security interest in all its existing and after-acquired property. The franchise represents the principal value of the business. The municipality refuses to consent to any assignment for collateral purposes. As a consequence, by virtue of other law, the security interest in the franchise does not attach. If the debtor enters bankruptcy and sells the business, the secured party will receive but a fraction of the business's value. Under the draft, however, the security interest would attach to the franchise. As a result, the security interest would attach to the proceeds of any sale of the franchise during bankruptcy. The draft would protect the interests of the municipality, by preventing the secured party from enforcing its security interest to the detriment of the municipality.

PART 4

FILING

**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).

**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~~ indicates 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 a 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 a ~~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~~ a 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]

(1) 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(nm) 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 (1)--Alternative B]

(1) 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(nm) 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:

(1) 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, or

(2) the person is ~~at the time of filing~~ an agricultural lienholder at the time of filing and the financing statement covers only collateral in which the person holds an effective agricultural lien. [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] that adds collateral and that claims an agricultural lien in the collateral covered by the financing statement shall send a copy of the financing statement or the [amendment] [amended financing statement] to the debtor not later than the 10th day following the filing. The person shall send the copy to the most recent address of the debtor known to the person.

(p) A person that files an original financing statement or an [amendment] [amended financing statement] in violation of subsection (n) or ~~who~~ that fails to send a copy of a financing statement or [amendment] [amended financing statement] to the debtor in accordance with subsection (o) 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(om) may be necessary. See Mass. Gen. Laws Chapter 106, Section 9-410.

#### **Reporters' Explanatory Note**

A problem has been raised concerning financing statements that name a representative as the secured party. Consider a secured party of record that acts as a representative for a group of bank lenders (Group A). If the secured party later agrees to act as a representative for another group of lenders (Group B) and further agrees that it is a representative for Group B under the financing statement originally filed on behalf of Group A, what are the relative priorities as among Group A and Group B, to the extent that each group claims the same collateral? Arguably, the priority of each group would date from the original filing. In a case of undersecurity, the later-in-time Group B's interest could deprive Group A of the full benefit of otherwise available collateral.

Presumably, under these circumstances the representative would be in breach of its agreement with Group A and could be held liable for money damages. Alternatively, Group A might have insisted that the financing statement recite that it operates only for the benefit of lenders under a particular agreement, as it may be amended from time to time. We recommend addressing this issue in the official comments.

#### **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 in which a new debtor has or acquires rights to the extent that the



financing statement would have been effective if the original debtor ~~had or~~ acquired rights in the collateral.

(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 [amended] [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 minor revision to subsection (a) is designed to exclude cases covered by draft § 9-402(j), i.e., cases in which the new debtor has or acquires rights in collateral in which the original debtor had rights.

2. The Drafting Committee has not yet decided whether the preferred mechanism under Part 4 for amending a financing statement should be an amended (i.e., restated) financing statement or an amendment to a financing statement. Accordingly, alternative language and brackets have been added to subsection (b) (2).

**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~~ complying 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 or agricultural lien perfected by a filed financing statement ~~that complies~~ complying with the ~~requirements~~ of Section 9-402(a) but that ~~contains~~ containing

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):

[["Change"] form to be inserted]

(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 or agricultural lien that was perfected by the financing statement becomes unperfected, unless the security interest [or agricultural lien] 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).

(~~l~~) 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.

(~~m~~) 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.



(nm) Except as otherwise provided in subsection (o) ~~(m)~~ 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.

(on) 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.

(po) The filing office shall perform the acts required by subsections ~~(m)~~ (n) and (o) ~~(m)~~ 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.

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

(rq) 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 (o) ~~(n)~~ should be used.

#### **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, if there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value, or if a financing statement covers accounts, chattel paper, or payment intangibles that have been sold but as to which the account debtor has discharged its obligation, 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 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.

