

D R A F T
FOR DISCUSSION ONLY

**UNIFORM COMMERCIAL CODE
REVISED ARTICLE 9 – SECURED TRANSACTIONS;
SALES OF ACCOUNTS AND CHATTEL PAPER (199__)**

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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**UNIFORM COMMERCIAL CODE
REVISED ARTICLE 9 – SECURED TRANSACTIONS;
SALES OF ACCOUNTS AND CHATTEL PAPER (199__)**

WITH PREFATORY NOTE AND COMMENTS

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SECURED TRANSACTIONS; SALES OF ACCOUNTS AND CHATTEL PAPER**

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**UNIFORM COMMERCIAL CODE
REVISED ARTICLE 9 – SECURED TRANSACTIONS;
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**UNIFORM COMMERCIAL CODE
REVISED ARTICLE 9 – SECURED TRANSACTIONS;
SALES OF ACCOUNTS AND CHATTEL PAPER (199__)**

PROPOSED REVISED TITLE:

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

REPORTER’S PREFATORY COMMENTS
AND STATEMENT OF POLICY ISSUES

1. Background and History of Article 9 Revisions

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

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

2. Status and Schedule

The Drafting Committee has met eight times (November, 1993; March, 1994; September-October, 1994; December, 1994; March, 1995; June, 1995; December, 1995; March, 1996). Meetings of the ALI Members Consultative Group on Article 9 were held on December 16-17, 1994, and November 17, 1995. The Conference considered the 1995 Annual Meeting Draft of revised Article 9 at its Annual Meeting in August, 1995. The ALI Council reviewed the November 15, 1995, Draft, at its meeting on December 8, 1995. The Chair of the Drafting Committee and the Reporters made an informational report to the membership of the ALI during its Annual Meeting in May, 1995. The March, 1996, Draft was submitted to the membership of the ALI for discussion during its Annual Meeting in May, 1996.

This draft takes account of the Drafting Committee’s deliberations during its March, 1996, meeting. Future meetings of the Drafting Committee are scheduled for June, 1996, and November, 1996. There will be one or two meetings in 1997 and one meeting in 1998. We expect the Article 9 revisions to be substantially completed in 1997 and presented to the sponsors for approval in 1998.

3. Summary of Revisions

Following is a brief summary of some of the more significant proposed revisions that are included in the draft. Note also that the draft reflects many changes in style, inasmuch as the Conference's style conventions differ substantially from those in effect when Article 9 was first drafted and when it was last substantially revised.

a. **Scope of Article 9.** The draft expands the scope of Article 9 in several respects.

The draft includes within Article 9's scope deposit accounts as original collateral. Current Article 9 deals with deposit accounts only as proceeds of other collateral.

The draft also includes within the scope of Article 9 most sales of "payment intangibles," defined as general intangibles under which an account debtor's principal obligation is to pay money. Current Article 9 includes sales of accounts and chattel paper, but not sales of payment intangibles. The draft continues the drafting convention found in current Article 9, which provides that the sale of accounts, chattel paper, or payment intangibles creates a "security interest."

The draft brings nonpossessory statutory agricultural liens within the scope of Article 9. In doing so, it relies heavily upon the report and recommendations of the Article 9 Task Force of the Sub-committee on Agricultural and Agri-Business Financing, Committee on Commercial Financial Services, Section of Business Law, American Bar Association ("Agricultural Financing Task Force").

The draft provides that "true consignments – bailments for the purpose of sale by the bailee – are security interests covered by Article 9, with certain exceptions. Currently, many consignments are subject to Article 9's filing requirements by operation of Section 2-326.

The draft also addresses explicitly obligations, such as guaranties and letters of credit, that support payment or performance of collateral such as accounts, chattel paper, and payment intangibles.

For discussion purposes only, the draft expands the scope of Article 9 to include insurance policies and tort claims, with important exceptions such as individuals' health and disability insurance and individuals' tort claims for personal injury. The Drafting Committee has not yet taken a position on the inclusion of insurance policies and tort claims.

Finally, the draft enables a security interest to attach to general intangibles, including a contract, permit, license, or franchise, notwithstanding a contractual or statutory prohibition against or limitation on assignment. The draft explicitly protects account debtors against any adverse effect of the creation or attempted enforcement of the security interest.

b. **Choice of Law.** The draft changes the choice-of-law rule governing perfection and the effect of perfection or nonperfection (i.e., priorities) for most collateral to the law of the jurisdiction where the debtor is located. Under current

law, the jurisdiction of the debtor's location governs only accounts, general intangibles, mobile goods, and, for purposes of perfection by filing, chattel paper and investment property. The draft also changes the definition of the location of the debtor from the debtor's place of business (or chief executive office, if the debtor has more than one place of business) to the jurisdiction under whose law the debtor is organized, e.g., a corporate debtor's State of incorporation.

The draft also includes several refinements to the treatment of choice of law matters for goods covered by certificates of title. It also provides special rules for deposit accounts similar to those for investment property under current law.

c. **Perfection.** With certain exceptions, the draft provides that a security interest in a deposit account or a letter of credit may be perfected **only** by the secured party's acquiring "control" over the deposit account or letter of credit. A secured party has "control" of a deposit account when, with the consent of the debtor, the secured party obtains the depository institution's agreement to act on the secured party's instructions (including when the secured party becomes the account holder) or when the secured party is itself the depository institution. "Control" of a letter of credit occurs when the issuer and nominated party consent to an assignment of proceeds or the letter of credit is transferred to the secured party.

The draft expands the types of collateral in which a security interest may be perfected by filing to include instruments. Agricultural liens and security interests in insurance policies and tort claims also are perfected by filing, under the draft. However, if the Drafting Committee ultimately decides that some insurance policies should be covered by Article 9, it probably will also consider whether perfection should be achieved by control instead of or as an alternative to filing.

The Drafting Committee recognizes that certain sales of payment intangibles – primarily bank loan participation transactions – should not be subject to the Article 9 filing rules, but it has struggled with the appropriate way to accomplish this result. The draft addresses the problem by expanding the definition of "account" to include certain receivables that Article 9 currently classifies as "general intangibles" and exempting the sale of "payment intangibles" (general intangibles under which the account debtor's principal obligation is the payment of money) from the filing requirements of Article 9. Thus the draft subjects to Article 9's filing system sales of more types of receivables than does current law.

Several provisions of the draft address aspects of security interests when the secured party or a third party is in possession of the collateral. In particular, revisions to draft Section 9-305 resolve a number of uncertainties under current law. The draft provides that a security interest in collateral in the possession of a third party is perfected when the third party acknowledges that it holds for the secured party's benefit. However, the draft also provides that a third party need not give such an acknowledgment and that its acknowledgment does not impose any duties on it, unless it otherwise agrees. The draft also clarifies the circumstances under which a security interest in goods covered by a certificate of title may be perfected by the secured party's taking possession.

The draft provides that a perfected security interest in collateral supported by a “support obligation (such as an account supported by a guaranty) also is a perfected security interest in the support obligation.

d. **Priority.** The draft includes several new priority rules.

The draft's rules applicable to deposit accounts are similar to those incorporated in Article 9 for investment property in conjunction with the recently-revised Article 8. If a secured party has control over a deposit account, its security interest is senior to a security interest perfected in another manner (e.g., as cash proceeds). Security interests perfected by control generally rank equally, but as between a depository institution's security interest and one held by another secured party, the depository institution's security interest is senior. A corresponding rule makes a depository institution's right of setoff generally senior to a security interest held by another secured party.

The draft includes priority rules for security interests in letters of credit that are somewhat analogous to those for deposit accounts. A security interest perfected by control has priority over one perfected in another manner (i.e., as a support obligation for the collateral in which a security interest is perfected). Security interests in letters of credit perfected by control generally rank equally, but one held by a transferee beneficiary has priority over other security interests.

The draft substantially rewrites the definition of purchase money security interest (PMSI). It makes clear that a security interest in collateral may be (to some extent) both a PMSI as well as a non-PMSI, in accord with the “dual status” rule applied by some courts under current law. It provides an even broader definition of a PMSI in inventory, yielding a result that accords with private agreements entered into in response to the uncertainty of current law. The draft also revises the PMSI priority rules, but generally without material change in substance. It clarifies the priority rules for competing PMSIs in the same collateral. Consignments are treated under the draft as purchase money security interests in inventory.

The draft follows the Agricultural Financing Task Force’s recommendation to provide a special PMSI priority for livestock. It also includes a new priority rule for “production money security interests” for secured parties that give new value used in the production of crops. The Task Force did not reach a consensus as to production money priority and the Drafting Committee has not yet resolved that issue. The draft also follows the Task Force’s recommendations on special priority rules for agricultural liens.

The draft also includes (i) revised priority rules for security interests in goods covered by a certificate of title, (ii) a simplified priority rule for purchasers of instruments and chattel paper who take possession of the collateral, and clarifications of selected other good faith purchase issues, (iii) provisions designed to ensure that security interests in deposit accounts will not extend to most transferees of funds on deposit or payees from deposit accounts and will not otherwise “clog” the payments system, (iv) a provision enabling most transferees of money to take free of a security interest; (v) new priority rules to deal with the “double debtor” problem arising when a debtor creates a security interest in collateral acquired subject to a security interest created by another person, and (vi)

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

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

f. **Filing.** Part 4 of Article 9 has been substantially rewritten to simplify the statutory text and to deal with numerous problems of interpretation and implementation that have arisen over the years. For example, it provides that a super-generic description such as "all assets" or "all personal property" in a financing statement is a sufficient indication of the collateral. The draft also introduces some new concepts and approaches. The draft is "medium-neutral"; that is, it makes clear that parties may file and otherwise communicate with a filing office by means of records communicated and stored in media other than on paper. To accommodate electronic filing better, the draft does not require that the debtor's signature appear on a financing statement. Instead, it prohibits the filing of unauthorized financing statements and imposes liability upon those who violate the prohibition. The draft also restricts the discretion of filing offices, mandates performance standards for filing offices, and requires filing offices to sell filing data to the public. It provides as well for the issuance of administrative rules to deal with details best left out of the statute. It also affords a statutory method by which a debtor who believes that a filed record is inaccurate or was wrongfully filed may indicate that fact in the files without affecting the efficacy, if any, of the challenged record. (The Drafting Committee recently rejected draft provisions imposing a duty on the filing office to notify the secured party of the debtor's filing and permitting the filing office, in the absence of a timely response, to affect the efficacy of the challenged record.)

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

(1) **Revisions related to consumer secured transactions.** The draft includes several new and revised provisions that apply only to the enforcement of consumer secured transactions, as defined in the draft. Although the Drafting Committee approved a few of these provisions, most of them were added for the sole purpose of enabling the Drafting Committee to review concrete examples of the types of provisions that interested persons had suggested for inclusion in revised Article 9. They do not necessarily reflect the views of the Drafting Committee or the Reporters.

After these provisions were added to the draft, the Conference appointed a Sub-committee on Consumer Transactions to consider whether and, if so, to what extent, the draft should contain consumer-protection provisions. The Sub-committee plans to make recommendations to the Drafting Committee at the Committee's June, 1996, meeting. At that time, the Drafting Committee will make a preliminary determination of what the draft should contain. However, the consumer-protection provisions of the draft will not be revised until after the

Executive Committee of the Conference reviews and responds to the Drafting Committee's conclusions at the Conference's Annual Meeting in July.

Accordingly, consideration of the consumer-protection provisions of the draft would be premature at this time. None of the provisions applicable only to consumer secured transactions will be on the agenda for the 1996 Annual Meeting of the Conference. Those interested in the consumer-protection issues may wish to contact the chair of the Drafting Committee's Sub-committee on Consumer Transactions, Professor Marion W. Benfield, Jr., Wake Forest University School of Law, Worrell Professional Center for Law & Management, P.O. Box 7206, Winston-Salem, NC 22109-7206.

(2) **General revisions.** Some of the draft provisions described below are affected by draft consumer-protection provisions. For the reasons explained above, the discussion omits any reference to the special consumer-protection rules contained in the draft.

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

Both in Section 9-502 and in Section 9-318, the draft explains in greater detail the rights of a secured party that seeks to collect or enforce collateral, including accounts, chattel paper, and payment intangibles, and the obligations of the account debtor.

The draft imposes on a secured party that disposes of collateral the warranties of title, quiet possession, and the like that are otherwise applicable under other law, and it provides rules for the exclusion or modification of those warranties. The draft also requires a secured party to give notification of a disposition of collateral to other secured parties and lien holders who have filed financing statements against the debtor which cover the collateral. (That duty was eliminated by the 1972 revisions to Article 9.) However, the draft relieves the secured party from that duty when the secured party undertakes a search of the records and a report of the search is unreasonably delayed. The draft specifies the contents of a sufficient notification of disposition and provides that a notification sent 10 days or more before the earliest time for disposition is sent within a reasonable time. The draft clarifies the effects of a disposition by a secured party, including the rights of transferees of the collateral. It also provides that a junior secured party who receives cash proceeds from a disposition in good faith and without knowledge that the receipt violates the rights of a senior secured party takes the proceeds free of the senior claim.

The draft contains a new provision making clear that a transfer of record or legal title to a secured party is not of itself a disposition under Part 5. This rule applies regardless of the circumstances under which the transfer of title occurs.

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

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

h. **Good Faith.** The draft includes a new definition of “good faith,” which includes not only “honesty in fact” but also “the observance of reasonable commercial standards of fair dealing.” The definition is similar to the ones adopted in connection with other, recently completed revisions of the UCC.

4. Miscellaneous Style and Citation Conventions

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

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

5. Statement of Policy Issues

Following is a listing of some of the more important questions of policy raised by the draft with respect to non-consumer secured transactions.

- a. Should the revised Article 9 continue to facilitate and promote the creation and enforcement of security interests?
- b. Should the revised Article 9 retain its priority scheme under which perfected security interests are senior to the rights of lien creditors and

unperfected security interests are junior to those rights? Should the revised Article 9 subordinate, in whole or in part, perfected security interests to the rights of some or all classes of unsecured creditors? Should the revised Article 9 subordinate the rights of lien creditors to unperfected security interests?

- c. Should the revised Article 9 include additional provisions designed to protect consumers? Are the new provisions included in the draft appropriate?
- d. Should the revised Article 9 change the choice of law rule for perfection and priority to the location of the debtor? If so, should the location of the debtor be changed to the jurisdiction where the debtor is organized, if applicable?
- e. Should the revised Article 9 include within its scope security interests in deposit accounts as original collateral? Are the perfection and priority rules for security interests in deposit accounts included in the draft appropriate?
- f. Should the revised Article 9 include within its scope sales of payment intangibles, i.e., general intangibles for money due or to become due? If so, should the sales be automatically perfected?
- g. Should the revised Article 9 include within its scope security interests in insurance policies and tort claims?

**UNIFORM COMMERCIAL CODE
REVISED ARTICLE 9 – SECURED TRANSACTIONS;
SALES OF ACCOUNTS AND CHATTEL PAPER (199__)**

PROPOSED REVISED TITLE:

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

**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) any transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;

(2) an agricultural lien;

(3) a sale of an account, chattel paper, or payment intangible; and

(4) a consignment.

(b) 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' Comments

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

2. **Agricultural Liens.** Subsection (a)(2) is new and expands the scope of this article to cover statutory agricultural liens, as defined in Section 9-105. The

article addresses perfection, priority, and enforcement of agricultural liens but leaves issues of attachment and scope to other law.

3. Sales of Payment Intangibles and Other Receivables. Subsection (a)(3) expands the scope of Article 9 by including the sale of a “payment intangible, defined in Section 9-106(c) as “a general intangible under which the account debtor's principal obligation is to pay money. To a considerable extent, this article affords these transactions treatment identical to that given sales of accounts and chattel paper. In some respects, however, payment intangibles are treated differently from other receivables. Although this article occasionally distinguishes between outright sales of receivables and sales that secure an obligation, neither this article nor the definition of “security interest (Section 1-201(37)) delineates how a particular transaction is to be classified. That issue is left to the courts.

4. Consignments. Subsection (a)(4) is new. This article applies to every “consignment. The term, as defined in Section [2-102] (reproduced in the Appendix), includes many “true consignments (i.e., bailments). The term “consignment also includes a “sale or return, as defined in Section [2-406] (also reproduced in the Appendix).

Under common law, creditors of a bailee are unable to reach the interest of the bailor (in the consignment case, the consignor-owner). Like the former article, this article changes the common-law result; however, it does so in a different manner. For purposes of determining the rights and interests of third-party creditors of, and purchasers of the goods from, the consignee, but not for other purposes, such as remedies of the consignor, the consignee acquires under this article whatever rights and title the consignor had or had power to transfer. See Section 9-114. The interest of a consignor is defined to be a security interest, see Section 1-201(37), more specifically, a purchase money security interest in the consignee's inventory. See Section 9-107(c). Thus, the rules pertaining to lien creditors (Section 9-301), buyers (Sections 9-301, 9-307), and attachment, perfection, and priority of competing security interests (Sections 9-203, 9-303, 9-312) apply to consigned goods.

Sometimes parties characterize transactions that secure an obligation (other than the bailee's obligation to returned bailed goods) as “consignments. These transactions are not “consignments within the meaning of Section 9-102(a)(4). See Section [2-102] (last clause of the definition of “consignment). This article applies also to these transactions, by virtue of Section 9-102(a)(1). They create a security interest within the meaning of the first sentence of Section 1-201(37).

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

(a) Nonpossessory security interest.

(1) This subsection applies to a nonpossessory 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 a debtor is located in a jurisdiction, perfection, the effect of perfection or nonperfection, and the priority of a security interest in the collateral are governed by the local law of that jurisdiction.

(3) While the debtor is located in a jurisdiction that is not a part of the United States and does not provide for perfection of 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 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;
and

(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 occurs first. 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 as against a purchaser of the collateral for value is deemed to have been unperfected at all previous times.

(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, while collateral is located in a jurisdiction, perfection, the effect of perfection or nonperfection, 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. Subsection (a)(4), (5), and (6) apply to an agricultural lien.

(4) Except as otherwise provided in this subsection, while collateral is located in a jurisdiction, the effect of perfection or nonperfection 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 the time the goods become covered by the certificate until the earlier of (i) the time the certificate becomes ineffective under the law of that jurisdiction or (ii) the time the goods become covered subsequently by 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) 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 as against a purchaser of the goods for value is deemed to have been unperfected at all previous times.

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 9-305 are not taken before the earlier of (i) 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 previous 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:

(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 under Section 9-302(d), after issuance of the certificate and without the conflicting secured party's knowledge of the security interest.

(d) Deposit accounts.

(1) This subsection applies to deposit accounts.

(2) Except as otherwise provided in paragraphs (3) and (4), perfection, the effect of perfection or 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:

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 occurs first. 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 as against a purchaser of the deposit account for value is deemed to have been unperfected at all previous times.

(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), while a security certificate is located in a jurisdiction, perfection, the effect of perfection or nonperfection, 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 and the priority of a security interest in an uncertificated security are governed by the local law of the issuer's jurisdiction as specified in Section 8-110(d).

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

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

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

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

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

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

intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the commodity intermediary.

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

Reporters' Comments

1. **Scope of Choice-of-law Rules.** Former Section 9-103 generally addresses which state's law governs “perfection and the effect of perfection or non-perfection of security interests. See, e.g., former Section 9-103(1)(b). This article follows the broader and more precise formulation in Section 9-103(6)(b) [now Section 9-103(f)(2)], which was revised in connection with the recent promulgation of Revised Article 8: “perfection, the effect of perfection or non-perfection, and the priority of security interests. This section does not govern questions of attachment and enforcement.

2. **General Approach.** Under former Section 9-103, the type of collateral determines which state's law applies to perfection and priority. That approach gives rise to several problems. In particular, the former law applies different choice-of-law rules to many types of tangible collateral (e.g., ordinary goods) from those applicable to many types of intangible collateral (e.g., accounts and chattel paper). New subsection (a) provides a single choice-of-law rule for most types of collateral. With some exceptions, the law applicable to nonpossessory security interests in both tangible and intangible collateral, whether perfected by filing or automatically, would be the law of the jurisdiction of the debtor's location. The “debtor's location rule derives from former subsection (3) (applicable to accounts, general intangibles, and mobile goods).

Under subsection (b), which derives from former subsection (1) (documents, instruments, and ordinary goods), the law applicable to possessory security interests would continue to be the law of the jurisdiction in which the collateral is located. Comment 5, below, discusses this subsection in greater detail.

3. **Advantages and Disadvantages of Single Rule.** Subsection (a) substantially simplifies the choice-of-law rules. It eliminates former Section 9-103(1)(c) and (d), which concern nonpossessory security interests in tangible collateral that is removed from one jurisdiction to the other. It is likely to reduce the frequency of cases in which the governing law changes after a financing statement is properly filed. (Presumably, debtors change their own location less frequently than they change the location of their collateral.) The approach taken in subsection (a) also eliminates some difficult priority issues and the need to

distinguish between “mobile and “ordinary goods, and it reduces the number of filing offices in which secured parties must file or search.

There are potential drawbacks, as well. Arguably, determining the location of the debtor is a less certain enterprise than is generally assumed. Purchase-money equipment financiers and others may be ill-equipped to determine the debtor's location and the peculiar filing requirements of that jurisdiction without incurring significant additional costs. Local interests may perceive the potential changes in the volume of filings to be so great that they may be motivated to oppose revision on this ground. In addition, all acknowledge the difficulties that would attend the transition from one set of choice-of-law rules to another. If the scope of revised Article 9 is expanded, as by including deposit accounts as original collateral, then the application of choice-of-law rules during the transition will prove even more problematic.

4. Location of Debtor. Subsection (a) departs materially from former subsection (3) with respect to the method of determining where certain debtors are located. Under subsection (a)(4)(i), “a registered entity is located at its jurisdiction of organization. Under Section 9-105, a “registered entity is “an organization registered under the law of a State . . . and as to which the State . . . maintains a public record showing the organization to have been organized, and the “jurisdiction of organization is the “jurisdiction under whose law the [registered] entity is organized. For example, a Delaware corporation is a registered entity, and Delaware is its jurisdiction of organization. Other examples of registered entities are limited partnerships and limited liability companies. The location of debtors other than registered entities will continue to be determined by the current rules under subsection (a)(4)(ii) (e.g., the debtor's chief executive office). The draft reproduces the current rules for determining the location of a non-U.S. debtor and a foreign air carrier (draft subsections (a)(3) and (a)(5), respectively). The Drafting Committee has yet to discuss these rules.

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

During discussions of the proposal to change the location of a registered entity to its jurisdiction of organization, concerns were expressed that the change might cause a significant shift in filing revenues from some States to others, and to Delaware in particular. That prospect, it was argued, could render the proposal politically impractical. According to a recent study, however, the impact would not be material. See Lynn M. LoPucki, *Why the Debtor's State of Incorporation Should Be the Proper Place for Article 9 Filing*, 79 Minn. L. Rev. 577 (1995). Professor LoPucki's study also suggests that for the vast majority of filings, the change would

have no impact at all. Most collateral, it appears, is located in the same jurisdiction where the debtor is located (and where corporate debtors are incorporated).

5. Possessory Security Interests. Subsection (b) applies to possessory security interests. Although it is patterned on former subsection (1), under which the location of collateral determines the applicable law, subsection (b) eliminates the “last event” test of former subsection (1).

The bifurcation of nonpossessory and possessory security interests creates the potential for the same jurisdiction to apply two different choice-of-law rules to determine perfection in the same collateral. For example, were a secured party in possession of an instrument or document to relinquish possession in reliance on temporary perfection, the applicable law immediately would change from that of the location of the collateral to that of the location of the debtor.

Particularly serious confusion may arise when the choice-of-law rules of a given jurisdiction result in each of two competing security interests in the same collateral being governed by a different priority rule. The potential for this confusion exists under former Section 9-103(4) with respect to chattel paper: Perfection by possession is governed by the law of the location of the paper, whereas perfection by filing is governed by the law of the location of the debtor. Consider the mess that would be created if the language or interpretation of Section 9-308 were to differ in the two relevant States, or if one of the relevant jurisdictions (e.g., a foreign State) had not adopted Article 9. If filing becomes a method of perfection for instruments (see Section 9-304(a)), then the potential for this problem to arise can be expected to increase. The potential for confusion could be exacerbated when a secured party perfects both by taking possession in the State where the collateral is located (State A) and by filing in the State where the debtor is located (State B) – a common practice for some chattel paper financiers.

6. Scope of Referral. In designating the jurisdiction whose law governs, this article directs the court to apply only the substantive (“local”) law of a particular jurisdiction and not its choice-of-law rules. Consider the following example: Litigation over the priority of a security interest in accounts arises in State X. State X has adopted the Official Text of this article, which sends one to the local law of the jurisdiction in which the debtor is located. The debtor is located in State Y. Even if State Y has enacted a nonuniform choice-of-law rule (e.g., one that provides that perfection is governed by the law of State Z), a State X court should look only to the substantive law of State Y. State Y’s substantive law indicates that financing statements should be filed in State Y. Note, however, that if the identical perfection issue were to be litigated in State Y, the court would look to State Y’s nonuniform Section 9-103 and conclude that the State Y filing is ineffective. It is impossible to eliminate this problem through revision of the uniform text. A complete solution would require complete uniformity.

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

rules. If this article, which eliminates the reference to choice-of-laws rules, is widely adopted, then these lawyers will have filed properly if the issue is litigated in any jurisdiction that has adopted a uniform Section 9-103 (i.e., in most jurisdictions other than State Y). The burden now falls on the litigators to file the lawsuit in the “correct place.