**SECTION 9-405. ASSIGNMENT OF RIGHTS UNDER FINANCING STATEMENT; 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.

**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.

**SECTION 9-406A. SUCCESSOR OF SECURED PARTY.**

(a) A "successor" of a person means another person that succeeds to substantially all of the rights of the person by operation of law, including a corporation with or into which the person has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator, and receiver.

(b) A person that becomes a secured party as a successor of a secured party may act under this part without disclosing its status as a successor or may act in its own name as the disclosed successor of a secured party.

**Reporters' Explanatory Notes**

1. The definition of "successor" derives in part from the definition of "successor of a beneficiary" in revised § 5-102(a)(15).

2. Some observers have raised questions as to the proper manner of handling successorship as a matter of law in connection with the Article 9 filing rules. Under this section, a successor of a secured party may act either in the name of the secured party that it has succeeded, without disclosing its status as a successor, or may act as a disclosed successor. For example, a successor secured party could sign a continuation statement as follows:

OLD SECURED PARTY

By: [Signature of successor's agent]  
Authorized Agent

Alternatively, it might sign as follows:

OLD SECURED PARTY

By: NEW SECURED PARTY, AS SUCCESSOR OF  
OLD SECURED PARTY

By: \_\_\_\_\_  
Vice President

**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.

**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~~ a 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, secures an obligation or whether the 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, secures an obligation or the 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 Note**

Existing Article 9 distinguishes between the true consignment and the "consignment intended as security." Although the former is a bailment, the filing and priority provisions of existing Article 9 apply to it; the latter creates a security interest that is in all respects subject to Article 9. Although this draft subsumes true consignments under the rubric of "security interest," it maintains the distinction between a (true) "consignment," as to which only certain aspects of Article 9 apply, and a consignment that "secures an obligation," to which Article 9 applies in full. The revisions to this section reflect the change in terminology.

#### **[SECTION 9-409. REGISTERED AGENT.]**

[Intentionally omitted]

#### **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].

**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.

**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 Sections 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.

**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.]

**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.

SECTION 9-415. CLAIM CONCERNING INACCURATE OR WRONGFULLY FILED RECORD; FAILURE TO SEND OR FILE TERMINATION STATEMENT; CORRECTION STATEMENT; TERMINATION REQUEST; OBJECTION STATEMENT; FILING OFFICE STATEMENT.

\_\_\_\_\_ (a) If a debtor believes [in good faith] that a record indexed under the debtor's name with the filing office is inaccurate or was wrongfully filed, the debtor may file with the filing office a correction statement with respect to the record or financing statement.

\_\_\_\_\_ (b) If a debtor believes [in good faith] that the secured party of record for a financing statement indexed under the debtor's name has failed to comply with its duty to file or send to the debtor a termination statement for the financing statement under Section 9-404, the debtor may file with the filing office a termination request with respect to the financing statement.

\_\_\_\_\_ (c) A correction statement or termination request must identify the record or the original financing statement to which it relates by the date of filing and the file number assigned under Section 9-403(n) or by another method prescribed by rule. A correction statement must give the basis for the debtor's belief that a record is inaccurate or was wrongfully filed and the manner in which the record should be amended in order to cure any inaccuracy. A termination request must give the basis for the debtor's belief that the secured party of record for a financing statement indexed under the debtor's name has failed to comply with its duty to file or send to the debtor a termination statement for the financing statement under Section 9-404.

(d) Upon filing, a correction statement or a termination request becomes a part of the record or financing statement to which it relates but, except as provided in subsection (g), neither the correction statement nor the termination request otherwise affects the record or financing statement.

(e) Within [XX] days after a correction statement or termination request is filed, the filing office shall send a copy of the correction statement or termination request to the secured party of record for the record or financing statement to which it relates. If, within [XX] days after sending a copy of a correction statement or termination request to a secured party of record, the filing office receives from the secured party of record an objection statement to the correction statement or termination request, the objection statement becomes a part of the record or financing statement to which it relates, but the objection statement does not otherwise affect the record or financing statement to which it relates and does not preclude any judicial relief to which the debtor may be entitled. An objection statement must identify the record or the original financing statement to which it relates by the date of filing and the file number assigned under Section 9-403(n) or by another method prescribed by rule. An objection statement must state that the secured party does not believe that a record is inaccurate or was wrongfully filed as stated by the debtor in a correction statement or does not believe that it has failed to comply with its duty to file or send to the debtor a termination statement as stated by the debtor in a termination request.



(f) If, within [XX] days after sending a copy of a correction statement or termination request to a secured party of record, the filing office does not receive from the secured party of record an objection statement to the correction statement or termination request, the filing office shall note that fact in a filing office statement and shall file the filing office statement in the filing office.

(g) Upon filing, a filing office statement becomes a part of the record or financing statement to which it relates, a record to which the filing office statement and a correction statement relate is amended in accordance with the correction statement, and a financing statement to which the filing office statement and a termination request relate becomes ineffective.

### **Reporters' Explanatory Notes**

1. This new section addresses two concerns that have arisen under existing law: (1) there is no nonjudicial means for a debtor to correct a financing statement that is inaccurate or another record that is inaccurate or wrongfully filed, and (2) there is no nonjudicial means for a debtor to correct the record when a secured party has failed to file or send to the debtor a required termination statement.

Subsection (a) would address the first concern by affording the debtor the right to file a correction statement. Subsection (b) would address the second concern by affording the debtor the right to file an termination request. In each case, subsection (c) would provide that the statement or request would give the basis for the debtor's belief that the public record should be corrected, and, under subsection (d), each statement or request would become part of the offending record or financing statement. These provisions resemble the analogous remedy in the Fair Credit Reporting Act.

Subsection (e) would require the filing office to send a copy of the correction statement or termination request to the secured party of record within a fixed, presumably short, period of time. The secured party would have another fixed period of time to file an objection statement. If the secured party does not file an objection statement within the stipulated time, the filing office

would note this fact in a filing office statement. See subsection (f). The objection statement or filing office statement, as the case may be, would become part of the public record.

Under subsection (g), the filing of a filing office statement would have serious consequences. If the debtor had filed a correction statement, then the record in question would be amended in accordance with the correction statement. If the debtor had filed a termination request, then the related financing statement would become ineffective. This remedial scheme contemplates that a debtor would respond to a spurious financing statement, e.g., one filed for the purpose of harassing the debtor or harming the debtor's reputation, by filing a termination request rather than a correction statement.

The draft would not displace the provisions of Article 9 that impose liability for making unauthorized filings, see draft § 9-402(p), or failing to file or send a termination statement. See draft § 9-404(c). Nor would it displace any available judicial remedies.

2. More aggressive approaches to this issue are possible under Article 9. For example, the statute might provide for administrative resolution of any dispute concerning accuracy or authorization. Or, the statute might permit filing officers, on their own initiative, to refuse to accept filings that meet certain criteria associated with spurious filings (e.g., filings against governmental bodies or officials) or otherwise appear to be unauthorized. The relatively modest system in the draft would impose substantial costs on the filing offices. The attendant benefits might not justify the reallocation of resources that the draft would require. In addition, subsection (g) would impose serious risks on legitimate secured parties who, through inadvertence, fail to make a timely response to a groundless correction statement or termination request. We have doubts about the advisability of the scheme proposed in the draft. The costs of more aggressive approaches within Article 9 are likely to outweigh any benefits substantially.

3. With respect to collateral other than consumer goods, the secured party's obligation to send a termination statement arises upon the debtor's written demand. See § 9-404. In some circumstances, such as when the secured party has gone out of existence or cannot be found, the debtor may be unable to send a meaningful demand. The draft does not address these situations directly. The Drafting Committee may wish to consider whether, and, if so, how the statute or comments might do so.