Now suppose State Y's nonuniform Section 9-103 refers to the substantive and choice-of-law rules of State X. If so, State X's referral to State Y's choice-of-law rules would present the classic *renvoi*: State X's Section 9-103 says to look to State Y's choice of law, and State Y's Section 9-103 says to look to State X's choice of law. (The 1972 amendments to Section 9-103(3) created precisely this scenario with respect to security interests in accounts created by debtors whose chief executive offices were in a State that had the 1962 official text but whose records concerning the accounts were located in a State that had adopted the 1972 official text.) Eliminating either state's reference to choice-of-laws rules would eliminate the *renvoi*.

7. Agricultural Liens. Subsection (b) also provides a choice-of-law rule for agricultural liens. As is the case with Section 9-103(f), concerning investment property, the subsection applies one choice-of-law rule to determine the law governing perfection and another to determine the law governing priority. Under subsection (b)(3), the law of the jurisdiction of the debtor's location governs perfection – i.e., filing, which is the sole means of perfecting an agricultural lien (other than the special rules for proceeds in Section 9-306). Under subsection (b)(4), priority is governed by the law of the jurisdiction where the collateral is located. Other choice-of-law rules, including Section 1-105, will determine the law governing other matters, such as remedies on default. Nonuniformity in the law governing agricultural liens and in non-UCC choice-of-law rules may engender some confusion in this area. Nevertheless, this section's approach seems generally consistent with current law applicable to statutory liens such as agricultural liens.

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

Scope of Subsection (c). Subsection (c) applies to “goods covered by a certificate of title. The new definition of “certificate of title” in subsection (c)(2)(i) makes clear that the subsection applies not only to certificate-of-title acts under which perfection occurs upon notation of the security interest on the certificate but also to those that contemplate notation but provide that perfection is achieved by other means, e.g., delivery of designated documents to an official. Subsection (c)(2)(ii), which is new, explains that goods become “covered” by a certificate of title when an application for a certificate and the appropriate fee are delivered to the issuing authority. Given the diversity in certificate-of-title statutes, the term “appropriate” is not defined. The time when goods become “covered” determines when subsection (c) begins to apply to perfection of security interests in the goods, and thus when the law of the jurisdiction under whose certificate the goods are covered will begin to apply. Subsection (c)(3), which is also new, makes clear that subsection (c) applies to certificates of a jurisdiction having no other contacts with the goods or the debtor. This result comports with most of the reported cases on the subject and with contemporary business practices in the trucking industry. The Drafting Committee will consider its effects on practices with respect to other types of goods (e.g., boats).

Law Governing Perfection. 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 from the time the goods become covered until the earlier of the events set forth in clauses (i) and (ii).

Normally, under the law of the relevant jurisdiction, the perfection step would consist of compliance with that jurisdiction's certificate-of-title act and a resulting notation of the security interest on the certificate of title. See Section 9-302(c), (d). In the typical case of an automobile or over-the-road truck, a person who wishes to take a security interest in the vehicle can ascertain whether it is subject to any security interests by looking at the certificate of title. But certificates of title cover certain types of goods in some States but not in others. A secured party who does not realize this may extend credit and attempt to perfect by filing in the jurisdiction where the debtor is located. If the goods had been titled in another jurisdiction, the lender would be unperfected.

Subsection (c)(4) explains when the law of the jurisdiction under whose certificate the goods are covered ceases to apply. Former Section 9-103(2)(b) provides that the law of the jurisdiction issuing the certificate ceases to apply upon “surrender” of the certificate. In the case of automobiles, certificate-of-title statutes generally require tender of any outstanding certificate as a condition for issuance of a new certificate. See, e.g., Uniform Motor Vehicle Certificate of Title and Anti-Theft Act Section 6(c)(1). This tender is the “surrender” to which former subsection (2)(b) refers. The former rule reflects the idea that notation of a security interest on a certificate of title affords notice to third parties only so long as the certificate is outstanding.

This article eliminates the concept of “surrender.” Instead, the law of the original jurisdiction ceases to apply when the certificate “becomes ineffective” under the law of that jurisdiction. Given the diversity in certificate-of-title statutes, the term “ineffective” is not defined. Depending on the certificate-of-title law, this revision may ameliorate somewhat the problem of certificates that are wrongfully

surrendered. Note, however, that if the certificate is surrendered in conjunction with an appropriate application for a certificate to be issued by another jurisdiction, the law of the original jurisdiction ceases to apply under subsection (c)(4)(i).

The last sentence of subsection (c)(4) indicates that, when one of the events in clauses (i) and (ii) occurs, the goods are “not covered by the certificate of title within the meaning of this section. Assume the goods are covered by a certificate of title from State X and that a security interest is perfected in accordance with State X's law. Thereafter, the goods are covered by a certificate of title from State Y. Under subsection (c)(4)(ii), the law of State X no longer governs perfection of the security interest. The goods no longer are covered by “**the** certificate of title (i.e., the **State X** certificate of title). They are, however, covered by **a** certificate of title (i.e., the **State Y** certificate) within the meaning of subsection (c)(1), so that the law of the jurisdiction under whose certificate of title the goods are covered (State Y) governs perfection.

Substantive Rule of Perfection and Priority. Like former Section 9-103(2), subsection (c) addresses not only choice of law but also the method of perfection itself and priority. The substantive rules, as well as substantive rules in other subsections of Section 9-103, ultimately may be relocated elsewhere in the article.

The fact that the law of one State ceases to apply under subsection (c)(4)(ii) does not necessarily mean that a security interest perfected under that law automatically becomes unperfected. 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. The draft presents alternative subsections that reflect the Drafting Committee's split of opinion on the issue. Under each Alternative, a security interest perfected by any method under the law of one State (e.g., State X) remains perfected notwithstanding that the goods have become covered by a certificate issued by another State (e.g., State Y). Each Alternative gives the secured party a four-month period within which to reperfect under the law of State Y. If the secured party fails to reperfect before the four-month period expires, the security interest becomes unperfected both prospectively and retroactively against a purchaser of the goods for value (i.e., a buyer or competing secured party). The secured party can maintain continuous perfection by perfecting under the law of State Y before the expiration of the four-month period. Each Alternative makes clear that, to maintain perfection under these circumstances, the secured party may perfect either under Section 9-302(d) by complying with State Y's certificate-of-title law or, if the secured party otherwise is entitled to do so, by taking possession of the collateral under Section 9-305.

The principal difference between the two Alternatives is the treatment of creditors who acquire liens after the expiration of the four-month period, in cases in which the secured party fails to reperfect under the law of State Y. Under Alternative A, perfection under the law of State X ceases upon expiration of the four-month period. Any judicial lien obtained thereafter would be senior to the unperfected security interest. Under Alternative B, the security interest perfected under the law of State X remains perfected until it becomes unperfected under the law of that State. Those who favor Alternative B argue that, through imperfections in the certificate-of-title system, the goods may become covered by State Y's

certificate even though the secured party is holding a State X certificate that notes its security interest. Such a secured party has little, if any, opportunity to discover that State Y has issued a clean certificate and would unwittingly allow the four-month period to expire without taking steps to reperfect.

The retroactive unperfection (“deemed to have been unperfected”) rule in subsection (c)(5), like the rule in former Section 9-103(1)(d), 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. To accomplish this result, it may be necessary to articulate the rule as a rule of subordination rather than retroactive unperfection.

Subsection (c)(6) affords protection to certain good faith purchasers for value who rely on a “clean” certificate of title. Under this subsection, a protected buyer can take free of, and a protected secured party can acquire priority over, a security interest that is perfected by any method under the law of another jurisdiction. The fact that the security interest has been reperfected by possession does not of itself disqualify a secured party from protection under this subsection.

Inventory. Compliance with a certificate-of-title act generally is **not** the method of perfecting security interests in inventory. Section 9-302(c) provides that a security interest created in inventory held by a person in the business of selling goods of that kind is subject to the normal filing rules; compliance with a certificate-of-title act is not necessary or effective to perfect the security interest. Most certificate-of-title acts are in accord.

The relationship between this rule and the choice-of-law rules in Section 9-103(c) and former Section 9-103(2) is subtle. Consider the following example. Goods are located in State A and covered by a certificate of title issued under the law of State A. The State A certificate of title is “clean”: it does not reflect a security interest. Owner takes the goods to State B and sells (trades in) the goods to Dealer, who is located (within the meaning of Section 9-103(a)) in State B. As is customary, Dealer retains the duly assigned State A certificate of title pending resale of the goods. Dealer's inventory financier obtains a security interest in the goods under its after-acquired property clause.

Under Section 9-302(c) of both State A and State B, Dealer's inventory financier, SP-B, must perfect by filing instead of complying with a certificate-of-title law. If under Section 9-103(c)(4) the law applicable to perfection of SP-B's security interest is that of State A, because the goods are covered by a State A certificate, SP-B would be required to file in State A under State A's Section 9-401. That result would be anomalous, to say the least, since the principle underlying Section 9-302(c) is that the inventory should be treated as ordinary goods. Section 9-103(c) (and former Section 9-103(2)) should be read as providing that the law of State B, not State A, applies. A court looking to the forum's Section 9-103(c) would find that the subsection applies only if two conditions are met: (i) the goods were “covered” by the certificate within the meaning of subsection (c)(1), i.e., application had been made for a State (here, State A) to issue a certificate of title covering the goods and (ii) the certificate is a “certificate of title” as defined in subsection (c)(2), i.e., a statute of that State “provides for the security interest in question to be indicated on the certificate as a condition or result of perfection.

Stated otherwise, Section 9-103(c) applies only when compliance with a certificate-of-title statute, and not filing, is the appropriate method of perfection. Under the law of State A, **for purposes of perfecting SP-B's security interest in the dealer's inventory**, the proper method of perfection is filing – not compliance with State A's certificate-of-title act. For that reason, the goods are not covered by a “certificate of title, and the second condition is not met. Thus, Section 9-103(c) does not apply to the goods. Instead, subsection (a) applies, and the applicable law is that of State B, where the debtor (dealer) is located.

Relation Back. We suggest that a Legislative Note recommend the elimination of relation-back provisions in certificate-of-title laws affecting perfection of security interests. See Section 9-302, Comment 6.

9. Deposit Accounts. Subsection (d), which contains choice-of-law rules for security interests in deposit accounts, is new. It derives from the choice-of-law rules governing security entitlements and securities accounts, which were promulgated in conjunction with the recent revision of Article 8. Subsection (d)(2) provides that the law of the “depository institution's jurisdiction controls, and subparagraphs (i)-(iv) of the subsection contain rules for determining the “depository institution's jurisdiction. The draft contains two alternatives for paragraph (i). Alternative B follows Section 8-110(e)(i); it determines the depository institution's jurisdiction by reference to the jurisdiction whose law the depository institution and its customer have chosen to govern their deposit agreement. Alternative A recognizes that the parties may wish to choose the law of one jurisdiction to govern perfection and priority of security interests but prefer to choose a different governing law for other purposes. Alternative A would give effect to this arrangement. If Alternative A is approved, it may be appropriate to conform Section 8-110(e). The Drafting Committee has not considered the issue.

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

SECTION 9-104. TRANSACTIONS EXCLUDED FROM ARTICLE.

This article does not apply to:

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

(2) a landlord's lien;

(3) 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;

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

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

(6) 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 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;

(7) a transfer by an individual of an interest in or claim under any policy of insurance 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;

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

(9) a 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 with respect to defenses or claims of an account debtor (Section 9-318(b));

(10) 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;

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

(12) a transfer of an interest in a deposit account maintained with a Federal Reserve Bank or maintained by a depository institution with another depository institution; or

(13) a transfer of an interest in a deposit account in a consumer secured transaction.

Reporters' Comments

1. **Federal Preemption.** Former Section 9-104(a) excludes from Article 9 “a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property. Some may read the former section (erroneously) to suggest that Article 9 defers to federal law even when federal law does not preempt Article 9. Revised Section 9-104(1) recognizes explicitly that this article defers to federal law only when and to the extent that it must – i.e., when federal law preempts it.

2. **Sales of General Intangibles.** Former subsection (f) excludes certain sales and assignments of accounts and chattel paper. Subsection (6) adds to the exclusion similar sales of payment intangibles.

3. **Insurance.** Subsection (7) substantially narrows the broad exclusion of interests in insurance policies under former subsection (g). It excludes only certain classes of insurance policies held by individuals and which protect important social welfare benefits. The Drafting Committee recognizes that insurance policies can be important items of collateral in many business contexts and that the “cash or “loan value of life insurance policies also can be a useful source of collateral for borrowing by individuals. Accordingly, sometime ago it instructed the Reporters to prepare draft language to assist in further consideration of the issues. The draft language appeared in the 1995 Annual Meeting Draft and prompted several comments from financiers and insurers. The Drafting Committee will consider various approaches to the issue at a meeting in June, 1996. As of this writing, the Drafting Committee has not approved the concept of subsection (7), let alone the specifics or language of the draft. If the scope of Article 9 is broadened along the lines of the draft, special provision for automatic perfection or perfection by control may be needed. Also, the notification provisions of Section 9-318 may be inappropriate for the obligations of the issuers of insurance policies as account debtors.

4. **Tort Claims.** Much of the foregoing Comment on subsection (7) applies as well to subsection (11), which narrows former subsection (k)'s broad exclusion of transfers of tort claims. The draft excludes only transfers by individuals of tort claims for personal injury. As with insurance policies, the Drafting Committee believes that tort claims can be important sources of collateral. As with subsection (7), however, the Drafting Committee has not approved the concept, language, or specifics of draft subsection (11).

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

6. Deposit Accounts. With certain exceptions set forth in subsection (12), deposit accounts may be taken as original collateral under this article. Under the former article, which excludes deposit accounts as original collateral, security interests in deposit accounts generally are governed by the common law. The common law is nonuniform, often difficult to discover and comprehend, and frequently costly to implement. As a consequence, debtors who wish to use deposit accounts as collateral sometimes are precluded from doing so as a practical matter.

This article contains several safeguards to protect debtors against inadvertently encumbering deposit accounts and to reduce the likelihood that a secured party will realize a windfall from the debtor's deposit accounts. For example, to describe a deposit account for purposes of attachment, a security agreement must specifically mention deposit accounts. See Section 9-110(b). To perfect a security interest in a deposit account as original collateral, a secured party (other than the depository institution with which the deposit account is maintained) must take "control" of the account either by obtaining the depository institution's written agreement or by putting the funds into its own account. See Sections 9-304(a)(2); 9-117(a). Either of these steps requires the debtor's consent.

This article also contains new rules that determine which state's law governs perfection and priority of a security interest in a deposit account, see Section 9-103(d), priority of conflicting security interests in a deposit account, see Sections 9-312(p); 9-312A, the rights of transferees of funds from an encumbered deposit account, see Section 9-308A, the obligations of the depository institution, see Section 9-318A, and enforcement of security interests in a deposit account. See Section 9-502(c).

Consumer Deposit Accounts. Although subsection (13) excludes as original collateral a "deposit account in a consumer secured transaction," the appropriate treatment of consumer deposit accounts will not be under consideration at the 1996 Annual Meeting. See Reporters' Prefatory Comment 3.g. In assessing provisions relating to deposit accounts, one should assume that they do not apply to deposit accounts in consumer transactions.

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, or general intangible.

(2) "Agricultural lien" means an interest in farm products or proceeds of farm products (i) which secures payment or performance of an obligation, (ii) 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) A person "becomes bound" as debtor by a security agreement entered into by another person if, 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].

(5) "Chattel paper" means a writing or writings that evidence both a monetary obligation and a security interest in or a lease of specific goods. 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.

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

(7) "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.

(8) “Consumer debtor” means a debtor in a consumer secured transaction.

(9) “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.

(10) “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) “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;

(ii) the seller of accounts, chattel paper, or payment intangibles; and

(iii) a consignee.

(12) “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) “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) “Document” means a document of title or a receipt of the kind described in Section 7-201(2).

(15) “Encumbrance” includes a real estate mortgage, other lien on real estate, and any other right in real estate which is not an ownership interest.

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

(17) “Financing statement” means the initial financing statement and any record on file relating to the initial financing statement.

(18) “Good faith” means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(19) “Goods” includes all things that are movable at the time a security interest attaches, fixtures, 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 does not include money, documents, instruments, investment property, accounts, chattel paper, general intangibles, deposit accounts, letters of credit, and minerals or the like, including oil and gas, before extraction.

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

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

(23) “New debtor” means a person that becomes bound as debtor by a security agreement previously entered into by another person.

(24) “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 does not include an obligation substituted for another obligation.

(25) “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 on the collateral.

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

(27) 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.

(28) “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.

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

(30) “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.

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

(32) “Secondary obligor means an obligor any portion of whose obligation is secondary.

(33) “Secured party means a 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.

(34) “Security agreement means an agreement that creates or provides for a security interest.

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

(36) “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.

(37) “Support obligation means a secondary obligation or letter of credit that supports the payment or performance of an account, chattel paper, general intangible, document, [insurance policy,] instrument, or investment property.

(38) “Transmitting utility means 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.
“Cash proceeds	Section 9-306.
“Certificate of title	Section 9-103.
“Commodity account	Section 9-115.
“Commodity contract	Section 9-115.
“Commodity customer	Section 9-115.
“Commodity intermediary	Section 9-115.
“Construction mortgage	Section 9-313.
“Consumer goods	Section 9-109.
“Control (deposit account)	Section 9-117.
“Control (investment property)	Section 9-118.
“Control (letter of credit)	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.
“Inventory proceeds	Section 9-312.
“Investment property	Section 9-115.

“Lien creditor	Section 9-301.
“Noncash proceeds	Section 9-306.
“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].
“Consignor	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. For purposes of this article, “good faith, as used in Section 1-203, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

Reporters' Comments

1. **Agricultural Financing.** The new definitions of “agricultural lien” and “agricultural lienholder” and certain revisions to the definitions of “collateral,” “debtor,” and “secured party” accommodate the inclusion of agricultural liens within the scope of Article 9. We suspect that agricultural liens do not arise in favor of representatives, but we have added the bracketed language in the second sentence of the definition just in case they do. The revised definition of “goods” is designed to resolve issues that arise in agricultural financing.

2. **Consignments.** The definitions of “debtor” and “secured party” have been revised to include a “consignee” and “consignor,” as newly defined in Article 2. See the Appendix.

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

4. **“Becomes Bound.”** Under Section 9-203(b), if a new debtor “becomes bound as debtor by a security agreement entered into by another person, the security agreement satisfies the requirement of Section 9-203(a)(1) as to the existing and after-acquired property of the new debtor to the extent the property is described in the agreement. The brackets around paragraph (ii) reflect the Drafting Committee’s even split over whether this article should defer entirely to other law on the issue or should contain supplemental rules.

Persons who “become [] bound under paragraph (ii) are limited to those who both become primarily liable for the original debtor’s obligations and succeed to (or acquire) its assets. Thus, the paragraph excludes sureties and other secondary obligors as well as persons who become obligated through veil piercing and other non-successorship doctrines. In many cases, paragraph (ii) will exclude successors to the assets and liabilities of a division of a debtor.

5. **“Communicate.”** The definition of “communicate” includes the act of transmitting both tangible and intangible records.

6. **“Debtor”; “Obligor”; “Secondary Obligor.”** Determining whether a person is a “debtor” under the definition in former Section 9-105(1)(d) requires a close examination of the context in which the word is used. To reduce the need for this examination, this article redefines “debtor” and adds new defined terms, “secondary obligor” and “obligor. In the context of Part 5, these definitions distinguish among three classes of persons: (1) those persons who may have a stake in the proper enforcement of a security interest by virtue of their non-lien property interest (typically, an ownership interest) in the collateral, (2) those persons who may have a stake in the proper enforcement of the security interest because of their obligation to pay the secured debt, and (3) those persons who have an obligation to pay the secured debt but have no stake in the proper enforcement of the security interest. Persons in the first class are debtors. Persons in the second class are secondary obligors if any portion of the obligation is secondary. One must consult the law of suretyship to determine whether an obligation is secondary. The Restatement (3d), Suretyship and Guaranty § 1 (1996) contains a useful explanation of the concept. Persons in the third class are neither debtors nor secondary obligors.

The definition of “debtor” includes transferees of collateral, whether or not the secured party knows of the transfer or the transferee’s identity. Rather than making adjustments in the definition to allow for the secured party’s lack of knowledge, exculpatory provisions in Part 5 protect the secured party in that circumstance. See Sections 9-501(i), 9-507(i) and (j).

Consider the following examples:

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

Example 2: Mooney borrows money and grants a security interest in his Miata to secure the debt. Harris co-signs the note. As before, Mooney is the debtor and an obligor. Because Harris’s obligation as a co-maker is secondary, Harris is a secondary obligor.

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

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

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

7. **"Collateral."** The revised definition of "collateral" includes property subject to an agricultural lien. It also makes clear that "collateral" includes proceeds.

8. **Consumer-related Definitions.** The definitions of "consumer debtor," "consumer obligor," and "consumer secured transaction" have been added in connection with various new (and old) consumer-protection rules in Part 5. Like the provisions they affect, the definitions will not be under discussion at the 1996 Annual Meeting. See Reporters' Prefatory Comment 3.g.

9. **"Deposit Account"; "Depository Institution."** The revised definition of "deposit account" incorporates the definition of "depository institution," which is new. Unlike the definition of "bank" in Section 4-105(1), which focuses on whether the organization is "engaged in the business of banking," the definition of "depository institution" focuses on whether the organization accepts deposits.

All accounts evidenced by Article 9 "instruments" are excluded from the scope of "deposit account." In contrast, the former version excludes from the "deposit account" definition "an account evidenced by a certificate of deposit [CD]." The change clarifies the proper treatment of non-negotiable or uncertificated CD's issued to reflect a deposit. Under this article, the latter would be a deposit account (assuming there is no writing evidencing the depository institution's obligation to pay) whereas the former would be a deposit account only if it is not an 9 "instrument" as defined in Section 9-105 (a question that turns on whether the non-negotiable CD is "of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment.)

A deposit account evidenced by an instrument is subject to the rules applicable to instruments generally. As a consequence, a security interest in such a deposit account cannot be perfected by "control" (see Section 9-117), and the special priority rules applicable to deposit accounts (see Sections 9-312 and

9-312A) do not apply. In addition, this article (like former Article 9) does not address the obligation of a depository institution to pay to a secured party any deposit evidenced by an instrument.

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

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

11. **“New Value.”** The new definition of “new value” derives from § 547(a) of the Bankruptcy Code and replaces former Section 9-108. The term is used in Sections 9-304(d) and 9-308.

12. **“Record.”** A “record” includes information that is in intangible form (e.g., electronically stored) as well as tangible form (e.g., written on paper). Whatever is filed in the Article 9 filing system, including financing statements, termination statements, and amendments, whether transmitted in tangible or intangible form, would fall within the definition.

The term embraces all means of communicating or storing information except human memory. Given the rapid development and commercial adoption of modern communication and storage technologies, requirements that documents or communications be “written, “in writing, or otherwise in tangible form do not necessarily reflect or aid commercial practices. Examples of current technologies commercially used to communicate or store information include, but are not limited to, magnetic media, optical discs, digital voice messaging systems, electronic mail, audio tapes, and photographic media, as well as paper. “Record” is an inclusive term that includes all of these methods of storing or communicating information. Any “writing” is a record.

A “record” need not be permanent or indestructible, but the term does not include any oral or other communication that is not stored or preserved by any means. The information must be stored on paper or in some other medium. Information that has not been retained other than through human memory does not qualify as a record. A record may be signed. See Section 9-105(35). A record may be created without the knowledge or intent of a particular party.

Like the terms “written” or “in writing,” the term “record” does not establish the purposes, permitted uses, or legal effect that a record may have under any particular provision of law. For example, a record may or may not be in appropriate form for filing with a filing office. Other provisions of this Act must be consulted to determine these issues.

In some instances, statutes or the rules of filing offices may require that a paper record be filed or that a particular form of signature be employed. In such cases, whether or not an electronic record is permitted under this article,

compliance with those statutes or rules is necessary. When a filing office adopts modern technologies, any record satisfying modified statutes or rules as may be adopted would be sufficient under this article.

Throughout this draft, the terms “writing” and “written” appear. The Drafting Committee has yet to undertake a comprehensive review of these provisions to determine which, if any, should require traditional writings (i.e., on paper) and which should not.

13. **“Secured Party.”** The definition of “secured party” clarifies the status of various types of representatives. The secured party is the person in whose favor the security interest has been created, as determined by reference to the security agreement. This definition controls, among other things, which person has the duties and potential liability that Part 5 imposes upon the secured party.

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

14. **“Support Obligation.”** This new 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.

This article contains rules explicitly governing attachment and perfection of security interests in support obligations. See Sections 9-203, 9-303, and 9-306. These provisions reflect the principle that a support obligation is an incident of the collateral it supports.

This article does not contain special priority provisions governing security interests in support obligations. For suretyship obligations, which are 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 accounts 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 Section 9-312(p) (security interest in letter of credit perfected by control has priority over a conflicting security interest).

As drafted, other types of credit enhancements are not covered by the definition of “support obligation.” Other law would determine 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. However, the Drafting Committee is considering whether and, if so, how Article 9 should express the broader common-law principle that “the collateral follows the obligation.”

SECTION 9-106. DEFINITIONS: “ACCOUNT”; “GENERAL INTANGIBLES”; “PAYMENT INTANGIBLE.”