PART 5

DEFAULT

**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 by agreement of the parties. A secured party may reduce the claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien 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) and (j), after default, a debtor and an obligor have the rights and remedies provided in this part, by agreement of the parties, 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(hd), 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 earliest of the date of perfection of the security interest or agricultural lien in the collateral, the date of filing a financing statement covering the collateral, and any date specified in a statute under which the agricultural lien was

created. A sale pursuant to the execution is a foreclosure of the security interest or agricultural lien 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 a secondary 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.

(j) Except as otherwise provided in Sections 9-502(c) and (f) and 9-504(d), the duties of a secured party under this Part do not apply to a secured party that is a consignor in a consignment that does not secure an obligation or a buyer of accounts, chattel paper, or payment intangibles.

(k) For purposes of this part, a default occurs in connection with an agricultural lien at the earlier of the time provided by agreement of the parties and the time the that secured party ~~is~~ becomes entitled to enforce the lien in accordance with the statute under which it was created.

#### **Reporters' Explanatory Note**

We have deferred drafting remedial provisions affecting a consignor under a "true" consignment until the Drafting Committee determines whether it approves the convention that the draft adopts, i.e., bringing true consignments into the definition of security interest. If the convention is adopted, then we contemplate that part 5 would be inapplicable to the true consignor's enforcement of its ownership interest. A special rule would be needed for cases in which the ownership interest of the true consignor is subordinate to the rights of the consignee's

secured party. An appropriate rule might be that an enforcing senior secured party must pay all of the excess proceeds to the junior consignor-owner.

**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 or other person obligated on collateral 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 or enforcing 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 or other person obligated on collateral, including by exercising the rights and remedies of the debtor ~~in~~ with respect ~~to~~ of (i) the ~~account debtor's~~ obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor, and (ii) any property that secures the ~~account debtor's~~ obligations of the account debtor or other person obligated on the collateral, ~~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) If so agreed, and in any event on default:

(1) a secured party that holds a security interest in a deposit account perfected by control under Section 9-117(a)(1) may apply the funds in the account to the obligation secured by the deposit account, and

(2) a secured party that holds a security interest in a deposit account perfected by control under Section 9-117(a)(2) or (a)(3) may instruct the depository institution to pay the funds in the account to or for the benefit of the secured party.

(dc) A secured party that ~~by agreement~~ is entitled [by agreement] to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or against ~~an affected a secondary~~ obligor and that undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral 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.

(ed) If a security interest or agricultural lien 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 or agricultural lien 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 or agricultural lien 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~~ a deficiency under this subsection is subject to Section 9-507.

[(~~f~~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 or agricultural lien 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.]

(~~g~~f) If the underlying transaction was a sale of accounts, chattel paper, or payment 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~~ a deficiency under this subsection is subject to Section 9-507.

#### **Reporters' Explanatory Notes**

1. The secured party's rights to collect from and enforce collateral against account debtors and others obligated on collateral under subsection (a) are subject to §§ 9-318, 9-318A, 9-318B, and other applicable law. Neither this draft nor the current version of § 9-502 should be understood to regulate the duties of an account debtor or other person obligated on collateral. Instead, § 9-502 establishes only the baseline rights of the secured party vis-a-vis the debtor--the secured party is entitled to enforce and collect upon default or earlier if so agreed. Draft subsection (a) has been expanded to embrace collection and enforcement against all persons obligated on collateral. The reference to guarantors and other sureties in subsection (a)(3) has been deleted because the draft's treatment of support obligations as components of collateral, see draft § 9-203(d), renders the reference redundant.

2. New subsection (c) sets forth the self-help remedy for a secured party whose collateral is a deposit account. Subsection (c)(1) addresses the rights of a secured party that is the depository institution with which the deposit account is maintained. That secured party automatically has control under draft § 9-117(a)(1). On default, and otherwise if so agreed, the depository institution/secured party may apply the funds on deposit to the secured obligation.

If the security interest of a third party is perfected by control (draft § 9-117(a)(2) or (a)(3)), the secured party may on default, and otherwise if so agreed, instruct the depository institution to pay out the funds in the account. If the third party has control under § 9-117(a)(3), the depository institution is obliged to obey the instruction because the secured party is its customer. See § 4-401. If the third party has control under § 9-117(a)(2), the control agreement determines the depository institution's obligation to obey.

If the security interest in a deposit account is unperfected, or is perfected by filing under draft § 9-306, the depository institution ordinarily owes no obligation to obey the secured party's instructions. See draft § 9-318A. To reach the funds, the secured party must use an available judicial procedure.

**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.

**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 or agricultural lien 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 payment 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 or agricultural lien 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~~ secondary 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 or agricultural lien 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:]



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 debtor, if different] agreed to let us do that when [you] [name of obligor, 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 or agricultural lien 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 has 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.

(q) A transfer of the record or legal title to collateral to a secured party is not of itself a disposition of collateral under this article and does not relieve the secured party of its duties under this article if the transfer is effected in a registration system or certificate of title system and if the transfer is a [commercially reasonable] step relating to a disposition of collateral under this article].

#### **Reporters' Explanatory Notes - November 15, 1995 Draft**

1. Potential buyers of collateral that is covered by a certificate of title (e.g., an automobile) or is subject to a registration system (e.g., a copyright) typically require as a condition of their purchase that the certificate or registry reflect their ownership. In many cases, this condition can be met only with the consent of the record owner. If, as often is the case, the record owner is the debtor and the debtor refuses to cooperate, the secured party may have great difficulty disposing of the collateral. Applicable non-UCC law (e.g., a certificate of title act, federal registry, or the like) may provide a means by which the secured party obtains record or legal title for the purpose of a subsequent disposition of the property under § 9-504.

Draft § 9-504(q) deals with "title-clearing" transactions. It acknowledges that such transactions merely put the secured party in a position to provide to a purchaser good legal or record title. Under the draft, the secured party retains its duties as such and the debtor retains its rights as well. The Drafting Committee should consider whether the bracketed language in draft § 9-504(q) is necessary or useful. We are inclined to omit it.

2. Draft § 9-504(q) does not itself provide a title-clearing mechanism; it would apply only when other law provides such a mechanism. The Drafting Committee may wish to consider whether Article 9 itself should provide a means by which an Article 9 secured party could dispose of collateral and afford good legal or record title to the purchaser. An Article 9 section to that effect might look something like the following:



(a) A "transfer statement" is a sworn statement, made by on behalf of a secured party, stating that (i) the debtor has defaulted in connection with a secured obligation, (ii) the secured party has exercised its post-default rights with respect to the collateral securing the obligation, and (iii) by reason of the exercise, the person identified is the transferee of the rights of the debtor in the collateral.

(b) A transfer statement is sufficient to entitle the identified transferee to the transfer of record of all rights of the debtor therein shown of record in any official filing, recording, registration, or title certificate system covering record ownership of the collateral. If a transfer statement is presented with the applicable fee to the official responsible for the maintenance of the system, the official must accept the transfer statement and promptly file, record and/or issue a new title certificate in accordance therewith for the benefit of the identified transferee. A transfer statement satisfies all otherwise applicable requirements of any statute or regulation relating to the system.

**[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.]

**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 so 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 so 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 secondary 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 or agricultural lien 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 secondary 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 it 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.

**SECTION 9-506. 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 secondary 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 a secondary 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) A Tender 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 secondary 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) A Tender tender of payment under subsection (b) restores to the debtor and a consumer obligor who is ~~an selected~~ a secondary 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 Note**

At the December, 1995, meeting, the Drafting Committee discussed the relationship between the right of a secured party to create a security interest in the collateral and the debtor's right to redeem. As explained in the Note to draft § 9-207, the debtor's right (as opposed to its practical ability) to redeem collateral is not affected by and does not affect the priority of a security interest created by the debtor's secured party. We think the best approach to this issue is through the official comments.