(a) “Account means a right to payment, whether or not earned by performance, for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, 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 provided or to be provided, or for the use or hire of a vessel under a charter or other contract. 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' Comments

1. **“Account.”** The definition of “account has been expanded and reformulated. Many categories of rights to payment that would have been classified as general intangibles under former Article 9 are accounts under this article. As accounts, they are not subject to the automatic-perfection rules applicable to payment intangibles. The Drafting Committee will continue to refine this definition.

2. **“General Intangibles.”** Subsection (b) establishes deposit accounts as a separate type of collateral. One important consequence is that the depository institution is not an “account debtor having the rights and obligations set forth in Section 9-318. In particular, it is not obligated to pay an assignee (secured party) upon receipt of the notification described in Section 9-318(e). Another important consequence relates to the adequacy of the description in the security agreement. See Section 9-110.

A letter of credit likewise is not a general intangible but rather a separate type of collateral. Accordingly, except as provided with respect to support obligations, filing would not be effective to perfect a security interest, and the issuer would not be an “account debtor.

3. **“Payment Intangible.”** Subsection (c) is new. It creates a sub-category of general intangibles the sale of which is subject to this article. See Section 9-102(a)(3).

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

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

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

Every “payment intangible” is also a “general intangible. Accordingly, except as otherwise provided, statutory provisions applicable to general intangibles apply to payment intangibles.

SECTION 9-107. DEFINITIONS: “PURCHASE MONEY SECURITY INTEREST”; “PURCHASE MONEY COLLATERAL”; PURCHASE MONEY OBLIGATION”; APPLICATION OF PAYMENTS; BURDEN OF ESTABLISHING PURCHASE MONEY SECURITY INTEREST.

(a) A security interest in goods[, including fixtures,] is a “purchase money security interest” to the extent that 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.

(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)).

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

(d) 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:

(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.

(f) 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' Comments

1. **“Purchase Money Security Interest.”** Subsection (a) limits purchase money security interests to goods, including fixtures. Otherwise, no change in meaning from former Section 9-107 is intended.

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

As used in subsection (a), the “price” of collateral includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, finance charges, interest, administrative charges, expenses of collection and enforcement, attorney’s fees, and other similar obligations.

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

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

Under subsection (b), S's security interest in **Item-1** securing **Item-2's unpaid price** would be a purchase money security interest. This is so because S has a

purchase money security interest in Item-1, Item-1 secures the price of (a “purchase money obligation with respect to) Item-2 (“other inventory), and Item-2 itself is subject to a purchase money security interest. Note that, to the extent Item-1 secures the price of Item-2, S's security interest in Item-1 would not be a purchase money security interest under the general definition in subsection (a). The security interest in Item-1 is a purchase money security interest under that subsection only 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).

3. **“Dual-Status” Rule; Allocation of Payments; Burden of Proof.** This article approves what some cases have called the “dual-status” rule, under which a security interest may be a purchase money security interest to some extent and a non-purchase money security interest to some extent. This rule is implicit in subsections (a) and (b) (“to the extent) and is made explicit in subsection (e).

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

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

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

By determining whether a security interest is a “purchase money security interest,” the dual-status rule and allocation formula affect perfection and priority under this article. See, e.g., Sections 9-302(a)(7); 9-312(c), (d), and (e). Whether a

security interest is a “purchase money security interest” under other law, e.g., the Bankruptcy Code, is determined by that law.

The statutory terms “renewed,” “refinanced,” and “restructured” are not defined. Whether the terms encompass a particular transaction depends upon whether, under the particular facts, the purchase-money character of the security interest fairly can be said to survive. Each term contemplates that an identifiable portion of the purchase money obligation could be traced to the new obligation resulting from a renewal, refinancing, or restructuring. As is the case when the extent of a security interest is in issue, the secured party claiming a purchase money security interest has the burden of establishing whether the security interest retains its purchase-money status following a renewal, refinancing, or restructuring. See subsection (f).

4. **Consignments.** Under former Section 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. This approach obviates any need to set forth special priority rules applicable to the interest of a consignor. Rather, the priority of the consignor's interest as against the rights of lien creditors of the consignee, competing secured parties, and purchasers of the goods from the consignee can be determined by reference to the generally applicable priority rules, such as Sections 9-301, 9-307, and 9-312.

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) A security interest in crops is a “production money security interest” to the extent that the collateral (“production money collateral”) secures an obligation incurred by an obligor for new value given to enable the debtor to produce the crops (“production money obligation”) if the value is in fact used for the production of crops.

[(b) 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.]

(c) When the extent to which a security interest is a production money security interest depends on the application of a payment to a particular obligation, the payment is to be applied:

(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 production money security interests in the order in which those obligations were incurred.

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

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

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

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

(e) 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 claiming a production money security interest has the burden of establishing the extent to which the security interest is a production money security interest.

1. There appears to be a general consensus that the former rule affording special priority to those who provide secured credit that enables a debtor to produce crops, found in former Section 9-312(2), is not workable. Accordingly, this article revises that rule. See Section 9-312(b). In conjunction with the new priority rule, this section provides a definition of “production money security interest. It is patterned closely on Section 9-107, which defines “purchase money security interest. The question of production money priority is controversial, and no consensus concerning the rule has arisen yet among those who engage in agricultural financing. Sections 9-107A and 9-312(b) are included with the hope that they will stimulate discussion and, perhaps, a consensus.

In this connection, the Drafting Committee could be assisted by any available empirical evidence. For example, Washington adopted a statutory crop lien regime that became effective in 1987. Wash. Rev. Code Ann § 60.11.010 - 60.11.140 (West 1995). The statutory lien was broadened in 1991. It provides a production-money-like lien for the benefit of suppliers, handlers of orchard crops, and landlords. Unlike draft Sections 9-107A and 9-312(b), however, the Washington lien does not benefit those who loan funds used for the costs of production. Evidence of the experiences of banks and other general agricultural financiers in Washington with the crop lien statute might be valuable to the Drafting Committee.

2. Section 9-107A provides production money status only for value that actually can be traced to the direct production of crops. It does not provide production money treatment to the extent that a security interest secures indirect costs of production such as general living expenses. Bracketed subsection (b) is intended to make this clear. Ultimately, this detail may be left to the Official Comments.

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

[Deleted]

Reporters’ Comment

This article deletes former Section 9-108. Its broad formulation of new value, which embraces the taking of after-acquired collateral for a pre-existing claim, is unnecessary, counterintuitive, and ineffective for its original purpose of sheltering after-acquired collateral from attack as a voidable preference in bankruptcy. A new definition of the term “new value” appears in Section 9-105.

SECTION 9-109. CLASSIFICATION OF GOODS: “CONSUMER GOODS”; “EQUIPMENT”; “FARM PRODUCTS”; “INVENTORY.”

(a) “Consumer goods” means goods that are used or bought for use primarily for personal, family, or household purposes.

(b) “Equipment” means goods that 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. The term includes goods that are not included in the definitions of inventory, farm products, or consumer goods.

(c) “Farm products” means (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, in each case if 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. If goods are inventory they are not equipment.

Reporters’ Comments

1. The definition of “inventory” has been revised to make clear that the term includes goods leased by the debtor to others as well as goods held for lease. The same result would obtain under the former definition.

2. The primary revision to the definition of “farm products” is to clarify the status of aquaculture.

SECTION 9-110. SUFFICIENCY OF DESCRIPTION.

(a) Except as otherwise provided in subsection (b), 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 sufficient only if it describes the deposit account by item, as all of the debtor's deposit accounts, or as an identified class of the debtor's deposit accounts.

Reporters' Comment

Under subsection (b) a debtor can grant a blanket security interest in all deposit accounts, existing and after-acquired; however, a security agreement containing a "super-generic" description (e.g., "all my personal property") is deemed to be insufficient evidence that the debtor intended to create a security interest in all its deposit accounts. Subsection (b) does not affect accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are not "deposit accounts." In assessing the subsection, one should assume that it does not apply to deposit accounts in consumer transactions. See Section 9-104, Comment 6.

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

[SECTION 9-111. APPLICABILITY OF ARTICLE ON BULK SALES.

[MINOR STYLE CHANGES ONLY] The creation of a security interest is not a bulk sale under Article 6 (Section 6-102).]

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

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

[Deleted]

Reporters' Comment

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

SECTION 9-113. SECURITY INTERESTS ARISING UNDER ARTICLE ON SALES OR UNDER ARTICLE ON LEASES. *[MINOR STYLE CHANGES ONLY]*

A security interest arising solely under the Article on Sales (Article 2) or the Article on Leases (Article 2A) is subject to the provisions of this article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods

- (a) no security agreement is necessary to make the security interest enforceable;
- (b) no filing is required to perfect the security interest; and
- (c) the rights of the secured party on default by the debtor are governed (i) by the Article on Sales (Article 2) in the case of a security interest arising solely under such Article or (ii) by the Article on Leases (Article 2A) in the case of a security interest arising solely under that article.

Reporters' Comment

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 AND SELLER OF ACCOUNT OR CHATTEL PAPER WITH RESPECT TO CREDITORS AND PURCHASERS.

(a) For purposes of determining the rights of creditors of, and purchasers of goods from, a consignee, while goods are in the possession of the consignee and the consignor's security interest is unperfected, the consignee has rights and title to the goods identical to those the consignor had or had power to transfer.

(b) For purposes of determining the rights of creditors of, and purchasers of an account or chattel paper from, a debtor that has sold an account or chattel paper,

while the buyer's security interest is unperfected, the debtor has rights and title to the account or chattel paper identical to those the debtor sold.]

Reporters' Comments

1. This new section entirely replaces former Section 9-114, which contained priority rules applicable to consignments. Under this article, the priority rules for purchase money security interests in inventory apply to consignments. See Section 9-107(c). Accordingly, a special section containing priority rules for consignments no longer is needed.

2. Section 9-114(a) 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 if the consignor's security interest is unperfected. The consignee acquires these rights even though, as between the parties, it purchases a limited interest in the goods (as would be the case, e.g., in a true consignment, under which the consignee acquires only the interest of a bailee). As a consequence of this section, creditors of the consignee can acquire judicial liens and security interests in the goods. Other sections of the article, e.g., Sections 9-301 and 9-312, determine whether those interests are senior to the interest of the consignor. Sections 9-301, 9-306, and 9-307 determine whether a buyer takes free of the consignor's interest.

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

3. Section 9-114(b) takes a similar approach to the interest of a debtor that has sold an account or chattel paper. If the buyer-secured party's security interest is unperfected, then the seller can transfer and the creditors of the seller can reach the account or chattel paper as if it had not been sold.

4. Section 9-114 would leave to other law (including Article 2 and applicable Article 9 cut-off and priority rules) the question whether a consignee has a property interest in the goods (beyond that of a bailee) that could be reached by creditors or acquired by purchasers if the consignor's security interest is perfected. However, if the security interest of a buyer of an account or chattel paper is perfected, the seller normally would not retain property rights in the account or chattel paper.

5. Section 9-114 appears in brackets to indicate that the Drafting Committee intends to give further consideration to its rationale and approach. Also, we are unsure as to whether the section is necessary. The cut-off and priority rules in Sections 9-301, 9-306, 9-307, and 9-312 may be sufficient to reach the correct results, especially if accompanied by adequate explanatory commentary.

SECTION 9-115. INVESTMENT PROPERTY.

(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) “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).

(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' Comments

1. This section, which was added in conjunction with Revised Article 8, contains a variety of rules applicable to security interests in investment property. We have begun the process of relocating each rule to the related section of Article 9. See, e.g., Sections 9-118 (definition of “control”); 9-305A (perfection by control).

2. Inasmuch as Section 9-107 limits purchase money security interests to goods, 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 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) 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), within 10 days 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), within 10 days after written demand by the debtor, shall pay the debtor all funds on deposit in the account.

(e) A secured party that fails to comply with subsection (d) is liable to the debtor for \$ 500 and, in addition, for any loss caused to the debtor by the failure.

Reporters' Comments

1. **Why “Control” Matters.** This section explains the concept of “control over a deposit account. “Control under this section may serve two functions. First, “control by agreement may substitute for a security agreement as an element of attachment. See Section 9-203(a)(1). Second, when a deposit account is taken as original collateral, the only method of perfection is taking control under this section. See Section 9-304(a). In assessing this section, one should assume that it does not apply to deposit accounts in consumer transactions. See Section 9-104, Comment 6.

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

Under subsection (a)(2), a secured party may take control by obtaining the depository institution's written agreement that it will comply with the secured party's instructions without further consent by the debtor. The analogous provision in Article 8 does not require that the agreement be in writing. An agreement to comply with the secured party's instructions suffices for “control this section even if the depository institution's agreement is subject to specified conditions, e.g., that the secured party's instructions are accompanied by a certification that the debtor is in default. (Of course, if the condition is the debtor's further consent, the statute explicitly provides that the agreement would not confer control.) The Reporters are considering whether the statutory text, perhaps accompanied by a change to the Official Comments, is clear enough to reach the desired result or whether a minor

amendment to this section is necessary. If this section is amended, the analogous provision in Section 8-106 probably should be revised as well.

Under subsection (a)(3), a secured party may take control by becoming the depository institution's customer. As the customer, the secured party would enjoy the right to withdraw funds from the deposit account. The Drafting Committee has yet to resolve all the issues that may arise from the situation in which the secured party has only a security interest in a deposit account that it appears to own (because it is maintained in the secured party's name).

Perfection by control is not be available for accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are not “deposit accounts.

Subsections (b) and (c) derive from Revised Article 8. The former makes clear that “control need not deprive the debtor of the ability to reach the funds on deposit. The latter protects depository institutions from the need to enter into agreements against their will and from the need to respond to inquiries from persons other than their customers.

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

4. Distinguishing Investment Property from Deposit Accounts. Some types of investment property (e.g., money market funds) appear to function so much like deposit accounts that distinguishing between the two may prove difficult in certain cases. The Drafting Committee is sensitive to the costs that may result from uncertainty over the proper classification of particular collateral. To the extent possible, future drafts will formulate a single set of rules to cover both types of collateral, so that very little will turn on the distinction. Nevertheless, one important distinction is likely to remain: a security interest in investment property may be perfected by filing, whereas filing normally is ineffective to perfect a security interest in a deposit account.

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' Comment

The provisions of new Section 9-118 have been moved from Section 9-115.

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' Comments

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 Section 9-312(p). This new 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 paragraph (2), the secured party may acquire control by becoming the transferee beneficiary of the letter of credit. As such, the secured party acquires the right to draw or otherwise demand payment under the letter of credit. The details of this section, particularly of paragraph (1), are likely to be refined further to take account of input from letter-of-credit specialists.

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 letter of credit has been honored. See Section 5-114(b). If the assignment creates a security interest, the security interest can be perfected at the time it is created. An assignment of, including the creation of a security interest in, 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.

3. A special choice-of-law rule is likely to be necessary for perfection by control of security interests in a letter of credit.

PART 2
VALIDITY OF SECURITY AGREEMENT AND
RIGHTS OF PARTIES TO SECURITY AGREEMENT

SECTION 9-201. GENERAL VALIDITY OF SECURITY
AGREEMENT. [MINOR STYLE CHANGES ONLY]

(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 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 the statute or regulation.

SECTION 9-202. TITLE TO COLLATERAL IMMATERIAL. Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, or 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' Comment

This section explicitly acknowledges two circumstances in which the effect of certain Article 9 provisions turns on ownership (title). First, the remedies of a consignor under a true consignment are determined by other law and not by part 5. The Comment to Section 9-501 explains this more fully. Second, in some respects sales of accounts, chattel paper, and payment intangibles receive special treatment. See, e.g., Sections 9-207(a); 9-208(b). This is true under existing law, as well. See, e.g., former Section 9-502(2).

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

(a) Subject to 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 the debtor's agreement, or the debtor has signed a security agreement that contains a description of the collateral and in addition, 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 the collateral [or, if the collateral is goods that have been delivered to the debtor in a consignment or 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 in 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 occurred 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 collateral gives the secured party a security interest in any support obligation with respect to the collateral.

(e) A transaction, although subject to this article, is also subject to

_____ *. In case of conflict between this article and that statute, the statute controls. Failure to comply with an applicable statute has only the effect the statute specifies.

*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' Comments

1. **Section 5-118.** Section 5-118, mentioned in subsection (a), is found in the Appendix.

2. **Requirement for Agreement.** Subsection (a)(1) clarifies two points. First, for purposes of this subsection, the secured party's possession must be obtained with the debtor's agreement. "Pursuant to agreement" in this subsection refers to the debtor's agreement to the secured party's possession for the purpose of creating a security interest. In the unlikely event that possession is obtained without the debtor's agreement, it would not suffice as a substitute for a written security agreement. However, once the security interest has become enforceable and has attached, it is not impaired by the fact that the secured party's possession is not maintained with the agreement of a subsequent debtor (e.g., a transferee). Second, possession as contemplated by Section 9-305 is possession for purposes of subsection (a), even though it may not constitute possession "pursuant to the debtor's agreement" and consequently might not serve as a substitute for a written security agreement under subsection (a).

Subsection (a)(1) also provides that control of a deposit account pursuant to the debtor's agreement is sufficient as a substitute for a written security agreement.

3. **Collateral Covered by Other Statute or Treaty.** One purpose of the formal requisites stated in subsection (a)(1) is evidentiary – to minimize the possibility of future disputes as to the terms of a security agreement and as to what property stands as collateral for the obligation secured. One should distinguish the evidentiary functions of the formal requisites of attachment and enforceability (such as the requirement that a security agreement contain a description of the collateral) from the more limited goals of "notice filing" for financing statements under Part 4, explained in former Section 9-402, Comment 3. When perfection is achieved by compliance with the requirements of a statute or treaty described in Section

9-302(c), such as a federal recording act or a certificate of title act, the manner of describing the collateral in a registry imposed by the statute or treaty may or may not be adequate for purposes of this section and Section 9-110. However, the description contained in the security agreement, not the description in a public registry or on a certificate of title, controls for purposes of this section.

4. **Consignments and Sales of Receivables.** The bracketed revision to subsection (a)(3) is not designed to change existing law. It addresses the following situations:

a. SP-1 delivers goods to D on consignment. SP-1 does not file. D then grants a security interest in the goods to SP-2. SP-2 files a proper financing statement. Assuming D is a mere bailee, as in a “true consignment, D would not appear to have any rights in the collateral (beyond those of a bailee) so as to permit SP-2’s security interest to attach to the greater rights. Nevertheless, SP-2’s interest attaches, is perfected by the filing, and is senior to SP-1’s interest.

b. D sells accounts or chattel paper to B-1. B-1 does not file. D then sells the same receivables to B-2. B-2 files a proper financing statement. Having sold the receivables to B-1, D would not appear to have any rights in the collateral so as to permit B-2’s security (ownership) interest to attach. Nevertheless, B-2’s interest attaches, is perfected by the filing, and is senior to B-1’s interest.

To make explicit what is now implicit, subsection (a)(3) eliminates the requirement of rights in collateral in the cases of a consignment and an account or chattel paper that has been sold, if the consignor’s or buyer’s security interest is unperfected. In effect, D retains the **power** to transfer rights to SP-2 and B-2. Cf. Section 2-403(1) (2d sentence) (person with voidable title has “power to transfer good title to a good faith purchaser for value). If the consignor’s or buyer’s security interest is perfected, on the other hand, the debtor normally has no rights (beyond a bailee’s) to transfer in a true consignment and has no remaining rights in the account or chattel paper that is sold. Neither this article nor the definition of “security interest” in Section 1-201(37) undertakes to delineate between assignments that are “sales” and those that “secure an obligation.

The revision to subsection (a)(3) appears in brackets to indicate that the Drafting Committee intends to give further consideration to the issue. If Section 9-114 is retained, for example, the revisions to subsection (a)(3) would be unnecessary.

The Drafting Committee will consider whether the provisions of subsection (a)(1) should be made applicable to consignments.

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

6. **Support Obligations.** Under new subsection (d)(2) a security interest in a “support obligation” (defined in Section 9-105) automatically follows from a security interest in the underlying, supported collateral. We believe this to be implicit in current law.

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 10 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)).

Reporters' Comment

This article validates “after-acquired property” and “future advance” clauses in security agreements not only when the transaction is for security purposes but also when the transaction is the sale of accounts, chattel paper, or payment intangibles. We understand this to be the case under existing law.

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, enforce, or otherwise deal with collateral, or to accept the return of collateral 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), perfection (Section 9-305), or enforcement of a security interest depends upon possession of the collateral by the secured party.

Reporters' Comment

Section 9-205 recognizes the broader rights of a secured party to “enforce collateral as well as to “collect and “compromise collateral. The reference to collecting and compromising “collateral in lieu of “accounts or chattel paper, used in former Section 9-205, contemplates the many other types of collateral that a secured party may wish to “collect, compromise, or enforce : deposit accounts, documents, financial assets, general intangibles, instruments, [insurance policies,] investment property, and letters of credit.

SECTION 9-206. AGREEMENT NOT TO ASSERT DEFENSES AGAINST ASSIGNEE.

(a) This section is subject to other law that establishes a different rule for consumer account debtors.

(b) Except as otherwise provided in subsection (c), an agreement [by an account debtor] [between an account debtor and an assignor] not to assert against an assignee any claim or defense that the account debtor may have against the assignor is unenforceable except by an assignee that takes an assignment for value (Section 3-303(a)), in good faith (Section 3-103(a)(4)), without notice of a claim of a property or possessory right to the property assigned, and without notice 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)).

(c) An agreement of the kind described in subsection (b) is not enforceable with respect to defenses of a type that may be asserted against a holder in due course of a negotiable instrument (Section 3-305(b)).

Reporters' Comments

1. **Scope.** This section has been expanded to apply to all account debtors, not just those who buy or lease goods.

2. **Relationship to Other Law.** The reference to “other law, in subsection (a) 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 Sub-committee on Consumer Transactions before drafting a definition.

This section displaces other law to the extent that the other law permits an assignee who takes an assignment with notice of a claim of a property or possessory right, a defense, or a claim in recoupment to enforce an agreement made with the assignor not to assert claims and defenses. (We intend to ask the Drafting Committee to revisit this issue, however.) This section does not displace an assignee’s right to assert that an account debtor is estopped from asserting a claim or defense. We anticipate that the Drafting Committee will consider whether the “good faith” and “without notice” requirements apply to waivers of potential future claims and defenses that are the subject of an agreement between the account debtor and the assignee. The bracketed alternatives in subsection (b) reflect this open issue. This section does not displace Section 1-107, concerning waiver of a breach that allegedly already has occurred.

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

This section deletes the last sentence of former Section 9-206(1), under which a buyer who signs a negotiable instrument and a security agreement as part of one transaction is deemed to have agreed to waive claims and defenses against a qualifying assignee. The effect of the deletion is that Article 3 determines the circumstances under which and the extent to which a person who signs a negotiable instrument is disabled from asserting them.

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

enforce would depend upon whether, under the particular facts, the account debtor's undertaking fairly could be construed as an agreement that falls within the scope of this section and whether the assignee meets the requirements of this section.

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, the secured party 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 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 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.

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

1. **Agricultural Liens.** The revised definitions of “collateral,” “debtor,” and “secured party” in Section 9-105 would make this section applicable to collateral subject to an agricultural lien if the collateral is in the agricultural lienholder’s possession. The Drafting Committee has not yet considered whether that result is appropriate.

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

3. **“Repledges.”** The change to subsection (b)(5) eliminates the qualification that the terms of a “repledge” may not “impair” a debtor’s “right to redeem” collateral. The change is for clarification only.

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 Section 9-506(a), and this section need not address it. For example, if the collateral is a negotiable note that the secured party (SP-1) repledges to SP-2, nothing in this section suggests that the debtor (D) does not retain the right to redeem the note upon payment to SP-1 of all obligations secured by the note. But, as explained below, the debtor’s unimpaired right to redeem as against the debtor’s original secured party nevertheless may not be enforceable as against the new secured party.

In resolving questions that arise from the creation of a security interest by SP-1, one must take care to distinguish D’s rights against SP-1 from D’s rights against SP-2. Once D discharges the secured obligation, under Section 9-506(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 Section 9-506(a) or otherwise. If so, and if SP-2 fails to deliver the note to D, then D will have a right to replevy the note from SP-2 or recover damages from SP-2 in conversion. In some circumstances, however, SP-2's security interest will survive discharge of SP-1's security interest. This will be the case, for example, if SP-2 is a holder in due course. See Sections 9-309, 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.

This section does not change existing law in this regard, but rather eliminates a possible ambiguity. Former Section 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 Section 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. Both readings are erroneous. Subsection (b)(5) makes clear that nothing in this article, including subsection (a), prohibits or restricts a secured party from creating, as a debtor, a security interest in collateral in which it holds a security interest. Subsection (b)(5) does not, by negative implication, prohibit or render ineffective a security interest created by a secured party in collateral that is not in the secured party's possession.

4. **Relationship to Section 9-501.** The change in the introductory clause of subsection (b) is intended to eliminate any doubt that the restrictions on waivers in Section 9-501 do not affect the secured party's right to create a security interest in the collateral under this section.

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.

Reporters' Comment

The Drafting Committee has yet to consider this section. However, in conjunction with other revisions, we have made two changes that affect it. First, the revised definitions of “collateral”, “debtor”, and “secured party” in Section 9-105 would make this section applicable to collateral subject to an agricultural lien. Second, the bracketed language in subsection (b) raises the question whether a seller of receivables needs the protection afforded by this section. The Drafting Committee will consider these changes at a future meeting, when it considers the section as a whole.

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

Reporters' Comment

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

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

**SECTION 9-301. PERSONS THAT TAKE PRIORITY OVER
UNPERFECTED SECURITY 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 person 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 is a 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 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 collateral, the security interest takes priority over the rights 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' Comments

1. The Drafting Committee has considered this section primarily as it applies to sales of receivables. Other aspects of this section will be considered at future meetings.

2. **Agricultural liens.** Subsection(a) subordinates unperfected agricultural liens in the same fashion that it subordinates unperfected security interests.

3. **Buyers of Receivables.** A buyer of accounts, chattel paper, or payment intangibles can be “a person that is not a secured party” under subsection (a)(3) or (4) only in a transaction that is excluded from Article 9 by Section 9-104(6).

As drafted, subsection (d) does not apply to outright sales of accounts, chattel paper, or payment intangibles. The subsection may need to be refined to take account of particular financing practices.

4. **Bulk Sales; Bulk Transfers.** Subsections (a)(3) and (b) delete the references, contained in prior official texts, 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.”

5. **“Receives Possession.”** The Official Comments should clarify when a debtor “receives possession” of collateral for purposes of subsection (b) and Section 9-312(c), (d), and (e).

SECTION 9-302. WHEN FILING REQUIRED TO PERFECT SECURITY INTEREST OR AGRICULTURAL LIEN; SECURITY INTERESTS AND AGRICULTURAL LIENS TO WHICH FILING PROVISIONS 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 in instruments, certificated securities, chattel paper, or documents perfected without filing or possession under Section 9-304(d) or (e);

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

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

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

(7) 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);

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

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

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

(11) a security interest in investment property which is perfected without filing under Section 9-305A 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, regulation, or treaty described in subsection (c);

(14) a security interest in a deposit account which is perfected without filing under Section 9-305A; and

(15) a sale of a payment intangible.

(b) If a secured party assigns a perfected security interest, no 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, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt subsection (a); [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 the

security interest's obtaining priority over the rights of a lien creditor with respect to the property.]

(d) Compliance with the requirements prescribed by a statute, regulation, or treaty described in subsection (c) for obtaining priority over the rights of a lien creditor 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, regulation, or treaty described in subsection (c) can be perfected only by compliance with those requirements, 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 prescribed by the statute, regulation, or treaty are governed by the statute, regulation, or treaty. In other respects the security interest is subject to this article.

Reporters' Comments

1. **Basic Rule.** Subsection (a) establishes a central Article 9 principle: Filing a financing statement is necessary for perfection of all security interests unless the subsection specifies otherwise.

Agricultural Liens. Agricultural liens may be perfected only by filing, except to the extent that Section 9-306(e) provides otherwise with respect to proceeds. Thus agricultural liens are not mentioned in subsection (a)(1) or Section 9-305, which deal with possessory security interests. The priority rule in Section 9-310 remains applicable to possessory agricultural liens.

Purchase Money Security Interest in Consumer Goods. No filing is required to perfect a purchase money security interest in consumer goods, other than goods that are subject to a statute or treaty described in subsection (c). However, filing is necessary to prevent a buyer of the goods from taking free of the security interest under Section 9-307(c), and a fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9-313.

Support Obligations. New subsection (a)(5) reflects the rule in new Section 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.

Payment Intangibles. Subsection (a)(8) expands upon former subsection (1)(e) by covering assignments of payment intangibles. New subsection (a)(15) affords automatic perfection to sales of payment intangibles. It reflects the practice under former Article 9. Under that article, filing a financing statement does not affect the rights of a buyer of payment intangibles, inasmuch as the article does cover those sales. To the extent that the exception in subsection (a)(8) covers outright sales of payment intangibles, which automatically are perfected under subsection (a)(15), the exception is redundant.

Preemptive Federal Law; Certificate of Title Acts. New subsection (a)(13) excepts from the filing requirement property covered by a statute, regulation, or treaty described in subsection (c). Perfection as to this property is governed by subsection (d).

Letters of Credit; Deposit Accounts. Subsections (a)(12) and (a)(14) are new. They reflect that a security interest in a letter of credit and proceeds of the letter of credit and a security interest in a deposit account may be perfected by control. See Sections 9-119 (control over letter of credit and proceeds of letter of credit) and 9-117 (control over deposit account).

Other Exceptions. The Drafting Committee has yet to consider all the exceptions. In particular, a question has been raised concerning the application of subsection (a)(6) to trusts formed for commercial purposes, e.g., in conjunction with a structured financing.

2. **Assignments of Perfected Security Interests.** Subsection (b), which concerns assignment of a perfection security interest, seems to contemplate only security interests perfected by filing. 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, regulation, or treaty under subsection (d).

3. **Federal Statutes, Regulations, and Treaties.** Subsection (c)(1) provides explicitly that the filing requirement of this article defers only to federal statutes, regulations, or treaties whose requirements for a security interest's obtaining priority over the rights of a lien creditor preempt subsection (a). The provision eschews reference to the term "perfection," inasmuch as Section 9-303 specifies the meaning of that term and a preemptive rule may use other terminology.

4. **Forum's Certificate of Title Statute.** The description of certificate of title statutes in subsection (c)(2) has been revised to track the language of Section 9-103(c). 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 this subsection, notation is both unnecessary and ineffective.

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

The phrase “held for sale or lease or leased by a person who is in the business of selling or leasing goods” is intended to include inventory in the possession of a lessee from a dealer. The definition of “inventory” (former Section 9-101(4)) contains a similar phrase, but omits any reference to goods that are “leased. Section 9-109(d) conforms the definition of inventory to Section 9-302(c)(2) by including a reference to “leased” goods. (See also former Section 9-103(3)(a), which seems to distinguish goods “leased” and goods “held for lease.”)

5. Foreign Jurisdiction's Certificate of Title Statute. Subsection (c) retains paragraph (3) (former subsection (3)(c)), with appropriate revisions to conform that paragraph to Section 9-103(c). However, paragraph (3) appears in brackets because Section 9-103(c) apparently makes the paragraph unnecessary. Assume that a court is applying Section 9-302 as enacted in State B. If goods are covered by a State A certificate of title and State B has not issued a certificate, then State A's law, including its Section 9-302(c)(2), will apply. Once application is made for a State B certificate, State B's law will apply, including State B's Sections 9-103(c)(4) and 9-302(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 Section 9-103(c)(5) does terminate perfection if perfection would have lapsed under the law of State A.

6. Compliance with Perfection Requirements of Other Statute. Subsection (d) clarifies former subsection (4) by providing that compliance with the perfection requirements (i.e., the requirements for obtaining priority over a lien creditor), but not other requirements, of a statute, regulation, or treaty described in subsection (c) is equivalent to filing and is sufficient for perfection under this article.

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. We 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 Section 9-103(c) and the time of perfection and also may result in turning some unobjectionable transactions into avoidable preferences under Bankruptcy Code § 547. (The preference risk arises if more than ten days passes between the time a security interest attaches and the time it is perfected.) A Note that instructs the legislature to amend the applicable certificate of title act to reflect the result urged by the Study Committee seems appropriate. Unless adjustments are made to a certificate of title act itself, conflicting rules in the act and Article 9 could create confusion and uncertainty.

Under some certificate-of-title statutes, including the Uniform Motor Vehicle Certificate of Title and Anti-Theft Act, perfection generally occurs upon delivery of specified documents to a state official but may, under certain circumstances, relate back to the time of attachment. This relation-back feature can create great difficulties for the application of the rules in Sections 9-103(c) and 9-302(d). Accordingly, we suggest that this article include a Note recommending to legislatures that they remove any relation-back provisions from certificate-of-title laws affecting security interests.

7. Compliance with Other Statute as Equivalent of Filing. Like former Section 9-302(4), Section 9-302(d) provides that compliance with a statute or treaty described in Section 9-302(c) (former Section 9-302(3)) “is equivalent to the filing of a financing statement. The meaning of this phrase currently is unclear, and many questions have arisen concerning the extent to which and manner in which Article 9 rules referring to “filing” are applicable to perfection by compliance with a certificate of title statute. There are at least three separate approaches for applying Article 9 filing rules to compliance with other statutes and treaties. First, as discussed in Comment 6 above, there are rules such as the rule establishing time of perfection (Section 9-403(a)) that we 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 Section 9-302(b), discussed in Comment 2 above, and Section 9-408. Third, other Article 9 rules may be made applicable to security interests perfected by compliance with another statute through the “equivalent to . . . filing” provision in the first sentence of Section 9-302(d). We suggest that the third approach be reflected for the most part in the Official Comments. Official Comments could be added to various sections to explain how particular rules apply when perfection is accomplished under Section 9-302(d). In the alternative, the Official Comments to Section 9-302 could be expanded to explain the “equivalent to . . . filing” concept as making applicable to the other statutes and treaties all references in Article 9 to “filing,” “financing statement,” and the like.

8. Perfection by Possession of Goods Covered by a Certificate of Title Statute. A secured party that has perfected a security interest under the law of State A in goods that subsequently are covered by a State B certificate of title may face a predicament. Ordinarily, the secured party will have four months under State B's draft Section 9-103(c)(5) in which to (re)perfect by having its security interest noted on a State B certificate. This procedure is likely to require the cooperation of the debtor and any competing secured party whose security interest has been noted on the certificate. Official Comment 4(e) to former Section 9-103 observes that “that cooperation is not likely to be forthcoming from an owner who wrongfully procured the issuance of a new certificate not showing the out-of-state security interest, or from a local secured party finding himself in a priority contest with the out-of-state secured party. According to the Comment, “[t]he only solution for the out-of-state secured party under present certificate of title laws seems to be to reperfect by possession, i.e., by repossessing the goods. But, as the Report observes, the “solution” may not work. Report, 176. Former Section 9-302(4) provides that a security interest in property subject to a certificate of title statute “can be perfected only by compliance therewith.

This article resolves the conflict in Sections 9-103(c)(5), 9-302(d), and 9-305(b) to provide that a security interest that remains perfected solely by virtue of Section 9-103(c)(5) can be (re)perfected by the secured party's taking possession of the collateral. These sections contemplate only that taking possession of goods covered by a certificate of title will work as a method of perfection. None of these sections creates a right to take possession. Section 9-503 and the agreement of the parties define the secured party's right to take possession.

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. 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. 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 one manner permitted under this article and is later perfected in another manner under this article, without an intermediate period when it was unperfected, the security interest or agricultural lien is perfected continuously.

(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' Comments

1. Subsection (b) is new. It describes the elements of perfection of an agricultural lien.

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

SECTION 9-304. PERFECTION OF SECURITY INTERESTS IN INSTRUMENTS, 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, 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).

(b) 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, or negotiable documents is perfected without filing or the taking of possession for a period of 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 20 days without filing if a secured party having a perfected security interest in an instrument, a certificated security, a negotiable document, or goods in possession of a bailee other than one that has issued a negotiable document for the goods

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

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

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

Reporters' Comments

1. **Deposit Accounts.** Subsection (a)(2) is new. It provides that the only means of perfecting a security interest in a deposit account as original collateral is by control. Filing is ineffective, except as provided in Section 9-306 with respect to proceeds. As defined in Section 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, subsection (a) takes an intermediate position between certain non-UCC law, which conditions the effectiveness of a security interest on the secured party's enjoyment of such dominion and control over the deposit account that the debtor is unable to dispose of the funds, and the approach this article takes to securities accounts (approved by the Conference as part of the Article 8 revisions in

1994), under which a secured party who is unable to reach the collateral without resort to judicial process may perfect by filing. By conditioning perfection on “control, subsection (a) accommodates the views of those who think that a secured party that wishes to rely upon a deposit account should take steps to be able to reach the funds upon the debtor's default without having to resort to the judicial process. It also accommodates those who think that requiring 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.

The appropriate treatment of consumer deposit accounts will not be under consideration at the 1996 Annual Meeting. See Section 9-104, Comment 6. In subsection (a)(2), one should assume that it does not apply to deposit accounts in consumer transactions.

2. Letters of Credit and Proceeds of Letters of Credit. Under subsection (a)(3), which is new, 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 Section 9-303(d).

3. Instruments. Under subsection (a), a security interest in instruments may be perfected by filing. Section 9-309 provides that a filed financing statement does not constitute notice that would preclude a subsequent purchaser from becoming a holder in due course. Under Section 9-308, purchasers that take possession of an instrument and give new value generally would achieve priority over a security interest in the instrument perfected by filing.

4. Goods in Possession of Bailee. The rule in subsection (c) has been limited to goods in the possession of an Article 7 “bailee that has issued a non-negotiable document. Subsection (b) applies to goods in the possession of an Article 7 “bailee that has issued a negotiable document. Section 9-305 governs perfection of a security interest in goods in the possession of a non-Article 7 bailee.

The perfection step under subsection (c) occurs when the bailee receives notification of the secured party's interest in the goods, regardless of who sends the notification. Receipt of notification is effective to perfect regardless of whether the bailee attorns to the secured party. Compare Section 9-305(c) (perfection by possession as to goods not covered by a document requires bailee's acknowledgment).

5. “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.

6. The time periods in subsections (d), (e), and (f) have been reduced from 21 to 20 days, which is the time period generally applicable in this article.

**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).

(c) This subsection applies to collateral other than goods covered by a document. If the collateral 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 holds possession for the secured party's benefit. If 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, takes possession of the collateral after having acknowledged [in writing] that it will hold possession of collateral for the secured party's benefit, the secured party takes possession when the person takes possession. [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 holds possession for the secured party's benefit.

(e) If a person acknowledges that it holds possession for the secured party's benefit, (i) the acknowledgment is effective under subsection (c) even 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.

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

Reporters' Comments

1. **Certificated Securities.** The second sentence of subsection (a) reflects the traditional rule for perfection of a security interest in certificated securities. Compare Sections 9-115(4)(a), 8-106(a), 9-115(6) (1994 official text); Sections 8-321, 8-313(1)(a) (1978 official text); Section 9-305 (1972 official text).

2. **Goods Covered by a Certificate of Title.** Subsection (b) is necessary to effect changes to the choice-of-law rules governing goods covered by a certificate of title. These changes are described in the Reporters' Comments to Section 9-302. Subsection (b), like subsection (a), does not create a right to take possession. Rather, it indicates the circumstances under which the secured party's taking possession of goods covered by a certificate of title is effective to perfect a security interest in the goods.

3. **Goods in Possession of a Third Party.** Former Section 9-305 permits perfection of a security interest by notification to a bailee in possession of collateral. This article distinguishes between goods in the possession of an Article 7 bailee that has issued a document covering the goods and goods in the possession of a third party that has not issued a document. Section 9-304(b) or (c) applies to the former, depending on whether the document is negotiable or not; Section 9-305(c) applies to the latter.

Notification of a third person does not suffice to perfect under Section 9-305(c). Rather, perfection does not occur unless the third person acknowledges that it holds possession of the collateral for the secured party's benefit. Compare Section 9-304(c), under which receipt of notification of the security party's interest by an Article 7 bailee holding goods subject to a non-negotiable document is sufficient to perfect, even if the bailee does not acknowledge receipt of the notification. A third person may acknowledge that it will hold for the secured party's benefit goods to be received in the future. Under these circumstances, perfection by possession occurs when the third person obtains possession of the goods.

Under Section 9-305(c), acknowledgment of notification by a lessee in ordinary course of business does not suffice for possession. The section thus rejects the reasoning of *In re Atlantic Systems, Inc.*, 135 B.R. 463 (Bankr. S.D.N.Y. 1992) (holding that notification to debtor-lessor's lessee sufficed to perfect security

interest in leased goods). See Steven O. Weise, *Perfection by Possession: The Need for an Objective Test*, 29 Idaho Law Rev. 705 (1992-93) (arguing that lessee's possession in ordinary course of debtor-lessor's business does not provide adequate public notice of possible security interest in leased goods). Inclusion of a per se rule concerning lessees is not meant to preclude a court, under appropriate circumstances, from determining that a third person is so closely connected to or controlled by the debtor that the debtor has retained effective possession. If so, the third person's acknowledgment would not be sufficient for perfection.

The brackets around the last sentence of subsection (c) reflect uncertainty about whether the sentence is necessary and, if so, where it should appear.

Subsections (e) and (f) are new and address matters as to which former Article 9 is silent. They derive in part from Section 8-106(g). Subsection (e) provides that a person in possession of collateral is not required to acknowledge that it holds for a secured party. Subsection (f) provides that an acknowledgment is effective even if wrongful as to the debtor and that, in the absence of the person's agreement, the person has no responsibilities to a secured party by virtue of its making an acknowledgment. For example, by acknowledging, a third party does not become obliged to act on the secured party's direction or to remain in possession of the collateral. Arrangements involving the possession of goods are hardly standardized. They include bailments for services to be performed on the goods (such as repair or processing), for use (leases), as security (pledges), for carriage, and for storage. This article leaves to the agreement of the parties and to any other applicable law the imposition of duties and responsibilities upon a person who acknowledges under subsection (d). The purpose of subsections (e) and (f) is to make clear that acknowledgment under this article does not give rise to any such duties or responsibilities.

4. **“Possession.”** This section does not define “possession. In determining whether a particular person has possession, the principles of agency apply. For example, if the collateral clearly is in possession of an agent of the secured party for the purposes of possessing on behalf of the secured party, and if the agent is not also an agent of the debtor, the secured party has taken actual possession without the need to rely on a third-party acknowledgment. However, if the agent is an agent of both the secured party and the debtor, as in a typical escrow arrangement, prudence might suggest that the secured party obtain the agent's acknowledgment in order to ensure perfection by possession.

SECTION 9-305A. PERFECTION BY CONTROL.

(a) A security interest in a deposit account, 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).

(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' Comment

The section provides a single statement of the rules for perfection of security interests by control. This article provides for perfection by control with respect to letters of credit and proceeds of letters of credit, 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;

(3) rights arising out of collateral;

(4) to the extent of the value of collateral, claims arising out of the loss or 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 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 on collateral notwithstanding disposition or becomes effective as to proceeds.

(d) Proceeds 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 principles, that is permitted 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 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' Comments

1. **What Constitutes Proceeds.** Subsection (a) expands the definition of proceeds beyond that contained in the 1972 Official Text of Section 9-306.

Distributions on Account of Collateral. The phrase “whatever is distributed on account of, collateral, in subsection (a)(2), is broad enough to cover cash or stock dividends distributed on account of securities or other investment property that is original collateral. Compare Section 9-306 (1994 Official Text) (“Any payments or distributions made with respect to investment property collateral are proceeds.). This section rejects the holding of *Hastie v. FDIC*, 2 F.3d 1042 (10th Cir. 1993) (holding that post-petition cash dividends on stock subject to pre-petition pledge are not “proceeds under Bankruptcy Code § 552(b)) to the extent the holding relies on the Article 9 definition of “proceeds.

Distributions on Account of Support Obligations. Subsection (a)(2) makes explicit what is implicit under current law: Collections and distributions under collateral consisting of various credit support arrangements (“support obligations, as defined in Section 9-105) are afforded treatment identical to proceeds collected from or distributed by the account debtor on the underlying (supported) right to payment or other intangible collateral. Proceeds of support obligations also are proceeds of the underlying rights to payment or intangible. Note that 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 Section 9-312(p) (security interest in letter of credit perfected by control has priority over a conflicting security interest).

Proceeds of Proceeds. The definition of “proceeds” no longer provides that proceeds of proceeds are themselves proceeds. This idea is expressed in the revised definition of “collateral” in Section 9-105. No change in meaning is intended.

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

2. **Authorized Dispositions.** Subsection (c), which derives from existing subsection (2), makes explicit that the authorized disposition to which it refers is an authorized disposition “free of” security interests. See PEB Commentary No. 3. The change in language is not intended to address the frequently-litigated situation in which the effectiveness of the secured party's consent to a disposition is conditioned upon the secured party's receipt of the proceeds. In that situation, subsection (c) would leave the determination of authorization to the courts, as under current law.

3. **Identifiability; Tracing.** Subsection (d) is new. It indicates when proceeds commingled with other property are identifiable proceeds. The Drafting Committee has yet to consider Section 9-315. The “equitable principles to which subsection (d) refers may include the “lowest intermediate balance rule.” See Restatement of Trusts, Second, § 202.

4. **Automatic Perfection in Proceeds.** This article extends the period of automatic perfection in proceeds from 10 days to 20 days, commencing with the day the security interest attaches to the proceeds. See subsection (e). The loss of perfected status under subsection (e) is prospective only. Compare Section 9-403(j) (deeming security interest unperfected retroactively).

Proceeds Acquired with Cash Proceeds or Funds from Deposit Account. Under former Section 9-306(3)(a), a security interest in proceeds remains perfected beyond the period of automatic perfection if 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 where the financing statement has been filed. A different rule applies if the proceeds are acquired with cash proceeds, as is the case if the original collateral (inventory) is sold for cash (cash proceeds) that is used to purchase equipment (proceeds). Under these circumstances, the security interest in the equipment proceeds remains perfected only if the description in the filed financing indicates the type of property constituting the proceeds (equipment). Subsection (e)(1) of this article applies the rule of former Section 9-306(3)(a) to proceeds that have been acquired with funds from a deposit account serving as original collateral.

Security interests in the proceeds of bank accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are not “deposit

accounts, would be governed by the rules applicable to proceeds of instruments generally.

Continuation of Perfection in Cash Proceeds. Former subsection (3)(b) provides that if a filed financing statement covers original collateral, a security interest in cash proceeds of the collateral remains perfected beyond the 10-day period of automatic perfection. Subsection (e)(2) extends the benefits of former paragraph (3)(b) to proceeds of original collateral in which a security interest is perfected by a method other than filing. This subsection provides that if the security interest in the original collateral was perfected, a security interest in identifiable cash proceeds will remain perfected indefinitely, regardless of whether the security interest in the original collateral remains perfected.

5. Transferees of Cash Proceeds. The former text of and Official Comments to Section 9-306 do not deal adequately with the rights of a person to whom the debtor has transferred cash proceeds, such as the payee of a check drawn on a deposit account. Section 9-308A addresses this issue.

6. Insolvency Proceedings; Returned and Repossessed Goods. This article deletes former subsection (4), which deals with proceeds in insolvency proceedings, and former subsection (5), which deals with returned and repossessed goods. In the absence of Section 9-306(5), Official Comments to Section 9-308 will explain and clarify the application of priority rules to returned and repossessed goods as proceeds of chattel paper.

7. Proceeds of Collateral Subject to Agricultural Lien. Subsection (c), which gives a secured party an interest in proceeds automatically, applies only to collateral encumbered by a security interest. If collateral is encumbered by an agricultural lien, other law (e.g. the statute giving rise to the agricultural lien), and not subsection (c), determines the extent to which the lien continues in proceeds. Only if other law provides that the agricultural lien covers proceeds do the rules relating to continued perfection of security interests in proceeds (i.e., subsections (e), (f), and (g)) apply to the proceeds.

8. Lapse or Termination of Financing Statement during 20-day Period. Subsection (g) provides that a security interest in or agricultural lien on proceeds perfected under subsection (e)(1) ceases to be perfected when the financing statement covering the original collateral lapses or is terminated. If the lapse or termination occurs before the 21st day after the security interest or agricultural lien attaches, however, the security interest in or agricultural lien on the proceeds remains perfected until the 21st day. Section 9-302(d) provides that compliance with the perfection requirements of a statute or treaty described in Section 9-302(c) “is equivalent to the filing of a financing statement. It follows that collateral subject to a security interest perfected by such compliance under Section 9-302(d) is covered by a “filed financing statement” within the meaning of Section 9-306(e)(1) and (g).

SECTION 9-307. PROTECTION OF BUYERS OF GOODS.

(a) This section does not affect a security interest in goods in the possession of the 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, 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' Comments

1. **Possessory Security Interests.** Subsection (a) is new. It rejects the holding of *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 350 N.E.2d 590 (N.Y. 1976) and, together with Section 9-301(a)(3), prevents a buyer of collateral from taking free of a security interest if the collateral is in the possession of the secured party. “The secured party referred in subsection (a) is the holder of the security interest referred to in one of the following subsections. A secured party is in possession of collateral for purposes of this subsection if the collateral is in the possession of a third party and the secured party takes possession under Section 9-305(c).

2. **Farm Products.** Brackets have been added to the farm products exception in subsection (b). The Drafting Committee will consider this question further.

3. **Other Issues.** The Drafting Committee has not considered other aspects of this section, including subsection (c).

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' Comments

1. **General Approach.** Section 9-308 eliminates the bifurcated test of former subsections (a) and (b) and replaces it with a single set of circumstances under which a purchaser of chattel paper or an instrument achieves priority over an earlier-perfected security interest. The “violation of rights” standard derives from the definition of “buyer in ordinary course of business” in Section 1-201(9).

Note that, if a perfected-by-possession security interest that does not qualify for priority under this section may be subordinate to a perfected-by-filing security interest under Section 9-312(m). In this respect, the priority rules applicable to negotiable instruments differ from those applicable to security certificates. Compare Section 9-115(f) (security interest perfected by possession takes priority over security interest perfected by filing).

2. **“Ordinary Course”; “New Value.”** This article retains the requirements of “the ordinary course of the purchaser's business” and the giving of “new value” as a conditions for priority. Concerning the latter, the article deletes former Section 9-108 and adds to Section 9-105 a new definition of the term “new value.” The Drafting Committee has yet to consider whether these requirements are appropriate for notes secured by real estate mortgages.

3. **Priority in Proceeds.** This section provides that the priority afforded to purchasers of chattel paper or instruments extends also to proceeds of the chattel paper or instrument. The purchaser acquires priority in proceeds regardless of whether the purchaser perfects as to the proceeds. Former Article 9 is silent as to the priority of a security interest in proceeds when a purchaser qualifies for priority under Section 9-308.