**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, a court may order or restrain 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~~ a person that, at the time of the failure, was a debtor, was a secondary obligor, or held a security interest in or other lien ~~in~~ on the collateral has a right to recover damages for its loss under this subsection. A debtor whose deficiency is eliminated ~~pursuant to~~ under subsection (c) (~~23~~) may recover damages for the loss of any surplus, but a debtor or consumer obligor whose deficiency is eliminated or reduced ~~pursuant to~~ under subsection (c) (~~23~~) 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 a secondary 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, ~~a secondary~~ an 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, ~~a secondary~~ an 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 a secondary 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 secondary 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 a secondary 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.

## APPENDIX

**SECTION 1-201. GENERAL DEFINITIONS.** Subject to additional definitions contained in the subsequent Articles of this Act which are applicable to specific Articles or Parts thereof, and unless the context otherwise requires, in this Act:

\* \* \*

(9) "Buyer in ordinary course of business" means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if ~~the person buys in the ordinary course of the person's business or affairs and the sale to the person is in the ordinary course of the seller's business.~~ A sale is in the ordinary course of the seller's business if the sale comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices. A person that sells minerals or the like, including oil and gas, at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a pre-existing contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller (Section [2-XXX]) may be a buyer in ordinary course of business. A person that

acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt is not a buyer in ordinary course of business.

\* \* \*

(32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, security interest, issue or re-issue, gift, or any other voluntary transaction creating an interest in property.

\* \* \*

(37) "Security interest" means . . . The term also includes any interest of a consignor and a buyer of accounts, chattel paper, or a payment intangible in a transaction that is subject to Article 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2-401 is not a "security interest", but a buyer may also acquire a "security interest" by complying with Article 9. ~~Unless a consignment is intended as security, reservation of title thereunder is not a "security interest", but a consignment in any event is subject to the provisions on consignment sales (Section 2-326).~~

\* \* \*

### **Reporters' Explanatory Notes**

1. The definition of "buyer in ordinary course of business" has been revised in accordance with the Drafting Committee's discussion in December. It no longer makes reference to the buyer's business practices.

2. The definition of "security interest" has been revised to turn the interests of all "consignors" (as defined in draft § [2-102]) into "security interests." See generally Note 2 to draft § 9-102.

**SECTION [2-102]. DEFINITIONS.**

(a) In this article:

\* \* \*

(x) "Consignee" means a person to which goods are delivered in a consignment.

(y) "Consignment" means a sale or return (Section 2-[406(a)]) or any transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale if the merchant deals in goods of that kind under a name other than the name of the person making delivery. However, a transaction is not a "consignment" if (i) the value of the goods is \$[1,000] or less at the time of delivery, (ii) the goods are consumer goods immediately prior to delivery, (iii) the person to which the goods are delivered is an auctioneer or is generally known by its creditors to be substantially engaged in selling the goods of others, or (iv) the transaction, regardless of its form, creates a security interest that secures an obligation.

(z) "Consignor" means a person that delivers goods to a consignee in a consignment.

\* \* \*



## Reporters' Explanatory Note

The definition of "consignment" is drawn in part from the October 1, 1995, draft of Article 2. It has been expanded to include delivery primarily for resale--a "sale or return" as defined in draft § [2-406(a)]. This conforms with the approach of the Article 2 draft as well as that of the Article 9 Study Committee. See Recommendation 25.A. The definition excludes, in clauses (i), (ii), and (iii), transactions for which filing would be inappropriate or of insufficient benefit to justify the costs. Cf. Recommendation 25.C. The definition also excludes, in clause (iv), what have been called "consignments intended for security." These "consignments" are not bailments but secured transactions. Accordingly, all of Article 9 should apply to them. The official comments could afford guidance in distinguishing between true and security consignments. See Recommendation 25.D.