Priority in Returned and Repossessed Goods. Returned and repossessed goods may constitute proceeds of chattel paper. Consider the following example:

Secured Party 1 (SP-1) has a security interest in all the inventory of a dealer in goods (Dealer); SP-1's security interest is perfected by filing. Dealer sells some of its inventory to a buyer in the ordinary course of business (BIOCOB) pursuant to a conditional sales contract (chattel paper). Secured Party 2 (SP-2) purchases the chattel paper from Dealer and takes possession of the paper in the ordinary course of business and without knowledge that the purchase violates the rights of SP-1. Subsequently, BIOCOB returns the goods to Dealer because they are defective. Alternatively, Dealer acquires possession of the goods following BIOCOB's default.

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

Assignment of Non-Lease Chattel Paper.

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

(1) **Returned Goods.** If BIOCOB returns the goods to Dealer for repairs, Dealer is merely a bailee and acquires thereby no meaningful rights in the goods to which SP-1's security interest could attach. (Although SP-1's security interest could attach to Dealer's interest as a bailee, that interest is not likely to be of any particular value to SP-1.) Dealer is the owner of the **chattel paper** (i.e., the owner of a right to payment secured by a security interest in the goods); SP-2 has a security interest in the chattel paper, as does SP-1 (as proceeds of the goods under Section 9-306(c)). Pursuant to Section 9-308, SP-2's security interest in the chattel paper is senior to that of SP-1. SP-2 enjoys this priority regardless of whether, or when, SP-2 filed a financing statement covering the chattel paper. Because chattel paper and goods represent different types of collateral, Dealer does not have any meaningful interest in **goods** to which either SP-1's or SP-2's security interest could attach in order to secure Dealer's obligations to either creditor. See Section 9-105(a)(5) (defining "chattel paper"), (a)(19) (defining "goods").

Now assume that BIOCOB returns the goods to Dealer under circumstances whereby Dealer once again becomes the owner of the goods. This would be the case, for example, if the goods were defective and BIOCOB were entitled to reject or revoke acceptance of the goods. See Sections 2-602 (rejection); 2-608 (revocation of acceptance). Unless BIOCOB has waived its defenses as against assignees of the chattel paper, SP-1's and SP-2's rights against BIOCOB would be subject to BIOCOB'S claims and defenses. See Sections 9-206; 9-318(a). SP-1's security interest would attach again because the returned goods would be proceeds of the chattel paper. Dealer's acquisition of the goods easily can be characterized as an "in kind" collection on or distribution on account of the chattel paper. See Section 9-306(a). Assuming that SP-1's security interest is perfected by filing against the goods and that the filing is made in the same office where

a filing would be made against the chattel paper, SP-1's security interest in the goods would be perfected. See Section 9-306(e)(1).

Because Dealer's newly reacquired interest in the goods is proceeds of the chattel paper, SP-2's security interest also would attach in the goods as proceeds. If SP-2 had perfected its security interest in the chattel paper by filing (again, assuming that filing against the chattel paper was made in the same office where a filing would be made against the goods), SP-2's security interest in the reacquired goods would be perfected beyond 20 days. See Section 9-306(e)(1). However, if the SP-2 had relied only on its possession of the chattel paper for perfection and had not filed against the chattel paper or the goods, SP-2's security interest would be unperfected after the 20-day period. See Section 9-306(e)(3). Nevertheless, SP-2's unperfected security interest in the goods would be senior to SP-1's security interest under Section 9-308. The result in this priority contest is not affected by SP-2's acquiescence or non-acquiescence in the return of the goods to Dealer.

(2) Repossessed Goods. As explained above, Dealer owns the chattel paper covering the goods, subject to security interests in favor of SP-1 and SP-2. In Article 9 parlance, Dealer has an interest in chattel paper, not goods. If Dealer, SP-1, or SP-2 repossesses the goods upon BIOCOP's default, whether the repossession is rightful or wrongful as among Dealer, SP-1, or SP-2, Dealer's interest will not change. The location of goods and the party who possesses them does not affect the fact that Dealer's interest is in chattel paper, not goods. The goods continue to be owned by BIOCOP. SP-1's security interest in the goods does not attach until such time as Dealer reacquires an interest (other than a bare possessory interest) in the goods. For example, Dealer might buy the goods at a foreclosure sale from SP-2 (whose security interest in the chattel paper is senior to that of SP-1); that disposition would cut off BIOCOP's rights in the goods. Section 9-504(n).

In many cases the matter would end upon sale of the goods to Dealer at a foreclosure sale and there would be no priority contest between SP-1 and SP-2; Dealer would be unlikely to buy the goods under circumstances whereby SP-2 would retain its security interest. There can be exceptions, however. For example, Dealer may be obliged to purchase the goods from SP-2, SP-2 may convey the goods to Dealer, and Dealer may fail to pay SP-2. Or, one could imagine that SP-2, like SP-1, has a general security interest in the inventory of Dealer. In the latter case, SP-2 should not receive the benefit of any special priority rule, since its interest in no way derives from priority under Section 9-308. In the former case, SP-2's security interest in the goods reacquired by Dealer is senior to SP-1's security interest under Section 9-308.

b. Dealer's Outright Sale of Chattel Paper to SP-2. Article 9 also applies to a transaction whereby SP-2 buys the chattel paper in an outright sale transaction without recourse against Dealer. Sections 1-201(37); 9-102(a)(2). Although Dealer does not, in such a transaction, retain any residual ownership interest in the chattel paper, the chattel paper constitutes

proceeds of the goods to which SP-1's security interest will attach and continue following the sale of the goods. Section 9-306(c). Even though Dealer has not retained any interest in the chattel paper, as discussed above BIOCOB subsequently may return the goods to Dealer under circumstances whereby Dealer reacquires an interest in the goods. The priority contest between SP-1 and SP-2 will be resolved as discussed above; Section 9-308 makes no distinction among purchasers of chattel paper on the basis of whether the purchaser is an outright buyer of chattel paper or one whose security interest secures an obligation of Dealer.

Assignment of Lease Chattel Paper.

Chattel paper includes not only writings that evidence security interests in specific goods but also those that evidence true leases of goods. Section 9-105(a)(5) (defining “chattel paper”).

The analysis with respect to lease chattel paper is similar to that set forth above with respect to non-lease chattel paper. It is complicated, however, by the fact that, unlike the case of chattel paper arising out of a sale, Dealer retains a residual interest in the **goods**. See Section 2A-103(1)(q) (defining “lessor's residual interest”); *In re Leasing Consultants, Inc.*, 486 F.2d 367 (2d Cir. 1973) (lessor's residual interest under true lease is an interest in goods and is a separate type of collateral from lessor's interest in the lease). If Dealer leases goods to a “lessee in ordinary course of business (LIOCOB), then LIOCOB takes its interest under the lease (i.e., its “leasehold interest”) free of the security interest of SP-1. See Sections 2A-307(3); 2A-103(1)(m) (defining “leasehold interest”), (1)(o) (defining “lessee in ordinary course of business”). SP-1 would, however, retain its security interest in the residual interest. In addition, SP-1 would acquire an interest in the lease chattel paper as proceeds. If Dealer then assigns the lease chattel paper to SP-2, Section 9-308 gives SP-2 priority over SP-1 with respect to the chattel paper, **but not** with respect to the residual interest in the **goods**. Consequently, assignees of lease chattel paper typically take a security interest in and file against the lessor's residual interest in goods, expecting their priority in the goods to be governed by the first-to-file-or-perfect rule of Section 9-312(m)(1).

If the goods are returned to Dealer, other than upon expiration of the lease term, then the security interests of both SP-1 and SP-2 normally would attach to the goods as proceeds of the chattel paper. (If the goods are returned to Dealer at the expiration of the lease term and the lessee has made all payments due under the lease, however, then Dealer no longer has any rights under the chattel paper. Dealer's interest in the goods consists solely of its residual interest, as to which SP-2 has no claim.) This would be the case, for example, when the lessee rescinds the lease or when the lessor recovers possession in the exercise of its remedies under Article 2A. See, e.g., Section 2A-525. If SP-2 enjoyed priority in the chattel paper under Section 9-308, then SP-2 likewise would enjoy priority in the returned goods as proceeds. This does not mean that SP-2 necessarily is entitled to the entire value of the returned goods. The value of the goods represents the sum of the present value of (i) the value of their use for the term of the lease and (ii) the value of the residual interest. SP-2 has priority in the former,

but SP-1 ordinarily would have priority in the latter. Thus, an allocation of a portion of the value of the goods to each component may be necessary.

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

SECTION 9-308A. TRANSFER OF 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' Comments

1. This section is new. It affords broad protection to transferees who take funds from a deposit account and to those who take money. The term “transferee” is not defined; however, the debtor itself is not a transferee. 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.

Subsection (b) applies only to the transfer of funds from a deposit account subject to a security interest. A transfer to which the subsection applies normally will be made by check or funds transfer. If the debtor obtains a cashier's check with the funds, the rules governing competing claims to instruments will control thereafter. See Sections 3-306; 9-309. If the debtor withdraws money (currency), then subsection (a), to the extent not displaced by federal law relating to money, applies. It contains the same rule as subsection (b). Competing claims to the deposit account itself are dealt with by other Article 9 priority rules. See Sections 9-301(a); 9-312(j); 9-312A; 9-318A.

2. Broad protection for transferees helps to ensure that security interests in deposit accounts do not impair the free flow of funds. It also minimizes the likelihood that a secured party will enjoy a claim to whatever the transferee purchases with the funds. Rules concerning recovery of payments traditionally have placed a high value on finality. The opportunity to upset a completed transaction, or even to place a completed transaction in jeopardy by bringing suit

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

3. To deal with the question of the “bad actor, this section borrows “collusion” language from Article 8. See, e.g., Sections 8-115, 8-503(e). This is the most protective (i.e., least stringent) of the various standards now found in the UCC. Compare, e.g., Section 1-201(9) (“without knowledge that the sale . . . is in violation of the . . . security interest”); Section 1-201(19) (“honesty in fact in the conduct or transaction concerned”); Section 3-302(a)(2)(v) (“without notice of any claim”). This standard differs from that contained in Section 9-308 (priority in chattel paper or instrument) and Section 9-502(f) (receipt of cash proceeds by enforcing junior secured party). The Drafting Committee is likely to reconsider these standards.

4. The Drafting Committee also may 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 Section 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 Section 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.

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), 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 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 those holders or purchasers.

SECTION 9-310. PRIORITY OF CERTAIN LIENS ARISING BY OPERATION OF LAW. [MINOR STYLE CHANGES ONLY] 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 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.

Reporters' Comments

1. If a debtor sells an account, chattel paper, or payment intangible outright, it has no remaining rights to transfer. If the buyer fails to perfect its interest, however, the debtor retains the **power** to give a senior interest to a subsequent purchaser. See Section 9-203(a)(3). If the subsequent purchaser (buyer or secured party) perfects, it will achieve priority over the earlier purchaser.

2. The debtor may grant a security interest to secure a debt in excess of the collateral's value and agree not to create subsequent security interests in the collateral. In violation of the security agreement, the debtor may purport to grant a subsequent security interest. This section validates the subsequent (prohibited) security interest, which might even achieve priority over the earlier security interest.

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 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; and Section 9-115 on security interests in investment property.

(b) Except as otherwise provided in subsection (l), 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 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 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 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 purchase money security interest in inventory 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 and its proceeds consisting of inventory ("inventory-proceeds") to the extent the identifiable cash proceeds and inventory-proceeds are 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 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 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 or livestock 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).

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

(i) a security interest securing 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 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.

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

(i) A security interest that is perfected by a filed financing statement that is effective solely under Section 9-402A 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. However, if more than one security interest in the same collateral is subordinate under this subsection, the other rules stated in this

section, as applicable, determine the priority of the subordinated security interests as among themselves.

(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 depository 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 depository 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 in subsections (b), (c), (d), (e), (f), (g), (j), and (p), 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' Comments

1. **Other priority rules.** Subsection (a) adds a reference to new Section 5-118, dealing with security interests arising under Article 5. Inasmuch as Section 9-107(c) deems the interest of a consignor to be a purchase money security interest for purposes of priority, the reference to former Section 9-114 has been deleted.

2. **Production Money Security Interests.** Subsection (b) is new. It provides a production money priority rule. No consensus has formed over whether such a priority is desirable, and the issue remains under discussion. See the Comments to Section 9-107A.

3. **Purchase Money Security Interests in Inventory.** Subsection (c) derives from former Section 9-312(3). The only substantive change is that the priority of the purchase money security interest in inventory has been extended to proceeds consisting of inventory, if the proceeds are received on or before delivery of the original inventory to a buyer. In other words, the priority has been extended to trade-ins.

Subsection (c) determines the priority of a consignor's interest in consigned goods as against a security interest in the goods created by the consignee. Inasmuch as a consignment is defined to be a purchase money security interest, see Section 9-107(c), no inference concerning the nature of the transaction should be drawn from the fact that a consignor uses the term "security interest" in its notice under subsection (c)(4). Similarly, a notice stating that the consignor has delivered or expects to deliver goods, properly described, "on consignment" meets the requirements of subsection (c)(4), even if it does not contain the term "security interest" and even if the transaction subsequently is determined to be a security interest. Cf. Section 9-408 (use of "consignor" and "consignee" in financing statement).

4. **Purchase Money Security Interests in Livestock.** New subsection (d) provides a purchase money priority rule for farm-products livestock that is patterned on the purchase money priority rule for inventory found in subsection (c), including a requirement that the purchase money secured party notify earlier-filed parties. Two differences between (c) and (d) are noteworthy. First, unlike the purchase money inventory lender, the purchase money livestock lender would have priority in **all** proceeds of the collateral. Thus, under subsection (d), the purchase money secured party takes priority in accounts over an earlier-filed accounts financier. Second, the bracketed language in subsection (d) affords priority in products of the collateral as well as proceeds. Former Article 9 does not deal with products in any meaningful way. The Drafting Committee has deferred considering whether the subsection (d) priority should carry over into products until such time as it considers the larger issues.

5. **Purchase Money Security Interests in Aquatic Farm Products.** Aquatic goods produced in aquacultural operations (e.g., catfish raised on a catfish farm) are farm products. See Section 9-109(c) (definition of "farm products"). The

definition does not indicate whether aquatic goods are “crops, as to which the production money security interest priority in subsection (b) applies, or “livestock, as to which the purchase money priority in subsection (d) applies. One possibility is to treat aquatic vegetables as “crops and aquatic animals as “livestock. An alternative is to place all aquatic goods in the category that seems to fit better most often. A third option is to leave the courts free to determine the classification of particular goods on a case-by-case basis, applying whichever priority rule makes more sense in the overall context of the debtor's business. The Drafting Committee has yet to discuss this issue.

6. Purchase Money Priority in Goods other than Inventory and Livestock. Subsection (e) extends from 10 days to 20 days the “grace period for achieving purchase money priority in non-inventory collateral found in former Section 9-312(4). It reflects that a secured party may hold a “purchase money security interest only in goods. See Section 9-107(a).

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

7. Multiple Production Money Security Interests. We have presented two alternatives of new draft subsection (f). Alternative A would rank equally all competing production money security interests that qualify for priority under subsection (b). The Official Comments should explain that equal rank means that the security interests will share the collateral *pro rata* according to the respective amounts of the obligations secured. Alternative B would apply the first-to-file rule of subsection (m). Note that, as drafted, production money priority requires perfection by filing. Consequently, Alternative B does not adopt the **first-to-file-or-perfect** formulation.

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

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

The first-to-file-or-perfect rule of subsection (m) applies to multiple purchase money security interests securing enabling loans.

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

9. **“Double Debtor” Problem.** Subsection (h) is new. It addresses the “double debtor” problem that arises when a debtor acquires property that is subject to a security interest created by another debtor. In the simplest example, A owns an item of its equipment subject to a security interest in favor of SP-A. A sells the equipment to B, not in the ordinary course of business. If SP-A's security interest is perfected, B will acquire its interest subject to SP-A's security interest. See Sections 9-201; 9-301(a)(3). Under subsection (h)(1), if B creates a security interest in the equipment in favor of SP-B, SP-B's interest also is subject to SP-A's interest, even if SP-B filed against B before SP-A filed against A, and even if SP-B took a purchase money security interest. Normally, SP-B could have investigated the source of the equipment and discovered SP-A's filing before making an advance against the equipment, whereas SP-A had no reason to search the filings against someone other than its debtor, A.

If SP-A's security interest is unperfected, B will take free of it as long as B gives value and takes delivery of the equipment without knowledge of the security interest. See Section 9-301(a)(3). If B takes free of SP-A's security interest and then creates a security interest in favor of SP-B, no priority issue arises; SP-B has the only security interest in the equipment. Suppose, however, that B knows of SP-A's security interest and therefore takes the equipment subject to it. If B creates a security interest in the equipment in favor of SP-B, and SP-B perfects its security interest, then under subsection (h)(2) the priority rules of Section 9-312 other than subsection (h) govern. Under Section 9-312(m)(1), the “first-to-file-or-perfect rule, SP-A's unperfected security interest will be junior to SP-B's perfected security interest. The award of priority to SP-B is premised on the belief that SP-A's failure to file could have misled SP-B.

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

10. **New Debtors.** Subsection (i) is new. The first sentence addresses the priority contest that arises when a new debtor becomes bound by the security agreement of an original debtor and each has a secured creditor. It subordinates the original debtor's secured party's security interest perfected under Section 9-402A to security interests in the same collateral perfected in another manner, e.g., by filing against the new debtor. Assume, for example, that SP-X holds a perfected security interest in X Corp's existing and after-acquired inventory, and SP-Y holds a perfected security interest in Y Corp's existing and after-acquired inventory. Y Corp “becomes bound” as debtor by X Corp's security agreement (e.g., Y Corp buys X Corp's assets and assumes its security agreement). Under Section 9-402A, SP-X's financing statement is effective to perfect a security interest in inventory

acquired by Y Corp after it becomes bound. Section 9-312(i) provides that SP-X's security interest is subordinate to SP-Y's, regardless of which financing statement was filed first.

The second sentence of subsection (i) addresses the priority among security interests created by the original debtor (X Corp). By invoking the other priority rules of this section, as applicable, the second sentence preserves the relative priority of security interests created by the original debtor.

11. Deposit Accounts. The special priority rules in subsection (j) derive from Revised Article 8. The rules do not apply to accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are not “deposit accounts. As for consumer accounts, see Section 9-104, Comment 6.

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

A secured party who takes a security interest in the deposit account as original collateral can protect itself against the results of this rule in one of two ways. It can take control of the deposit account by becoming the depository institution's customer (i.e., by having the account in its name). Under subsection (j)(4), this arrangement operates to subordinate the depository institution's security interest. Alternatively, the secured party can obtain an express subordination agreement from the depository institution. See Section 9-316. Additional clarification of subsection (j)(4) or the Official Comments may be needed to cover cases in which both the debtor and the secured party are indebted to the depository institution.

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

Control. Under draft subsection (j)(1), security interests perfected by control (Section 9-117) take priority over those perfected otherwise, e.g., as identifiable cash proceeds under Section 9-306(e)(2). Secured parties for whom the deposit account is an integral part of the credit decision will, at a minimum, insist upon the right to immediate access to the deposit account upon the debtor's default (i.e., control). Those secured parties for whom the deposit account is less essential will not take control, thereby running the risk that the debtor will dispose of funds on deposit (either outright or for collateral purposes) after default but before the account can be frozen by court order or the secured party can obtain control.

Subsection (j)(2) governs the case (expected to be very rare) in which a depository institution enters into a Section 9-117(a)(2) control agreement with more than one secured party. If the depository institution is solvent, there is no need for a priority rule. If not, the security interests rank equally.

Priority in Proceeds. The priority afforded by subsection (j) is not intended to extend to proceeds of a deposit account. Accordingly, subsection (m), the first-to-file-or-perfect rule, normally will govern priorities in proceeds. A secured party who obtains control but who nevertheless leaves the debtor with the power (but perhaps not the right) to withdraw from the deposit account is not entitled to special priority in the proceeds. Section 9-306(e) addresses continuation of perfection in proceeds of deposit accounts. As to funds transferred from a deposit account that serves as collateral, see Section 9-308A.

Priority as to Future Advances. Subsection (o) adds to former Section 9-312(7) security interests in deposit accounts perfected by control to those security interests with respect to which subsection (m) (first-to-file-or-perfect), and not the time of an advance, determines priority.

12. **Agricultural Liens.** Subsections (k) and (l) are new and deal with agricultural liens. The former sets forth narrow circumstances under which a non-UCC priority rule may displace the applicable Article 9 priority rule: a perfected agricultural lien may achieve priority notwithstanding the Article 9 priority rules only if the statute creating the lien so provides. Subsection (l) deals with a creditor who holds both an agricultural lien and an Article 9 production money security interest in the same collateral. In these cases, the priority rules applicable to agricultural liens govern. The creditor can avoid this result by waiving its agricultural lien. These rules remain under consideration by the Drafting Committee.

13. **Letters of Credit.** Subsection (p)(1) is new. It awards priority to 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 Section 5-114(c)) 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. The Drafting Committee will reconsider this rule, which first appeared in the March 15, 1996, Draft, after it receives comments from interested persons.

Subsection (p)(3), awarding priority to a transferee beneficiary, is consistent with Section 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. In the interest of clarity, however, subsection (p)(3) makes the priority explicit in Article 9.

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

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

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

Reporters' Comments

1. **General Approach.** This section, which is new, resolves the conflict between a security interest in a deposit account and the depositary institution's rights of recoupment and set-off. It is an exception to the general exclusion of the right of set-off from Article 9. See Section 9-104(9). The issue has been the subject of much dispute under former Article 9.

Subsection (a) states the general rule and provides that the depositary bank may effectively exercise rights of recoupment and set-off against the secured party. Subsection (b) contains an exception: if the secured party has control under Section 9-117(a)(3) (i.e., if it has become the depositary institution's customer), then any setoff exercised by the depositary institution against a debt owed by the debtor is ineffective. The depositary institution may, however, exercise its recoupment rights effectively. This result is consistent with the priority rule in Section 9-312(j)(4), under which the security interest of a depositary institution in a deposit account is subordinate to that of a secured party that has control under Section 9-117(a)(3). Additional clarification of this section or the Official Comments may be needed to cover cases in which both the debtor and the secured party are indebted to the depositary institution.

2. **Deposit Evidenced by Instrument.** Under Section 9-105, a deposit evidenced by an instrument (e.g., certain certificates of deposit) is not a "deposit account." Accordingly, Section 9-312A does not apply to the depositary institution's right to set off against such an account. If the instrument is an Article 3 "instrument" and the secured party is a holder in due course (HDC), Section 9-309 makes clear that Article 3 governs, and the secured party would prevail. But if the secured party is not a holder in due course, the result under former Article 9 is uncertain: either the security interest prevails over the right of set-off under Section 9-201 or the secured party has the rights of any other non-HDC under Article 3 (in which case it might or might not prevail, depending on whether the right of set-off is a defense or claim in recoupment of the kind described in Section 3-305(a)(2) or (3)). A similar uncertainty arises under current law if the Article 9 instrument is not negotiable: either the secured party prevails over the right of set-off under Section

9-201 or the secured party has the rights of any other assignee under the common law or any applicable statute. The Drafting Committee has yet to determine whether to resolve these issues and, if so, how to do so.

**SECTION 9-313. PRIORITY OF SECURITY INTERESTS IN
FIXTURES. [MINOR STYLE CHANGES ONLY]**

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

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

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

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

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

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

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

(1) the security interest is a purchase money security interest, the interest of the encumbrancer or owner arises before the goods become fixtures, the security

interest is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the debtor has an interest of record in the real estate or is in possession of the real estate;

(2) the security interest is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the security interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the debtor has an interest of record in the real estate or is in possession of the real estate;

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

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

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

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

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

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

given to refinance a construction mortgage, a mortgage has this priority to the same extent as the construction mortgage.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

SECTION 9-316. PRIORITY SUBJECT TO SUBORDINATION.

[MINOR STYLE CHANGES ONLY] Nothing in this article prevents subordination by agreement by any person entitled to priority.

SECTION 9-317. SECURED PARTY NOT OBLIGATED ON CONTRACT OF DEBTOR. *[MINOR STYLE CHANGES ONLY]* The mere existence of a security interest or 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; NOTIFICATION OF ASSIGNMENT; IDENTIFICATION AND PROOF OF ASSIGNMENT; TERM PROHIBITING ASSIGNMENT INEFFECTIVE.

(a) Unless an account debtor has made an enforceable agreement not to assert defenses or claims (Section 9-206), and subject to subsection (b), 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; and

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

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

(c) 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 the modification or substitution is a breach by the assignor.

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

its obligation by 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.

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

(f) A notification under subsection (d) 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) An assignee may not send a notification under subsection (d) that notifies an account debtor to make less than the full amount of any installment payment to the assignee, whether or not (i) only a portion of the account, chattel paper, or general intangible has been assigned to that assignee, (ii) a portion has been assigned to another assignee, and (iii) the account debtor knows that the assignment to that assignee is limited. An account debtor may treat a notification sent in violation of this subsection as ineffective.

(h) If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made. 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 (d).

(i) 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 is ineffective if it prohibits, restricts, or requires the account debtor's consent to assignment of an account, chattel paper, or a payment intangible.

Reporters' Comments

1. **Rights of Assignee.** Subsection (a) has been revised to reflect that waiver-of-defense clauses under Section 9-206 are not limited to sales and leases and to track Section 3-305(a)(3) more closely. The Drafting Committee may reconsider clarifying the effect of agreements between the account debtor and the assignee. See the Comments to Section 9-206.

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

2. **Application to “Account Debtor.”** This section deals only with the rights and duties of “account debtors – and for the most part only with account debtors on accounts, chattel paper, and payment intangibles. Neither this section nor any other provision of this article, including Section 9-318B, 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).

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

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

Subsection (d) also has been revised to apply only to account debtors on accounts, chattel paper, and payment intangibles. (The term “account debtor” is defined in Section 9-105(a)(1) to include those obligated on all general intangibles.) Although this revision renders subsection (d) more precise, it probably does not change the law. Former Section 9-318(3) refers to the account debtor's obligation to “pay,” thereby suggesting that the subsection is limited to account debtors on accounts, chattel paper, and other payment obligations.

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

Subsection (e) tracks former Section 9-318(3) and makes ineffective a notification that does not reasonably identify the rights assigned.

Subsection (f), which is new, applies only to sales of payment intangibles. It makes a notification ineffective to the extent that other law gives effect to an agreement between an account debtor and a seller of a payment intangible that limits the account debtor's duty to pay a person other than the seller. Payment intangibles are substantially less fungible than accounts and chattel paper. In some (e.g., commercial bank loans), account debtors customarily and legitimately expect

that they will not be required to pay any person other than the financial institution that has advanced funds.

It has become common in financing transactions to assign interests in a single obligation to more than one assignee. Subsection (g) prohibits an assignee from sending a notifying an account debtor to pay the assignee less than the full amount of any installment payment. If an account debtor receives a notification in violation of this subsection, the “account debtor may treat the notification . . . as ineffective, ignore the notice, and discharge the assigned obligation by paying the assignor. However, the account debtor may not realize that it may ignore the notice with impunity. Accordingly, because this subsection does not require the account debtor to treat the notification as ineffective, it permits the account debtor to make payment to the assignee in accordance with the notice and thereby to satisfy its obligation *pro tanto*. The rights and duties created by this subsection cannot be waived or varied. See Section 9-501(c).

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

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

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

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

Like former subsection (4), subsection (i) provides that anti-assignment clauses are “ineffective. 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.

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

SECTION 9-318A. DEPOSITORY 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) the creation or perfection of a security interest in the deposit account;
- (2) the depository institution's knowledge of the security interest; or
- (3) the depository institution's receipt of instructions from the secured party.

Reporters' Comments

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

2. The general rule of this section is subject to Section 9-312A, under which the setoff rights of the depository institution may not be exercised against a deposit account in the secured party's name. This result reflects current law in many jurisdictions and does not appear to have unduly disrupted banking practices or the payments system. The more important function of this section, which is not impaired by Section 9-312A, is the depository institution's right to follow the

debtor's (customer's) instructions (e.g., by honoring checks, permitting withdrawals, etc.) until such time as the depository institution is served with judicial process or receives instructions with respect to the funds on deposit from a secured party that has control over the deposit account.

3. This article does not determine whether a depository institution's that pays out funds from an encumbered deposit is liable to the holder of a security interest. Although the fact that a secured party has control over the deposit account and the manner by which control was achieved may be relevant to the imposition of liability, whatever rule applies generally when a bank pays out funds in which a third party has an interest should determine liability to a secured party. Often, this rule is found in a non-UCC adverse claim statute. If a rule were to be introduced into the UCC, Article 4, and not Article 9, would seem to be the proper location for it. Cf. Section 8-115 (securities intermediary not liable to adverse claimant).

4. This section does not address the obligations of depository institutions that issue instruments evidencing deposits (e.g., certain certificates of deposit).

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

(a) Subsection (b) 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' Comments

1. This section makes ineffective any attempt to restrict assignment of a general intangible, whether the restriction appears in the terms of the general intangible (subsection (b)) or in a statute, rule, or regulation (subsection (c)). The principal goal is to protect the creation, attachment, and perfection of a security interest (including a sale of a payment intangible) while preventing these events from giving rise to a default or breach by the assignor or from triggering a remedy of the account debtor, all in the interest of enhancing the ability of certain debtors to obtain credit. On the other hand, subsection (d) protects the account debtor from any adverse effects of the security interest. It leaves the account debtor's rights and obligations unaffected if a restriction rendered ineffective by subsection (b) or (c) would be effective under other law.

2. This section is likely to have a substantial 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 Section 9-318B, however, the security interest would attach to the franchise. As a result, the security interest would attach to the proceeds of any sale of the franchise during bankruptcy. This section would protect the interests of the municipality, by preventing the secured party from enforcing its security interest to the detriment of the municipality.

3. This section does not override federal law to the contrary.

PART 4

FILING

Reporters' Introductory Comment to Part 4

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

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

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

In reviewing Part 4, the reader should keep in mind that Section 9-105 defines the term "financing statement" to include not only the initial financing statement and amendments, but also the remaining parts of the package that constitute the complete financing statement of record – e.g., assignments, continuation statements, and any other records on file that relate to the initial financing statement.

SECTION 9-401. PLACE OF FILING.

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

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

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

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

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

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

Reporters' Comments

1. Section 9-401(a) indicates where in a given State a financing statement is to be filed. Former Article 9 affords each State three alternative approaches, depending on the extent to which the State desires central filing (usually with the Secretary of State), local filing (usually with a county office), or both. Local filing increases the net costs of secured transactions by increasing uncertainty and the number of required filings. Any benefit that local filing may have had in the 1950's (e.g., ease of access to local creditors) is now insubstantial. Accordingly, this article dictates central filing for most situations, while retaining local filing for real-estate-related collateral and special filing provisions for transmitting utilities. (The Drafting Committee has yet to consider whether the current definition of "transmitting utility" is adequate.)

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

**SECTION 9-402. CONTENTS OF FINANCING STATEMENT;
MORTGAGE AS FINANCING STATEMENT; EFFECTIVENESS OF
FINANCING STATEMENT AFTER CERTAIN CHANGES;
AMENDMENTS; 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 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 gives the name, if any, given 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 and indicates, in the debtor's name or otherwise, that the debtor is a trust; and

(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 name 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 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 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 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.

(l) Subject to Section 9-406, a secured party of record may add or release collateral covered by a financing statement or otherwise amend the information contained in a financing statement by filing an amendment that identifies the initial financing statement by the date of filing and the file number assigned under Section 9-403(n) 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.

(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 initial financing statement or an amendment 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 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 written security agreement, the debtor authorizes the secured party to file an initial financing statement and an amendment covering the collateral described in the security agreement.

(o) A person that files an initial financing statement or an amendment 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 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 initial financing statement or an amendment in violation of subsection (n) or that fails to send a copy of a financing statement or amendment 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(o) may be necessary. See Mass. Gen. Laws Chapter 106, Section 9-410.

Reporters' Comments

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

2. **Debtor's Signature.** Subsection (a) omits the requirement that the debtor sign a financing statement. Although, as a proposed PEB commentary indicates, a paperless financing statement may be filed electronically under existing law, the elimination of the signature requirement facilitates paperless filing. Section 9-402 still requires that the debtor authorize any filings against it; however, the section does not require that an authenticating symbol be contained in the public record. More specifically, subsection (n) permits a person to file an initial financing statement or an amendment that adds collateral only if the debtor authorizes the filing, and subsection (p) provides a remedy for unauthorized filings. See Comment 13 below. Sections 9-403(b)(1) and 9-413 supplement these provisions by permitting the filing office to prescribe criteria for determining, for example, whether the filer is who the filer purports to be and to refuse to accept for filing a fraudulent record. In addition, Section 9-415 provides a procedure whereby a person may add to the public record a statement to the effect that a financing statement indexed under the person's name was wrongfully filed. Elimination of the debtor's signature requirement makes the exceptions provided by former subsection (2) unnecessary.

3. **Certain Other Requirements.** This section deletes other formerly required information because it seems unwise (real estate description for financing statements covering crops), unnecessary (adequacy of copies of financing statements), or both (copy of security agreement as financing statement). Inasmuch as a secured party owes no obligation to disclose information concerning the security interest to third parties, the address requirement now refers to “a mailing address” for the secured party as well as for the debtor.

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

Subsections (a) and (b) (former subsections (5) and (6)) contain the following terms: “for record, “real estate records, “interest of record, and “record owner. These are terms traditionally used in real estate law. This context “otherwise requires that the definition of “record” in Section 9-105 is not applicable.

5. **Debtor's Name.** The requirement that a financing statement give the debtor's name is particularly important. Financing statements are indexed under the name of the debtor, and those who wish to find financing statements search for them under the debtor's name. Subsection (c) explains what the debtor's name is for purposes of a financing statement. If the debtor is a “registered entity” (defined in Section 9-105 so as to ordinarily include corporations, limited partnerships, and limited liability companies), then the debtor's name is the name shown on the public records of the debtor's “jurisdiction of organization” (also as defined in Section 9-105). Subsections (c)(2) and (c)(3) contain special rules for decedent's estates and trusts, as to which current law is now silent. Subsection (c)(4) essentially follows former Section 9-402(7) (first sentence).

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

6. **Secured Party's Name.** Subsection (f) is new. It makes clear that when the secured party is a representative, the financing statement is sufficient if it names the secured party, whether or not it indicates any representative capacity. Similarly, a financing statement that names a representative of the secured party need not indicate the representative capacity. Consider, for example, a transaction in which a security interest is granted to a group of secured parties, but not to their representative, the collateral agent. The representative of the secured parties would not itself be a secured party. See Section 9-105. Under subsections (a) and (f), however, a financing statement would not be insufficient because it names the collateral agent instead of the actual secured parties, even if it omitted the collateral agent's representative capacity.

Difficulties may arise if (i) a person (A) is the representative for one group of lenders (Group A), (ii) the financing statement names A as the secured party

without indicating that A serves as a representative for Group A, and (iii) A agrees to serve as 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 between 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 initial 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.

To prevent this result, 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, and recite further that it is ineffective for other purposes. If Group A did not do so, presumably it could be held A liable for money damages for breach of its agreement with Group A.

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

8. **Indication of Collateral.** Subsection (g) expands the class of sufficient collateral references to embrace "a statement to the effect that the financing statement covers all assets or all personal property. If the property in question belongs to the debtor and is personal property, any searcher will know that the property is covered by the financing statement.

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

10. **Post-filing Changes in Extrinsic Facts.** Subsections (i), (j), and (k) deal with situations in which the information in a proper financing statement becomes inaccurate. Subsection (i) addresses a "pure change of name that does not implicate a new debtor. It clarifies the effectiveness of a seriously misleading financing statement for the four months following a name change and provides that the record can be corrected by an amendment to the financing statement that specifies the debtor's new correct name or otherwise renders the financing statement not seriously misleading.

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

Subsection (k) provides that, except for the four-month rules in subsection (i) ("pure name change) and Section 9-402A (new debtor that becomes bound), post-filing changes that render a financing statement inaccurate and seriously

misleading have no effect on a financing statement. The financing statement remains effective.

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

Subsection (l) contemplates that changes would be made by filing an amendment. The amendment could identify only the information contained in a financing statement that is to be changed or, alternatively, it could take the form of an amended and restated financing statement. The latter would state, for example, that the financing statement “is amended and restated to read as follows: References in this Part to an “amended financing statement” are to a financing statement as amended by an amendment.

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

12. Security Agreement as Financing Statement. Subsection (m) is taken from former Section 9-402(1). Although it may be unnecessary, a majority of the Drafting Committee believe that the provision has proven useful. See also Section 9-303(a) (contemplating situations in which a financing statement is filed before a security interest attaches).

13. Unauthorized Filings. Subsection (n) substitutes for the debtor's signature a requirement that the debtor authorize the filing of an initial financing statement or an amendment that adds collateral.

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

14. Agricultural Liens. Under subsection (n) an agricultural lienholder may file a financing statement covering collateral subject to the lien without obtaining the debtor's authorization. Because the lien arises as matter of law, the debtor's consent should not be required. However, subsection (o) imposes a duty on the lienholder to give the debtor a copy of the financing statement. That requirement provides some protection against overbroad collateral descriptions and other wrongful filings. It is the principal protection employed by the personal property security acts in some Canadian provinces. Subsection (p) makes noncompliance with subsection (n) or (o) grounds for the statutory penalties and liability. Noncompliance does not, however, invalidate the filing or otherwise affect priority over third parties.

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 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 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' Comments

1. **The Problem.** Sections 9-203(b) and 9-402A deal with situations where one party (the “new debtor”) becomes bound as debtor by a security agreement entered into by another person (the “original debtor”). These situations often arise as a consequence of changes in business structure. For example, the original debtor may be an individual debtor who operates a business as a sole proprietorship and then incorporates it. Or, the original debtor may be a corporation that is merged into another corporation. Under both former Article 9 and this article, collateral that is transferred in the course of the incorporation or merger normally would remain subject to a perfected security interest. See Sections 9-306; 9-402. Former Article 9 is less clear with respect to whether an after-acquired property clause in a security agreement signed by the original debtor would be effective to create a security interest in property acquired by the new corporation or the merger survivor and, if so, whether a financing statement filed against the original debtor would be effective to perfect the security interest. Sections 9-203(b) and 9-402A are an attempt at clarification.

2. **How a New Debtor Becomes Bound.** Normally, a security interest is unenforceable unless the debtor has signed a security agreement describing the

collateral. See Section 9-203(a). New Section 9-203(b) creates an exception, under which a security agreement signed by one person is effective with respect to the property of another. This exception comes into play if a “new debtor “becomes bound as debtor by a security agreement entered into by another person (the “original debtor). (The quoted terms are defined in three new subsections of Section 9-105.) If a new debtor does become bound, then the security agreement signed by the original debtor satisfies the security-agreement requirement of Section 9-203(a)(1) as to existing or after-acquired property of the new debtor to the extent the property is described in the agreement. In that case, no other agreement is necessary to make a security interest enforceable in that property. See Section 9-203(b).

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

Some members of the Drafting Committee are of the view that, under certain circumstances, a new debtor should “become bound for purposes of Article 9 even though it would not be bound under other law. Bracketed language in Section 9-105 reflects this view. The bracketed language provides that a new debtor would become bound when (i) it becomes obligated not only for the secured obligation but also generally under applicable non-UCC law for the obligations of the original debtor and (ii) acquires or succeeds to substantially all the assets of the original debtor. For example, some corporate laws provide that, when two corporations merge, the surviving corporation succeeds to the assets of its merger partner and “has all liabilities of both corporations. In the case where, for example, A Corp merges into B Corp (and A Corp ceases to exist), some people have questioned whether A Corp's grant of a security interest in its existing and after-acquired property becomes a “liability of B Corp, such that B Corp's existing and after-acquired property becomes subject to a security interest in favor of A Corp's lender. Even if corporate law were to give a negative answer, under bracketed language in Section 9-105, B Corp would “become bound for purposes of Sections 9-203(b) and 9-402A.

3. When a Financing Statement Is Effective Against a New Debtor.

Subsection (a) provides that a filing against the original debtor is effective to perfect a security interest in collateral that a new debtor acquires before the expiration of four months after the new debtor becomes bound by the security agreement. Under subsection (b), however, if the filing against the original debtor is seriously misleading as to the new debtor's name, the filing is effective as to collateral acquired by the new debtor after the four-month period only if the secured party files during the four-month period an amendment rendering the filing not seriously misleading. A similar rule appears in Section 9-402(i) with respect to changes in a debtor's name.

Note, however, that this section does not apply to collateral transferred by the original debtor to a new debtor. Under those circumstances, the filing against

the original continues to be effective until it lapses. See subsection (c); Section 9-402(j).

4. **Priority.** Section 9-312(i) governs the priority contest between a secured creditor of the original debtor and a secured creditor of the new debtor. This priority rule no doubt will be both under- and over-inclusive.

**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.

(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 initial 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 initial 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 initial 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 initial 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 complying with 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 complying with Section 9-402(a) but 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 initial financing statement in the following form except for a reason set forth in subsection (b):

[INSERT FINANCING STATEMENT FORM]

[INSERT ADDENDUM FORM]

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

[INSERT [CHANGE] FORM]

(j) Except as otherwise provided in subsection (l), a filed financing statement is effective for a period of five years after the date of filing. The effectiveness of a filed financing statement lapses on the expiration of the five-year period unless before the lapse a continuation statement is filed pursuant to subsection (k) [, notwithstanding the commencement of insolvency proceedings by or against the debtor]. Upon lapse, a financing statement becomes ineffective and any security interest 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 at all previous times as against a purchaser of the collateral for value.

(k) A continuation statement may be filed by a secured party of record for a financing statement only within six months before the expiration of the five-year period specified in subsection (j).

(l) A continuation statement must identify the initial 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 initial 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 initial 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.

(n) Except as otherwise provided in subsection (o) 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 initial 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.

(o) 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.

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

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

(r) 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) should be used.

Reporters' Comments

1. **What Constitutes Filing; Effectiveness of Rejected Filings.**

Subsection (a) deals generically with what constitutes filing of a record, including an initial financing statement, an amendment, a statement of assignment, a termination statement, and a continuation statement. It follows former Section 9-403(1), under which either acceptance of a record by the filing office or presentation of the record and tender of the filing fee constitutes filing.

A financing statement or other record that is presented to the filing office but which the filing office rejects provides no public notice, regardless of the reason for the rejection. However, this section distinguishes between records that the filing office rightfully rejects and those that it wrongfully rejects. (The grounds for rejection are discussed below in Comment 2.) A filer is able to prevent a rightful rejection by complying with the requirements of subsection (b). No purpose is served by giving effect to records that justifiably never find their way into the system, and subsection (b) so provides.

Subsection (g) deals with the filing office's unjustified refusal to accept a record. Here, the filer is in no position to prevent the rejection and, many believe, as a general matter should not be prejudiced by it. Although wrongfully rejected records generally are effective, subsection (g) contains a special rule to protect a third party purchaser of the collateral (e.g., a buyer or competing secured party) that gives value in reliance upon the apparent absence of the record in the files. As against an innocent reliance party, subsection (g) imposes upon the filer the risk that a record failed to make its way into the filing system. Subsection (f), discussed

in the following Comment, contains a somewhat different formulation of a similar rule. A single formulation may prove to be workable.

2. Refusal to Accept a Record for Filing. In some States, filing offices have considered themselves obligated to review the form and content of a financing statement and to refuse to accept those that they determine are legally insufficient. Some filing offices impose requirements for or conditions to filing that do not appear in the statute. Under this section, the filing office would not be expected to make legal judgments and would not be permitted to impose additional conditions or requirements.

Subsections (b) and (c), which are new, limit the bases for the filing office to reject records. For the most part, the bases for rejection are limited to those that prevent the filing office from dealing with a record that it receives – because some the requisite information (e.g., the debtor's name) is missing or illegible, because the record is not communicated by an method or medium that the filing office accepts (e.g., it is mime-, rather than uu-encoded), or because the filer fails to tender an amount equal to or greater than the filing fee. See subsections (b)(1)-(4) and (6).

The Drafting Committee is inclined to include among the reasons for rejection of an initial financing statement the failure to give certain information that is not required as a condition of effectiveness. Subsection (b)(5) permits the filing office to refuse to accept an otherwise legally sufficient financing statement because it does not disclose whether the debtor is an individual or an organization (e.g., a partnership or corporation) or, if the debtor is an organization, does not give specific information concerning the organization. The requirements assist searchers in weeding out “false positives, i.e., records that a search reveals but which do not pertain to the debtor in question. They assist filers by helping to insure that the debtor's name is correct and that the financing statement is filed in the proper jurisdiction.

If the filing office accepts a financing statement that does not give this information at all, the filing is fully effective. The Drafting Committee has yet to determine what consequences should attach to a filed financing statement containing information required by subsection (b)(5) that is incorrect. There is some sentiment for the approach reflected in draft subsection (f), under which there would be no adverse consequences to the filer unless a purchaser of the collateral gives value in reasonable reliance upon the incorrect information. Some would like to see more of a safe harbor for the filer. Suggestions have included making the financing statement effective if the filer reasonably relied on misinformation obtained from the debtor, or if the filer made a good faith effort to get the information correct. Note that subsection (f) applies to financing statements filed to perfect agricultural liens.

Subsection (d) is new. It requires the filing office to communicate the fact of rejection and the reason therefor within a fixed period of time. Inasmuch as a rightfully rejected record is ineffective and a wrongfully rejected record is not fully effective, prompt communication concerning any rejection is important.

3. **“Safe Harbor” Written Forms.** Although subsections (b) and (c) limit the bases upon which the filing office can refuse to accept records, subsections (h) and (i) provide sample written forms that would be acceptable in every filing office in the country. By using one of the statutory forms, a secured party could be certain that the filing office is obligated to accept every record it presents. The formatting of the forms has been designed to reduce error by both filers and filing offices.

The form in subsection (h) is based upon a national financing statement form that already is in use. It has been modified to reflect the changes made by this draft. The principal modifications are the elimination of a block for the debtor's signature, the inclusion of a box for claiming all the debtor's assets, and the provision of space for supplemental information about the debtor that is not required for perfection. Work continues on the preparation of an addendum to the form. The addendum will provide space for additional debtors and secured parties, lengthy references to collateral, and additional information concerning realty-related collateral.

The national financing statement form now in use was developed over an extended period and reflects the comments and suggestions of filing officers, secured parties and their counsel (both directly and through organizations such as the American Bar Association), service companies, and the Drafting Committee. It is widely available from printers and search companies, and filing offices in a majority of States have undertaken to accept it, in most cases without any extra or non-standard filing fee.

The form in subsection (i) is the most recent draft version of a “change form. This multi-purpose form will cover changes with respect to the debtor, the secured party, the collateral, and the status of the financing statement (termination and continuation). The form, which is still in the development stage, anticipates certain statutory changes that are not reflected in the draft.

4. **Lapse.** Subsection (j) is a modified version of former Section 9-403(2), concerning lapse. Section 204 of the Bankruptcy Reform Act of 1994 permits a secured party to continue or maintain the perfected status of its security interest without first obtaining relief from the automatic stay. Accordingly, subsection (j) deletes the former tolling provision. It also contains bracketed language for the Drafting Committee's consideration, to the effect that lapse occurs notwithstanding the debtor's entry into insolvency proceedings. With or without the bracketed language, this subsection imposes a new burden on the secured party, to be sure that a financing statement does not lapse during the debtor's bankruptcy. The last sentence of the subsection addresses the effect of lapse. Of course, to the extent that federal bankruptcy law dictates the consequences of lapse, the provisions of this article would be of no effect. Note that subsection (j) applies to financing statements filed to perfect agricultural liens.

5. **Continuation Statements.** Subsection (k) deals with the details of filing continuation statements. Consistent with the medium-neutral approach of draft Part 4 as a whole, the secured party's signature is not required under the draft. The other changes give effect to the medium-neutral approach or are for clarification. Subsection (l) specifies the contents and effect of a continuation statement and addresses certain administrative matters.

6. Filing Officer's Duties; Standards of Performance; Mis-indexing.

Subsections (n) and (o) derive from former subsections (4) and (7). The revisions largely reflect medium-neutral drafting. Subsection (p) is new. It imposes a minimum standard of performance. Prompt indexing is crucial to the effectiveness of any filing system. An accepted but un-indexed record affords no public notice.

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

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

Concerning the references to “of record” and “for record” in draft subsections (m) and (o), see Comment 4 to Section 9-402.

SECTION 9-404. TERMINATION STATEMENT.

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

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

(c) If a financing statement covers [consumer goods], 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.

Reporters' Comments

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

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

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

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

5. Filing offices in some States have been beset by “bogus” filings containing forged debtor signatures. Apparently, some of these filings have been

made as a form of protest or civil disobedience. Section 9-415 addresses this problem.

SECTION 9-405. ASSIGNMENT OF RIGHTS UNDER FINANCING STATEMENT; DUTIES OF FILING OFFICE.

(a) Except as otherwise provided in subsection (c), an initial 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 initial 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 identifies the initial 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 filed under this subsection is a secured party of record for the financing statement.

(c) An assignment of record of a security interest in a fixture covered by a real estate mortgage that is effective as a fixture filing under Section 9-402(b) may

be made only by an assignment of record of the mortgage in the manner provided by the law of this State other than this article.

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

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

Reporters' Comments

1. Most of the changes to this section are for clarification, to embrace medium-neutral drafting, or to impose standards of performance on the filing office. As a general matter, this article preserves the opportunity given by former Section 9-405 to assign a security interest of record in one of two different ways. Under subsection (a), a secured party may assign all of its rights with respect to some or all of the collateral covered by an initial financing statement by naming an assignee in the financing statement. The secured party may accomplish the same result under subsection (b), by making a subsequent filing. Subsection (b) also may be used for an assignment of part of the secured party's rights with respect to some or all of the covered collateral.

2. The indexing duty and standard of performance with respect to assignments other than those relating to real-estate-related collateral are in Section 9-403(n) and (p).

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, continuation

statement, or termination statement concerning its rights under the financing statement.

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

Reporters' Comments

1. This section deals with multiple secured parties. It permits a secured party of record to make filings concerning its own rights under a financing statement, but protects the secured party's rights from the effects of filings made by another secured party of record. For example, assume that a financing statement names A and B as the secured parties. If B files an amendment that limits the collateral covered by the financing statement or files a termination statement, A's rights would not be affected. The financing statement would continue to name A as a secured party and, as to A, the collateral description would remain unaffected by B's amendment.

2. Former Section 9-406 deals with releases of collateral. Under new Section 9-402(l), releases of collateral are dealt with as a form of amendment that modifies the indication of collateral covered by a financing statement.

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' Comments

1. This section is new. It resolves a practical problem faced by successors to a secured party – how to affect records filed by its predecessor. 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:

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) In complying with its duty under subsection (b), the filing office may communicate the information in any medium. However, if requested, the filing office shall communicate the information by issuing its written certificate.