### **SECTION [2-406]. SALE ON APPROVAL AND SALE OR RETURN; SPECIAL INCIDENTS.**

(a) If delivered goods conform to the contract and may be returned by the buyer, the transaction is:

(1) a "sale on approval" if the goods are delivered primarily for use; or

(2) a "sale or return" if the goods are delivered primarily for resale.

\* \* \*

(e) ~~Subject to Section 2-407, goods~~ Goods held on approval are not subject to claims of a buyer's creditors until acceptance. ~~However, goods held on sale or return are subject to those claims while in the buyer's possession.~~

(f) While goods are in the possession of a consignee, the rights of creditors of, and purchasers of the goods from, the consignee are governed by Article 9.

## Reporters' Explanatory Note

The revisions to draft § [2-406] accommodate the inclusion of the rules for consignments (including sale or return transactions) in Article 9.

~~SECTION [2-407]. CONSIGNMENT SALES AND RIGHTS OF CREDITORS.~~

~~(a) Except for goods valued at \$1,000 or less and goods delivered to an auctioneer, if goods are delivered to a person who deals in goods of that kind under a name other than the name of the person making delivery for the purpose of sale, the goods of the person making delivery for the purpose of sale, the goods are subject to claims of creditors while in the possession of that person unless the requirements of subsection (b) are satisfied. This subsection applies even if an agreement purports to reserve title to the person making delivery until payment or resale or uses words such as "on consignment" or "on memorandum".~~

~~(b) A person making a delivery subject to subsection (a) has priority in the goods and any proceeds of sale over creditors of the person to whom the goods were delivered, if the person making delivery:~~

~~(1) establishes that the person to whom the goods were delivered is generally known by its creditors to be substantially engaged in selling the goods of others; or~~

~~(2) complies with Section 9-114(a) or complies with the requirements for perfecting a security interest in the goods, to the extent provided in Section 9-114(a) or otherwise in Article 9.~~

**Reporters' Explanatory Note**

The material from this section has been moved elsewhere. See Draft §§ [2-102], 9-107, and 9-114.

**SECTION 5-118. SECURITY INTEREST IN DOCUMENTS, INSTRUMENTS,  
AND CERTIFICATED SECURITIES ACCOMPANYING PRESENTATION AND  
PROCEEDS.**

(a) An issuer or a nominated person has a security  
interest in a negotiable document, instrument, or certificated  
security and its proceeds:

(1) if the document, instrument, or security certificate  
representing the certificated security is delivered to the issuer  
or nominated person and delivery is a requirement of a  
presentation under the letter of credit; and

(2) to the extent that the issuer has given value by  
honoring a presentation or nominated person has given value in  
connection with the letter of credit.

(b) So long as and to the extent that an issuer or  
nominated person has not been reimbursed or has not otherwise  
recovered the value given with respect to a security interest  
under subsection (a) the security interest continues and is  
subject to Article 9, but:

(1) no security agreement is necessary to make the  
security interest enforceable (Section 9-203(a)(1));

(2) if the security interest is perfected it has  
priority over conflicting perfected security interests in the  
collateral or its proceeds.

**Reporters' Explanatory Notes**

1. New § 5-118 would give the issuer of a letter of credit or a nominated person thereunder a security interest in a negotiable document, instrument, or certificated security, if the issuer or nominated person takes delivery of the document, instrument, or security certificate, to the extent of the value that is given.

This security interest is analogous to that awarded to a collecting bank under § 4-210. The security interest would have first priority if it is perfected. The section contemplates that the secured party normally would perfect the security interest under § 9-305. Unlike § 4-210, this section does not affirmatively absolve the secured party from filing. The draft necessarily is a very preliminary effort; persons interested in letter of credit law have not yet reviewed this provision.

2. It is arguable that this section is not necessary because that the same results would be reached under a proper interpretation of §§ 2-506 and 4-210. We intend to solicit further input on this point from specialists in the transactions that this section addresses.