(d) 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.

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

Reporters' Comments

1. This section no longer is presented to state legislatures as optional. Most of the other changes from former Article 9 are for clarification, to embrace medium-neutral drafting, or to impose standards of performance on the filing office.

2. Under current practice, some filing offices routinely limit their searches to financing statements showing a particular address for the debtor. Unless the search request is limited to a particular address, a response that is so limited would not comply with the duty imposed by this section. This section contemplates that, by making a single request, a searcher will receive the results of a search of the entire public record maintained by any given filing office. This section does not contemplate that the filing office be permitted to compel a searcher to limit a request by address.

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

4. The former statute provides that the filing office respond to a request for information by providing a certificate. The principle of medium-neutrality would suggest that the statute not require a written certificate. However, official written certificates might be introduced into evidence more easily than official communications in another medium. Under draft subsection (c), the filing office may respond to a request for information in any medium; however, it is obligated to provide its certificate upon request. The Drafting Committee has yet to reach consensus on this point.

5. Subsection (e), which is new, mandates that the appropriate official or the filing office sell or license the filing records to the public in bulk, on a nonexclusive basis, in every medium available to the filing office. The details of implementation are left to the administrative rules. See generally Section 9-413.

SECTION 9-408. FILING AND COMPLIANCE WITH OTHER STATUTES AND TREATIES FOR CONSIGNMENTS, LEASES, BAILMENTS, AND OTHER TRANSACTIONS. A consignor, lessor, or bailor of goods or a buyer of a payment intangible 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 a financing statement and to 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 collateral secures an obligation. However, if it is determined for another reason that the collateral secures an obligation, 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' Comments

1. Section 9-408 provides the same benefits for compliance with a statute or treaty described in Section 9-302(c) that former Section 9-408 provides for filing, in connection with the use of terms such as “lessor, consignor, etc. It also expands the rule to embrace more generally other bailments and transactions. The references to “owner and “registered owner are intended to address, for example, the situation where a putative lessor is the registered owner of an automobile covered by a certificate of title and the transaction is determined to create a security

interest. Although this section provides that the security interest is perfected, it may be advisable or necessary to amend the relevant certificate of title act in order to ensure that this result will be achieved. The references to “buyer” and “seller” encompass sales transactions, primarily sales of intangibles.

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

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

[SECTION 9-409. REGISTERED AGENT.]

[Intentionally omitted]

Reporters’ Comment

The Reporters distributed to the Drafting Committee a proposal under which a State would permit each debtor to select a “registered agent” to maintain financing statements and other Article 9 records pertaining to the debtor. Pending the Drafting Committee’s determination whether it wishes to pursue that proposal, the Reporters have not prepared the draft statutory text that would be needed to give effect to the proposal.

SECTION 9-410. ASSIGNMENT OF FUNCTIONS TO PRIVATE

CONTRACTOR. The [insert appropriate official or governmental agency] [filing office] may contract with a private party to perform some or all of its functions under this part, other than the adoption of rules under Section 9-413. A contract under this section is subject to [insert reference to any applicable statute that regulates government contracting and procurement].

Reporters’ Comment

Section 9-410, which is new, explicitly confers on the filing office or the appropriate government agency the power to make arrangements with a private contractor for the performance of the functions of the filing office.

SECTION 9-411. DELAY BY FILING OFFICE. Delay by the filing office beyond the time limits prescribed in this part is excused if (i) the delay is caused by interruption of communication or computer facilities, war, emergency conditions, failure of equipment, or other circumstances beyond control of the filing office and (ii) the filing office exercises reasonable diligence under the circumstances.

Reporters' Comment

This new section derives from Section 4-109.

SECTION 9-412. FEES.

(a) The fee for filing and indexing a [record under this part] [financing statement, amendment, continuation statement, or termination statement] [and for marking a written copy furnished by the secured party to show the time and place of filing] is \$ _____ if the record is communicated in writing and \$ _____ if the record is communicated by another medium authorized by rule, [plus in each case, if the financing statement is subject to the last sentence of Section 9-402(a), \$ _____]. The fee for each name more than one required to be indexed is \$ _____. [The fee for filing a written record in a form other than as set forth in 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.

Reporters' Comment

This section contains all fee requirements for filing and for responding to requests for information. It derives from various sections of former Part 4. The penultimate sentence of subsection (a) is intended to discourage filing offices from favoring a local "standard form" over the forms set forth in subsections (h) and (i) of Section 9-403.

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 consult the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators; 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.

Reporters' Comments

1. This section is new. Subsection (a) requires the issuance of administrative rules to carry out the provisions of Article 9. The rules must be consistent with the provisions of the statute and adopted in accordance with local procedures.

2. Subsection (b) derives in part from the Uniform Consumer Credit Code (1974). In today's national economy, uniformity of the policies, practices, and technology of the filing offices will reduce the costs of secured transactions substantially. The International Association of Corporate Administrators (IACA), referred to in subsection (b), is an organization whose membership includes filing officers from every State. These individuals are responsible for the proper functioning of the Article 9 filing system. IACA has been working with liaisons from the Drafting Committee to develop workable statutory provisions as well as model administrative rules, all with a view toward efficiency and uniformity. The Drafting Committee has approved the concept but not the draft language of subsection (b).

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, and a statement of the extent to which the rules are not in harmony with the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators and the reasons for these variations.

Reporters' Comment

This section is new and has been approved by the Drafting Committee in concept but not language. It derives from the Uniform Consumer Credit Code (1974) and is designed to promote compliance with the standards of performance imposed upon the filing office and with the requirement that the filing office's policies, practices, and technology be consistent and compatible with the policies, practices, and technology of other filing offices.

**SECTION 9-415. CLAIM CONCERNING INACCURATE OR
WRONGFULLY FILED RECORD; FAILURE TO SEND OR FILE
TERMINATION STATEMENT.**

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

(b) If a person believes [in good faith] that the secured party of record for a financing statement indexed under the person's name has failed to comply with its duty to file or send to the person a termination statement for the financing statement under Section 9-404, the person 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 initial 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 person'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 person's belief that the secured party of record for a financing statement indexed under the person's name has failed to comply with its duty to file or send to the person 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 neither the correction statement nor the termination request otherwise affects the record or financing statement.

Reporters' Comments

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 or other record that is inaccurate or wrongfully filed, and (2) there is no nonjudicial means for a debtor to correct the public record when a secured party has failed to file or send to the debtor a required termination statement.

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

This section does not displace other provisions of this article that impose liability for making unauthorized filings, see Section 9-402(p), or failing to file or send a termination statement. See Section 9-404(c). Nor does it displace any available judicial remedies.

2. The Drafting Committee has considered and rejected a variety of more aggressive approaches to this issue. Least aggressive among the rejected approaches is a requirement that the filing office notify the allegedly offending secured party of record that a correction statement or a termination request has been filed. Such a requirement would impose substantial costs on the filing offices. The attendant benefits of even this proposal are unlikely to justify the reallocation of resources that would be required. Other proposals would have imposed even greater costs, and some would have imposed serious risks on legitimate secured parties.

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 Section 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, but the Drafting Committee may consider whether, and, if so, how the statute or Comments might do so. One approach would be for the parties to provide in the security agreement the circumstances under which a debtor could file a termination statement on the secured party's behalf.

PART 5 DEFAULT

Reporters' Introductory Comments to Part 5

1. **Definitions.** The definitions of “debtor, “obligor, and “secondary obligor are discussed in the Comments to Section 9-105. These terms play a significant role in Part 5 inasmuch as they identify certain classes of persons that have rights and to which a secured party owes duties under Part 5.

2. **Consumer-protection Provisions.** Several provisions of Part 5 address issues of consumer protection. **It is particularly important to reiterate that the Drafting Committee did not reach a consensus on the substance of most of these provisions or on whether Part 5 should treat the various concerns that the provisions address.** For reasons set forth in Reporters' Prefatory Comment 3.g., the consumer-protection provisions will not be discussed at the 1996 Annual Meeting, and the Reporters' Comments to this part generally ignore them.

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 subsections (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(g), which deals with an account debtor's right to ignore certain notifications; 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([h]), 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 or is 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 at which the secured party becomes entitled to enforce the lien in accordance with the statute under which it was created.

Reporters' Comments

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

2. **Cumulative Remedies.** Former Section 9-501(1) provides that the secured party's remedies are cumulative but does not explicitly provide whether the remedies may be exercised simultaneously. The last sentence of subsection (a) permits the simultaneous exercise of remedies if the secured party acts in good faith. The liability scheme of Section 9-507 affords redress to an aggrieved debtor or obligor. Moreover, subsection (a) does not override non-UCC law, including the law of tort and statutes regulating collection of debts, which would render a creditor liable for abusive behavior or harassment.

3. **Waiver by Debtors.** Subsection (c) contains restrictions on waivers by debtors. Subsection (c) also revises former Section 9-501(3) by restricting the ability to waive or modify additional rights and duties: (i) the duty to collect collateral in a commercially reasonable manner (Section 9-502), (ii) the duty to

apply noncash proceeds of collection or disposition in a commercially reasonable manner (Sections 9-502 and 9-504), (iii) the implicit duty to refrain from a breach of the peace in taking possession of collateral under Section 9-503, and (iv) notifications to account debtors (Section 9-318).

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

4. Waiver by Others. The restrictions on waiver imposed in subsection (c) relate only to waivers by a debtor (defined in Section 9-105 as a person with a property interest, other than a security interest or other lien, in the collateral). Subsection (d) provides explicitly that a waiver by any other party, such as a junior lien claimant, a former debtor that has sold the collateral and retains only a security interest in it at the time of the waiver, or an obligor, is governed by non-UCC law. This is so notwithstanding the first sentence of Section 1-102(3), which generally prohibits disclaimers of the “obligations of good faith, diligence, reasonableness and care prescribed by this Act.

Secondary obligors enjoy many of the same rights as debtors. However, a non-debtor obligor may waive all of its rights and all of the secured party's duties under Part 5 in accordance with other law. The waiver of rights or duties by a secondary obligor does not prejudice the rights of a debtor. For example, the debtor may assert its claims and defenses arising out of a secured party's noncompliance with Part 5 in an action brought by the secondary obligor based on either reimbursement or subrogation. See Restatement (3d), Suretyship and Guaranty §§ 24(1)(c); 28(1)(a)(1996).

5. Real-estate-related Collateral. The Drafting Committee's discussion of real-estate-related collateral was preliminary and will be continued and expanded at its meeting in June, 1996, after the Drafting Committee receives the input it has requested from several committees of the American Bar Association.

Subsection (f) alters former subsection (4) to make clear that a secured party that exercises rights under Part 5 does not prejudice any rights under real property law.

Subsection (g) is new. It is intended to make clear that a security interest in fixtures may be enforced under any of the applicable provisions of Part 5, including sale or other disposition either before or after removal of the fixtures (see former Section 9-313(8)). Subsection (g) also serves to overrule cases holding that a secured party's only remedy after default is the removal of the fixtures from the real estate. See, e.g., *Maplewood Bank & Trust v. Sears, Roebuck & Co.*, 625 A.2d 537 (N.J. Super. Ct. App. Div. 1993).

The draft does not address certain other real estate-related problems. In a number of States, the exercise of remedies by a creditor that is secured by both real estate and non-real estate collateral is governed by special legal rules. For example, under some anti-deficiency laws, creditors risk loss of rights against personal

property collateral if they err in enforcing their rights against the real estate. Under a “one-form-of-action” rule (or rule against splitting a cause of action), a creditor that judicially enforces a real estate mortgage and does not proceed in the same action to enforce a security interest in personalty may (among other consequences) lose the right to proceed against the personalty. Obviously, statutes of this kind create impediments to Article 9 secured parties. Several approaches are available, including: (i) revise Article 9 to override any limitations contained in other law and (ii) continue to submit to other law.

6. **Judicial Enforcement.** Subsection (h) generally follows former Section 9-501(5). The principal change provides that a levy relates back to the earlier of the date of filing and the date of perfection. This provides a secured party that enforces its security interest by levy with the benefit of the “first-to-file-or-perfect” priority rule of Section 9-312(m)(1).

7. **Duties to Unknown Persons.** Subsection (i) is new. It relieves a secured party from duties to a debtor or affected obligor if the secured party does not know about the debtor or affected obligor. For example, a secured party may be unaware that the original debtor has sold the collateral subject to the security interest and that the new owner now is the debtor. This subsection should be read in conjunction with the exculpatory provisions in Section 9-507(i), (j), and (k).

8. **Buyers of Receivables.** New subsection (j) provides that, except as provided in the sections that it mentions, the duties imposed on secured parties do not apply to buyers of accounts, chattel paper, or payment intangibles. Although denominated “secured parties,” these buyers normally own the entire interest in the property sold and so may enforce their rights without regard to the seller (“debtor”).

9. **Consignments.** We have yet to draft remedial provisions affecting a consignor under a “true” consignment. We contemplate that part 5 would be inapplicable to the true consignor's enforcement of its ownership interest. See subsection (j). 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.

10. **Agricultural Liens.** For the most part, Part 5 provides parallel treatment for the enforcement of agricultural liens and security interests. Several minor changes to former Part 5 were necessary to accomplish this result. For example, inasmuch as there normally would not be a security agreement in connection with an agricultural lien, subsections (a) and (b) change the references to the “security agreement” to the “agreement of the parties” as a source of rights and remedies.

Because agricultural liens are statutory rather than consensual, this article does draw a few distinctions between the liens and security interests. Under subsection (h), the statute creating an agricultural lien would govern whether and the date to which an execution lien relates back. Subsection (k) provides a meaning for “default” in the agricultural lien context. It requires consultation of the enabling statute for a determination of when the lienholder is entitled to enforce the lien.

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 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 with respect to (i) the 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 obligations of the account debtor or other person obligated on the collateral.

[(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.

(d) A secured party that is entitled [by agreement] to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or against 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.

(e) 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 a deficiency under this subsection is subject to Section 9-507.

(f) 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) 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 a deficiency under this subsection is subject to Section 9-507.

Reporters' Comments

1. **Scope of Section 9-502.** As a general matter Part 5 deals with the rights and duties of debtors and secured parties following default. However, Section 9-502 applies to the collection and enforcement rights of secured parties whether or not a default has occurred. Although seemingly anomalous, in practice it is not

unusual for debtors to agree that secured parties are entitled to collect and enforce rights against account debtors prior to default.

The secured party's rights to collect from and enforce collateral against account debtors and others obligated on collateral under subsection (a) are subject to Sections 9-318, 9-318A, 9-318B, and other applicable law. Neither this article nor former Section 9-502 should be understood to regulate the duties of an account debtor or other person obligated on collateral. For example, the secured party may be unable to exercise the debtor's rights under an instrument, if the debtor is in possession of the instrument, or under a non-transferable letter of credit, if the debtor is the beneficiary. Instead, Section 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.

2. Primary Changes. The primary substantive changes to this section are: (i) expansion of its application to collection and enforcement against all persons obligated on collateral, not just account debtors; (ii) explicit provision for the secured party's enforcement of the debtor's rights in respect of the account debtor's (and other third parties') obligations; (iii) provision for the secured party's enforcement of support obligations with respect to those obligations (support obligations are components of the collateral, see Section 9-203(d)); (iv) explicit provision for the application of proceeds recovered by the secured party in substantially the same manner as provided in Section 9-504(b) and (c) for dispositions of collateral; and (v) reference to the applicability of Section 9-507 in the event of the secured party's failure to comply with the commercial reasonableness requirement.

3. Rights Against Third Parties. The rights of a secured party against an account debtor or other third party under subsection (a) include the right to enforce claims that the debtor may enjoy against others. The claims might include a breach of warranty claim arising out of a defect in equipment that is collateral or a secured party's action for an injunction against infringement of a patent that is collateral. Those claims typically would be proceeds of original collateral under Section 9-306(a).

4. Rights Against Real Estate Mortgagor. Subsection (b) is one of several provisions concerning which the Reporters and the Drafting Committee will continue to consult with representatives of the real estate bar. This new, bracketed subsection would permit the secured party whose collateral consists of a mortgage note to proceed after the debtor's (mortgagor's) default with a nonjudicial foreclosure of the real estate mortgage securing the note. Exercise of this right would be conditioned upon the secured party recording the security agreement and an affidavit certifying default in the applicable real estate records. Of course, the secured party's rights derive from those of its debtor. The bracketed paragraph would not entitle the secured party to proceed with a foreclosure unless the mortgagor also is in default or the debtor (mortgagee) otherwise enjoyed the right to foreclose.

5. Deposit Account Collateral. 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 Section 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 (Section 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 Section 9-117(a)(3), the depository institution is obliged to obey the instruction because the secured party is its customer. See Section 4-401. If the third party has control under Section 9-117(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 Section 9-306, the depository institution ordinarily owes no obligation to obey the secured party's instructions. See Section 9-318A. To reach the funds, the secured party must use an available judicial procedure.

6. Commercial Reasonableness. Subsection (d) provides that the secured party's collection and enforcement rights under subsection (a) must be exercised in a commercially reasonable manner, unless the underlying transaction is a sale of accounts, chattel paper, or general intangibles for the payment of money and the secured party (buyer) has no right of recourse against the debtor or an affected obligor. The secured party's rights to collect and enforce include the right to settle and compromise claims against the account debtor, subject to the standard of commercial reasonableness. The secured party's failure to observe the standard of commercial reasonableness could render it liable to an aggrieved person under Section 9-507 and the secured party's recovery of a deficiency also would be subject to Section 9-507.

7. Attorney's Fees and Legal Expenses. The phrase "reasonable attorneys' fees and legal expenses," which appears in subsection (d), includes only those fees and expenses incurred in proceeding against **account debtors or other third parties**. The secured party's right to recover these expenses arises automatically under this section. The secured party also may incur other attorneys' fees and legal expenses in proceeding against the debtor or obligor. Whether the secured party has a right to recover those fees and expenses depends on whether the debtor or obligor has agreed to pay them, as is the case with respect to attorneys' fees and legal expenses under Section 9-505(d)(1)(i) and Section 9-504(b)(1)(i). The parties also may agree to allocate a portion of the secured party's overhead to collection and enforcement under subsection (d) or (e).

8. Noncash Proceeds. Subsection (e)(2) is new. It addresses the situation in which an enforcing secured party receives noncash proceeds, such as the account debtor's promissory note. The secured party may wish to credit the debtor with the principal amount of the note upon receipt of the note or may wish to credit the debtor only as and when the note is paid. Under subsection (e)(2) a secured party whose collection or disposition yields noncash proceeds (e.g., a promissory note) is under no duty to apply the note or its value to the outstanding obligation. If a secured party elects to apply the note to the outstanding obligation, however, it must do so in a commercially reasonable manner. The parties may provide for the

method of application of noncash proceeds in the security agreement, if the method is not manifestly unreasonable. See Section 9-501(e).

9. Collections by Junior Secured Party. Subsection (f) is new. It relieves a junior secured party from any responsibility to apply or pay over collections to senior claimants under certain circumstances and provides that receipt of cash proceeds by a qualifying junior secured party terminates the interest, if any, of a senior secured party or lienholder. This subsection does not protect a junior secured party that fails to act in good faith or that acts with knowledge that it is violating the rights of senior claimants. Subsection (f) is similar to Section 9-504(e), which applies to proceeds of a disposition by a junior secured party. In the case of a disposition, the senior claimant may be able to reach the collateral in the hands of the purchaser. In the case of collections, however, the account debtor normally will be discharged (see Section 9-318), leaving nothing for the senior party.

Some observers believe that this potential for a harsher result in the case of collections warrants treatment different from that given to proceeds of dispositions. They would prefer a rule that is less protective of junior secured parties who collect receivables. To underscore their position, these observers argue that secured parties normally do not extend credit in reliance on what they know to be a junior interest in receivables, and that any amounts collected by the junior are a windfall.

SECTION 9-503. SECURED PARTY'S RIGHT TO TAKE POSSESSION AFTER DEFAULT. [MINOR STYLE CHANGES ONLY] Unless otherwise agreed, a secured party has the right on default to take possession of the collateral. In taking possession, a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If a security agreement so provides, a secured party may require a debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal, a secured party may render equipment unusable, and may dispose of collateral on a debtor's premises under Section 9-504.

Reporters' Comments

1. More than one secured party may be entitled to take possession under this section. Conflicting rights to possession among parties are resolved by the priority rules of this article or, as applicable, other law. Thus, a senior secured party is entitled to possession as against a junior claimant.

2. Non-UCC law governs whether a junior secured party in possession of collateral is liable to the senior in conversion.

3. Section 9-504 governs a junior secured party's rights to recover its expenses from the collateral.

**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) 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 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 to:

(1) 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) any other secured party that, [XX] 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 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) any other secured party that, [XX] 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 complies with the notification requirement specified in subsection (g)(2) if not later than [XX] days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the office 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) is nevertheless 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 if it contains minor errors that are not seriously misleading.

(4) The following form of notification, when completed, contains sufficient information:

NOTIFICATION OF DISPOSITION OF COLLATERAL

To: [Name of debtor or obligor to whom the notification is sent]

From: [Name, address, and telephone number of secured party]

Name of Debtor(s): [Include only if debtor(s) are not an addressee]

[For a public disposition:]

We will sell [or lease or license, **as applicable**] the [describe collateral] [to the highest qualified bidder] in public as follows:

Day and Date: _____

Time: _____

Place: _____

[For a private disposition:]

We will sell [or lease or license, **as applicable**] the [describe
collateral] privately sometime after [day and date] .

[End of Form]

(l) This subsection applies to a consumer secured transaction.

(1) A notification of disposition must contain the following information:

(i) the information specified in subsection (k)(1);

(ii) a description of any liability for a deficiency of the person to which the notification is sent;

(iii) the amount that must be paid to the secured party to redeem (Section 9-506) the obligation secured;

(iv) the amount that must be paid to the secured party to reinstate (Section 9-506) the obligation secured; and

(v) a telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

(2) A particular phrasing of the notification is not required. A notification substantially complying with the requirements of this subsection is sufficient, even if it contains minor errors that are not seriously misleading.

(3) The following form of notification, when completed, contains sufficient information:

NOTICE OF OUR PLAN TO SELL PROPERTY

To: [Name of debtor or obligor to whom the notification is sent]

From: [Name, address, and telephone number of secured party]

Name of Debtor(s): [Include only if debtor(s) are not an addressee]

[You] [name of obligor, if different] owe(s) us money on a debt and [you have] [has] not paid it to us on time. We have [your] [the debtor's] [describe collateral] because we took it from [you] [the debtor] or [you] [the debtor] voluntarily gave it to us. [You] [name of 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[n] [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 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, 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 of itself relieve the secured party of its duties under this article.

Reporters' Comments

1. **Former Subsection (1) Reorganized.** Subsections (a), (b), and (d) include the substance of former subsection (1), with several changes. Subsection (a) states the secured party's basic right to dispose of collateral after default. It deletes as unnecessary a sentence in former subsection (1) indicating that a foreclosure sale of goods is subject to Article 2. Subsections (b), (c), and (d) cover the application of the proceeds of a disposition.

2. **Warranties.** Subsection (a) affords the transferee at a disposition under Section 9-504 the benefit of any title, possession, quiet enjoyment, and similar warranties that would have accompanied the disposition by operation of non-Article 9 law had the disposition been conducted under ordinary circumstances. For example, the Article 2 warranty of title would apply to a sale of goods, the analogous warranties of Article 2A would apply to a lease of goods, and any common law warranties of title would apply to dispositions of other types of collateral. See, e.g., Restatement (2d) Contracts § 333 (warranties of assignor).

Subsection (a) explicitly contemplates that these warranties can be disclaimed. It provides a sample of wording that will effectively exclude the warranties in a disposition under this section, whether or not the exclusion would be effective under non-Article 9 law.

The warranties incorporated by subsection (a) are those relating to "title, possession, quiet enjoyment, and the like. Non-Article 9 law determines whether other statutory or implied warranties, e.g., warranties of quality or fitness for purpose, apply to a disposition under this section. It also determines issues relating to disclaimer of such warranties. For example, a foreclosure sale of a car by a car dealer would give rise to a warranty of merchantability (Section 2-314) unless effectively disclaimed (Section 2-316).

This section's approach to these warranties conflicts with Official Comment 5 to Section 2-312: "Subsection (2) [of Section 2-312] recognizes that sales by . . . foreclosing lienors and person similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller that is purporting to sell only an unknown or limited right. This article rejects the baseline assumption that commercially reasonable dispositions under this section are "out of the ordinary commercial course" or "peculiar. The Article 2 Drafting Committee has yet to consider this issue.

3. Pre-disposition Preparation and Processing. Former Section 9-504(1), appears to give the secured party the choice of disposing of collateral either “in its then condition or following any commercially reasonable preparation or processing. Many courts have held that the “commercially reasonable” standard of Section 9-504(3) nevertheless may impose an affirmative duty on the secured party to process or prepare the collateral prior to sale. The Drafting Committee was concerned that if the quoted language were added to the list in subsection (f), courts might be unnecessarily quick to impose a duty of preparation or processing on the secured party. Accordingly, the Drafting Committee chose to retain the language in subsection (a). Subsection (a) does not grant the secured party the right to dispose of the collateral “in its then condition” under all circumstances. A secured party may not dispose of collateral “in its then condition” when, taking into account the costs and probable benefits of preparation or processing and the fact that the secured party would be advancing the costs at its risk, it would be commercially unreasonable to dispose of the collateral in its then condition.

4. Application of Proceeds. Subsections (b), (c), and (d) contain the rules governing application of proceeds and the debtor's liability for a deficiency. Subsection (b) provides a “safe harbor” for a secured party that complies with its terms. However, a secured party that does not comply with subsection (b) is liable only as provided in Section 9-507.

5. Noncash Proceeds. Subsection (c) addresses the application of noncash proceeds of a disposition, such as a note or lease. The explanation in the Comments to Section 9-502 generally applies to Section 9-504(c). Under subsection (c), if a disposition produces noncash proceeds, such as a promissory note, the secured party is under no duty to apply the proceeds or their value to the secured obligation. If a secured party elects to apply the note to the outstanding obligation, however, it must do so in a commercially reasonable manner. One would expect that where noncash proceeds are or may be material, the parties would agree to more specific standards in the security agreement or in an agreement entered into after default. The parties may provide for the method of application of noncash proceeds in the security agreement, if the method is not manifestly unreasonable. See Section 9-501(e).

6. Surplus and Deficiency. Subsection (d) deals with surplus and deficiency. Clause (i) of subsection (d) revises former Section 9-504(2) by imposing an explicit requirement that the secured party “pay” the debtor for any surplus, while retaining the secured party's duty to “account.” Inasmuch as the debtor may not be an obligor, subsection (d) now provides that the obligor (not the debtor) is liable for the deficiency. The special rule governing surplus and deficiency when receivables have been sold likewise has been revised to take into account the new distinction between debtor and obligor.

When the debtor sells collateral subject to a security interest, the original debtor (creator of the security interest) is no longer a debtor inasmuch as it no longer has a property interest in the collateral; the buyer is the debtor. See Section 9-105. As between the debtor (buyer of the collateral) and the original debtor (seller of the collateral), the debtor (buyer) normally would be entitled to the surplus. Subsection (d) therefore requires the secured party to pay the surplus to the debtor (buyer), not to the original debtor (seller) with which it has dealt. But,

because this situation arises as a result of the debtor's wrongful act, this article does not expose the secured party to the risk of determining ownership of the collateral. If the secured party does not know about the new debtor and accordingly pays the surplus to the original debtor, the exculpatory provisions of this article exonerate the secured party from liability to the new debtor. See Sections 9-501(e), 9-507(i) and (j). If a debtor sells collateral **free** of a security interest, such as a sale to a buyer in ordinary course of business (see Section 9-307(1)), the property is no longer collateral and the buyer is not a debtor.

7. Disposition by Junior Secured Party. Subsection (a) is not limited to first-priority security interests. Rather, any secured party as to which there has been a default enjoys the right to dispose of collateral under this subsection. The exercise of this right by a secured party whose security interest is subordinate to that of another secured party does not of itself constitute a conversion or otherwise give rise to liability in favor of the holder of the senior security interest, and, as subsection (b) makes clear, the junior secured party owes no obligation under Article 9 to apply the proceeds of disposition to the satisfaction of the obligations secured by the senior security interest. Subsection (e) builds on this general rule by protecting certain juniors from claims of a senior concerning cash proceeds of the disposition. Even if a senior were to have a non-Article 9 claim to proceeds of a junior's disposition, subsection (e) would protect a junior that acts in good faith and without knowledge that its actions violate the rights of a senior party. Moreover, because the disposition by a junior would not cut off a senior's security interest or lien (discussed below), in many (probably most) cases the junior's receipt of the cash proceeds would not violate the rights of the senior. Subsection (g)(2) affords some protection to seniors by generally requiring a foreclosing secured party to send to secured parties of record a notification of an intended disposition. A junior who fails to send the required notification is liable for damages under Section 9-507. A senior who receives notification is entitled, by virtue of its priority, to take possession of collateral from the junior secured party and conduct its own disposition, provided that the senior enjoys the right to take possession of the collateral from the debtor. See Section 9-503. A junior who refuses to relinquish possession upon the demand of a secured party having a superior possessory right thereto is liable in conversion.

This article affords some protection to a senior that does not prevent the junior from disposing of the collateral. Under subsection (n), the junior's disposition does not of itself discharge the senior's security interest; unless the senior secured party has authorized the disposition free and clear of its security interest, the senior's security interest ordinarily will continue under Section 9-306(c). Thus, if the senior enjoys the right to repossess the collateral from the debtor, the senior likewise may recover the collateral from the transferee.

When a secured party's collateral is encumbered by another security interest or by a lien, one of the claimants may seek to invoke the equitable doctrine of marshaling. As explained by the Supreme Court, that doctrine “rests upon the principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds. *Meyer v. United States*, 375 U.S. 233, 236 (1963), quoting *Sowell v. Federal Reserve Bank*, 268 U.S. 449, 456-57 (1925). The purpose of the doctrine is “to prevent the arbitrary action of a senior lienor from destroying the

rights of a junior lienor or a creditor having less security. *Id.* at 237. Because it is an equitable doctrine, marshaling “is applied only when it can be equitably fashioned as to all of the parties having an interest in the property. *Id.* This article leaves courts free to determine whether marshaling is appropriate in any given case. See Section 1-103.

8. Security Interests of Equal Rank. Two security interests enjoy the same priority. This situation may arise by contract, e.g., pursuant to “equal and ratable provisions in indentures, or by operation of law. See Section 9-115(e)(2), (5), and Section 9-312(j)(2). This article treats a security interest having equal priority like a senior security interest in many respects. Assume, for example, that SP-X and SP-Y enjoy equal priority, SP-W is senior to them, and SP-Z is junior. If SP-X disposes of the collateral under this section, then (1) SP-W's and SP-Y's security interests survive the disposition but SP-Z's does not, and (2) neither SP-W nor SP-Y is entitled to receive a distribution of proceeds but SP-Z is.

When one considers the ability to obtain possession of the collateral, a secured party with equal priority is unlike a senior secured party. As the senior secured party, SP-W should enjoy the right to possession as against SP-X. See Section 9-503, Comments. If SP-W takes possession and disposes of the collateral under this section, it is entitled to apply the proceeds to satisfy its secured claim. SP-Y, however, should not have such a right to take possession from SP-X; otherwise, once SP-Y took possession from SP-X, SP-X would have the right to get possession from SP-Y, which would be obligated to redeliver possession to SP-X, and so on. Resolution of this problem is left to the parties and, if necessary, the courts.

9. Public vs. Private Dispositions. Subsections (f) and (n) maintain three distinctions between “public and other dispositions: (i) the secured party may buy at the former, but not at the latter; (ii) the debtor is entitled to notification of “the time and place of any public sale and notification of “the time after which any private sale or other intended disposition is to be made; (iii) the section is less protective of transferees in a noncomplying public sale than in other noncomplying dispositions. As used in this section, a “public sale is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. “Meaningful opportunity is meant to imply that some form of advertisement or public notice must precede the sale and that the public (or the commercially relevant segment of the public) must have access to the sale.

10. Investment Securities. Dispositions of investment property may be regulated by the federal securities laws. Although the “public sale of securities pursuant to Section 9-504 may implicate the registration requirements of the Securities Act of 1933, it need not do so. A disposition that qualifies for deviations from the rules for “private placement exemptions under the Securities Act of 1933 in connection with public advertising nevertheless may constitute a “public sale within the meaning of this section. Moreover, the “commercially reasonable requirements of Section 9-504 need not prevent a secured party from conducting a foreclosure sale without first complying with federal registration requirements. To eliminate any doubt, a secured party whose collateral consists unregistered securities may wish to include in the security agreement an undertaking by the debtor to cause the securities to be registered under the 1933 Act upon the secured

party's request. The debtor's failure to comply with such a requirement should free the secured party (insofar as Article 9 is concerned) to dispose of the unregistered securities in an otherwise commercially reasonable manner. An agreement along these lines would be enforceable as a "standard[] that is not "manifestly unreasonable" under Section 9-501(e).

11. Wholesale vs. Retail Dispositions. A disposition at wholesale is not per se commercially unreasonable. Regarding whether disposition at wholesale is commercially reasonable when retail facilities are readily available, this article leaves the courts free to resolve each case on its own facts.

12. Relevance of Price. The Comments to Section 9-507 discuss the relationship between the requirement in 9-504(f) that "every aspect of the disposition, including the . . . terms, must be commercially reasonable" and the statement in Section 9-507(d) that "[t]he fact that a greater amount could have been obtained by a . . . disposition at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the . . . disposition was made in a commercially reasonable manner.

13. Notification.

Who Is Entitled. Subsection (g) provides that the duty to send notification of a disposition runs not only to the debtor but also to a secondary obligor. This resolves an uncertainty under former Article 9 by providing that secondary obligors (sureties) will be entitled to receive notification of an intended disposition of collateral, regardless of who created the security interest in the collateral. If the surety created the security interest, it would be the debtor. If it did not, it would be a secondary obligor. (This section also resolves the question of the secondary party's ability to waive the right to notification. See below.) Section 9-501(i) relieves a secured party from any duty to send notification to a debtor or secondary obligor unknown to the secured party.

The rules in subsection (g) also might differ from those in former Article 9 in another way. The principal obligor (borrower) would not be entitled to notification of disposition in all cases. Suppose that Mooney borrows on an unsecured basis and Harris grants a security interest in his car to secure the debt. Mooney would be a primary obligor, not a secondary obligor. As such, he would not be entitled to notification of disposition under this section.

Notification of Other Secured Parties. Prior to the 1972 amendments, Section 9-504(3) required the enforcing secured party to send reasonable notification of the sale:

except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this state or who is known by the secured party to have a security interest in the collateral.

The 1972 amendments eliminated the duty to give notice to secured parties other than those from whom the foreclosing secured party had received written notice of a claim of an interest in the collateral.

Many of the problems arising from dispositions of collateral encumbered by multiple security interests can be ameliorated or solved by informing all secured parties of an intended disposition and affording them the opportunity to work with one another. To this end, subsection (g)(2) expands the duties of the foreclosing secured party to include the duty to notify (and the corresponding burden of searching the files to discover) certain competing secured parties. The subsection imposes a search burden that in some cases may be greater than the pre-1972 burden on foreclosing secured parties but certainly is more modest than that faced by a new lender. To determine who is entitled to notification, the foreclosing secured party must determine what the proper office for filing a financing statement was as of a particular date and see whether any financing statements covering the collateral in fact were filed there and were indexed under the debtor's name (as the name existed as of that date). The foreclosing secured party generally need not notify secured parties whose effective financing statements have become more difficult to locate because of changes in the location of the debtor, proceeds rules, or changes in the debtor's name. Under subsection (g)(3), the secured party also must notify a secured party that has perfected a security interest by complying with a statute or treaty described in Section 9-302(c), such as a certificate-of-title act.

Bracketed subsection (h) provides a “safe harbor” that takes into account the inevitable delays attendant to receiving information from the public filing offices. It provides, generally, that the secured party will be deemed to have satisfied its notification duties under clause (ii) if it requests search(es) from the proper office(s) at least [XX] days before sending notification to the debtor and it also sends a notification to all secured parties reflected on the search report(s). The secured party's duties under clause (ii) also will be satisfied if the secured party does not receive any search report(s) before the notification is sent to the debtor.

In considering the extent, if any, to which expansion of the notification requirement is desirable, one should keep in mind the consequences of failing to send notification to the holder of a competing security interest: the aggrieved secured party has the burden of establishing its loss. See Section 9-507. Also relevant are subsection (e), under which senior secured parties ordinarily are not entitled to share in proceeds of a junior's disposition, and subsection (b), under which a disposition cuts off junior security interests and junior secured parties are not entitled to receive excess proceeds from the disposing secured party unless they demand them.

Writing Requirement. Subsection (g) explicitly provides that notification of disposition must be “written.” (For the time being, the draft uses the defined term “written.” The Drafting Committee plans to consider all references to “written” in light of the widespread use of fax machines, e-mail, and other substitutes for traditional writings. In appropriate cases, the new defined term “record” will be used.) In adding the word “written,” the draft resolves a conflict in the reported cases.

“Recognized Market.” A “recognized market,” as used in subsections (f) and (g), is one in which the items sold are fungible and prices are not subject to individual negotiation. For example, the New York Stock Exchange is a recognized market, whereas the markets for used automobiles and livestock are not.

Second Try. This article leaves judicial resolution, based upon the facts of each case, the question whether the requirement of “reasonable notification” requires a “second try”, i.e., whether a secured party that sends notification and learns that the debtor did not receive it must attempt to locate the debtor and send another notification.

Failure to Conduct Notified Disposition. Nothing in this section prevents a secured party from not conducting a disposition after sending notice or sending a revised notification if its plans for disposition change; provided, however, that the secured party acts in good faith, the revised notification is reasonable, and the revised plan for disposition and any attendant delay are commercially reasonable.

Waiver. The waiver rules appear in subsection (i). In an effort at clarification, this article uses the term “waive” instead of “renouncing or modifying,” which appears in former Section 9-504(3).

To see the operation of this subsection, consider the following examples:

Example 1: Corporation grants a security interest in its equipment to secure a loan. President issues an unsecured guarantee of Corporation's debt. Corporation is the debtor, and President is the secondary obligor. Under Section 9-501(d), President is entitled to waive notification of disposition to the extent and in the manner prescribed by non-UCC law.

Example 2: Corporation is obligated to creditor. The debt is secured only by equipment owned by Parent. Here, although Parent is a secondary obligor, it also is the debtor. Corporation, the principal obligor, is neither the debtor nor a secondary obligor. Although Corporation is entitled under the language of Section 9-501(d) to waive rights and the secured party's duties to the extent and in the manner prescribed by non-UCC law, the secured party has no duty to notify Corporation of a disposition. However, a purported waiver of notification by Parent would be effective only if in writing after default under Section 9-504(i).

The brackets in the second sentence of Section 9-504(i) indicate division among members of the Drafting Committee as to whether the secured party should bear the burden of proving that a debtor expressly agreed to the terms of a purported waiver in non-consumer secured transactions.

Section 9-504 makes no provision for waiving the rule prohibiting a secured party from buying at its own private sale. Transactions of this kind are equivalent to “strict foreclosures” and are governed by Section 9-505.

Timing. Subsection (j) is new. The 10-day notice period is intended to be a “safe harbor” and not a minimum requirement. To qualify for the “safe harbor” the notification must be sent after default. A notification also must be sent in a commercially reasonable manner. See subsection (g) (written notification must be reasonable). Those requirements prevent a secured party from taking advantage of the “safe harbor” by, for example, giving the debtor a notification at the time of the original extension of credit or sending the notice by surface mail to a debtor overseas.

Contents. Subsection (k) is new. To comply with the “reasonable written notification requirement of subsection (g), the contents of a notification must be reasonable. The contents of a notification that includes the information set forth in subsection (k)(1) are sufficient as a matter of law, unless the parties agree otherwise. (The reference to “time of disposition means here, as it does in former Section 9-504(3) and Section 9-504(g), not only the hour of the day but also the date.) Although a secured party may choose to include additional information concerning the transaction or the debtor's rights and obligations, no additional information is required unless the parties agree otherwise. A notification that lacks some of the information set forth in paragraph (1) nevertheless may be sufficient if found to be so by the trier of fact. A properly completed sample form of notification in paragraph (4) is one example of a notification that would contain the information set forth in paragraph (1). No particular phrasing of the notification is required, however.

14. Calculation of Deficiency and Surplus. Subsection (m) is another new provision. It requires a secured party to give a debtor notification of relevant information concerning the calculation of a surplus or deficiency claim at the time the secured party accounts for a surplus or first makes demand for payment of a deficiency. Brackets around the first sentence indicate that the Drafting Committee has not reached consensus as to whether this rule should apply in non-consumer secured transactions.

15. Title Taken by Transferee. Subsections (n) and (o), which address the title taken by a transferee of property disposed of after default, derive from former Section 9-504(4). They change the term “purchaser to “transferee, inasmuch as a buyer at a foreclosure sale does not meet the definition of “purchaser in Section 1-201. Subsection (n) sets forth the rights acquired by persons that qualify under paragraphs (1) or (2). By virtue of the expanded definition of the term “debtor in Section 9-105, subsection (n) makes clear that the ownership interest of a person that bought the collateral subject to the security interest is terminated. Such a person is a debtor under this article. Under the former article, the result arguably is the same, but the statute is not clear.

Subsection (o) specifies the consequences for a transferee that does not qualify for protection (e.g., a transferee with knowledge of defects in a public sale). The subsection also adds a sentence intended to make clear that a disposition does not discharge senior interests or interests of equal rank unless they would be discharged under other provisions of Article 9.

Secured parties may utilize the services of third persons to dispose of repossessed collateral. Assume that a secured party takes possession of goods collateral after default and entrusts the goods to a merchant, and further that the merchant then wrongfully sells the collateral to a buyer in ordinary course of business. That disposition would transfer to the buyer all of the secured party's rights and the rights that the secured party had the power to transfer (including those of the debtor). Sections 2-403(1); 9-504(n). The sale would constitute a disposition under Section 9-504 and as such would give rise to the consequences specified in Part 5. The secured party would have a conversion claim against the merchant, and the debtor could assert its rights under Part 5 arising out the secured party's (probably) noncomplying disposition.

16. Assignments and Repurchase Agreements. Subsection (p) clarifies former subsection (5). Under this subsection, assignments of secured obligations and other transactions (regardless of form) that function like assignments of secured obligations are not dispositions to which this section applies. Rather, such transactions constitute assignments of rights and (occasionally) delegations of duties. Application of the rule may require an investigation into the agreement of the parties, which may not be reflected in the words of the repurchase agreement (e.g., when the agreement requires a recourse party to “purchase the collateral” but contemplates that the purchaser will then conduct an Article 9 foreclosure sale).

Subsection (p), like former subsection (5), does not constitute a general and comprehensive rule for allocating rights and duties upon assignment of a secured obligation. Rather, it applies only in recourse situations. Whether the assignee of a secured obligation acquires the rights and duties of the secured party in other contexts is determined by other law.

18. Transfer of Record or Legal Title. Potential buyers of collateral that is covered by a certificate of title (e.g., an automobile) or is subject to a registration system (e.g., a copyright) typically require as a condition of their purchase that the certificate or registry reflect their ownership. In many cases, this condition can be met only with the consent of the record owner. If, 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 Section 9-504.

Section 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 this subsection, the secured party retains its duties as such and the debtor retains its rights as well.

Section 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 has instructed the Reporters to prepare a draft statutory provision containing a title-clearing mechanism pursuant to which an Article 9 secured party could dispose of collateral and convey good legal or record title to the purchaser even though record or legal title is in the name of the debtor.

[SECTION 9-504A. LIMITATION ON DEFICIENCY CLAIMS IN CONSUMER GOODS TRANSACTION. If, after default, a secured party [in a consumer secured transaction] takes possession of collateral consisting of consumer goods and the amount owing on the obligation secured by the collateral does not exceed \$[XX] at the time of default, a consumer obligor is not liable to the secured party for the unpaid balance of the obligation secured.]

Reporters' Comment

For the status of this new section, see Reporters' Prefatory Comment 3.g.

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 20 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 20 days after notification is sent to that person; and

(2) in other cases, within 20 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, [XX] 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) 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.

Reporters' Comments

1. **Overview and Organization.** This section deals with strict foreclosure, a procedure by which the secured party acquires the debtor's interest in the collateral without the need for a sale or other disposition under Section 9-504. The section has been entirely reorganized and substantially rewritten. The more straightforward approach taken in this article eliminates the fiction that the secured party always will present a "proposal" for the retention of collateral to which the debtor will have a fixed period to respond. By eliminating the need (but preserving the possibility) for proceeding in this fashion, this section eliminates much of the

awkwardness of former Section 9-505. It reflects the belief that strict foreclosures should be encouraged and often will produce better results than a disposition for all concerned. This Comment explains how the section is organized. The following Comments contain a subsection-by-subsection analysis of the text. The discussion relates only to non-consumer secured transactions.

Subsection (b) sets forth the conditions necessary to an effective acceptance (formerly, retention) of collateral in full or partial satisfaction of the secured obligation. The first condition is that the debtor must consent to the acceptance. Subsection (d) provides that this consent must be manifested either by the debtor's post-default, signed, written agreement to the acceptance or, in the case of an acceptance in full satisfaction, by the debtor's 20-day silence after receipt of a written "proposal" (as defined in subsection (a)). Subsection (c) conditions the effectiveness of an apparent acceptance on the secured party's written acceptance or its sending a proposal; "constructive" or "deemed" acceptances are not effective.

The second condition necessary to an effective acceptance of collateral is the absence of a timely objection from a person that holds an interest subordinate to the security interest in question. Subsection (e) indicates when an objection is timely. If either of these three conditions is not met, any purported or apparent acceptance in satisfaction is ineffective.

In addition to the conditions described above, subsection (f) requires that a secured party that wishes to proceed under this section notify certain other persons that have or that claim an interest in the collateral. Unlike the failure to meet the conditions in subsection (b), under subsection (i) the failure to comply with the notification requirement of subsection (f) does not render the acceptance of collateral ineffective. Rather, the acceptance can take effect notwithstanding the secured party's noncompliance. Subsection (i) indicates that a person to which the required notice was not sent has the right to recover damages under Section 9-507(b). Subsection (h) sets forth the effect of an acceptance of collateral under Section 9-505.

2. **Proposals.** Subsection (a) is new. It defines the term "proposal." A "proposal" is necessary only if the debtor does not agree to an acceptance in a signed writing as described in subsection (d)(1) or (d)(2)(i). A proposal under subsection (a) need not take any particular form as long as it sets forth the terms under which the secured party is willing to accept collateral in satisfaction. A proposal to accept collateral should specify the amount (or a means of calculating the amount, such as by including a per diem accrual figure) of the secured obligations to be satisfied, state the conditions (if any) under which the proposal may be revoked, and describe any other applicable conditions.

3. **Conditions to Effective Acceptance.** Subsection (b) contains the conditions necessary to the effectiveness of an acceptance of collateral. Subsection (b)(1) requires the debtor's consent. Under subsections (d)(1) and (d)(2)(i), the debtor may consent by agreeing to the acceptance in writing after default. Subsection (d)(2) contains an alternative method by which to satisfy the debtor's-consent condition in subsection (b)(1). It follows the proposal-and-objection model found in former Section 9-505: The debtor consents if the secured party sends a proposal to the debtor and does not receive an objection within 21 days. Subsection

(d)(1) provides that silence is not deemed to be consent with respect to acceptances in partial satisfaction. Thus, a secured party that wishes to conduct a “partial strict foreclosure” must obtain the debtor's written agreement. In all other respects, the conditions necessary to an effective partial strict foreclosure are the same as those governing acceptance of collateral in full satisfaction.

The time when a debtor consents to a strict foreclosure is significant in several circumstances under this section. See Section 9-505(b)(1), (b)(3), (c)(1), (d)(2), and (e)(1), (2), and (3). For purposes of determining the time of consent under this section, a debtor's conditional consent constitutes consent.

Subsection (b)(2) contains the second condition to the effectiveness of an acceptance under this section – the absence of an objection from a person holding a junior interest in the collateral or from an obligor having a right of recourse against the debtor. Any junior party secured party or lien holder – is entitled to lodge an objection to a proposal, even if that person was not entitled to notification under subsection (f). Subsection (e), discussed below, indicates when an objection is timely.

4. When Acceptance Occurs. This section does not impose any formalities or identify any steps that a secured party must take in order to accept collateral once the conditions of subsection (b) have been met. Absent facts or circumstances indicating a contrary intention, the fact that the conditions have been met provides a sufficient indication that the secured party has accepted the collateral on the terms to which the debtor has agreed or failed to object. Acceptance of the collateral normally is automatic upon the secured party's becoming bound and the time for objection passing. As a matter of good business practice, an enforcing secured party may wish to memorialize its acceptance, such as by notifying the debtor that the strict foreclosure is effective or by placing a written record to that effect in its files. The secured party's agreement to accept collateral is self-executing and cannot be breached. The secured party is bound by its agreement to accept collateral and by any proposal to which the debtor consents.

5. No Possession Requirement. This section eliminates the former requirement that the secured party be “in possession” of collateral.

6. No Constructive Strict Foreclosure. Under subsection (c), a delay in collection or disposition of collateral does not constitute a “constructive” strict foreclosure. Instead, a delay that is unreasonable may be a factor relating to whether the secured party acted in a commercially reasonable manner for purposes of Section 9-502 or 9-504. A debtor's voluntary surrender of collateral to a secured party and the secured party's acceptance of possession of the collateral raises no implication whatsoever that the secured party intends or is proposing to accept the collateral in satisfaction of the secured obligation under this section.

7. When Objection Timely. Subsection (e) explains when an objection is timely and thus prevents an acceptance of collateral from taking effect. An objection by a person to which notification was sent under subsection (f) or (g) is effective if it is received by the secured party within 20 days from the date the notification was sent to that person. Other objecting parties (i.e., third parties that are not entitled to notification) may object at any time within 20 days after the last

notification is sent under subsection (f) or (g). If no such notification is sent, third parties must object before the debtor agrees to the acceptance in writing or is deemed to have consented by silence. The former may occur any time after default, and the latter requires a 20-day waiting period.

8. **Notification.** Subsection (f) specifies three classes of competing claimants to which the secured party must send notification of its proposal: (i) those that notify the secured party that they claim an interest in the collateral, (ii) holders of certain security interests and liens which have filed against the debtor, and (iii) holders of certain security interests and liens which have perfected by compliance with a certificate of title statute. Subsection (f) also requires notification to any secondary obligor if the proposal is one for partial satisfaction.

9. **Effect of Acceptance.** Subsection (h) specifies the effect of an acceptance of collateral in full or partial satisfaction of the secured obligation. Paragraph (1) expresses the fundamental consequence of accepting collateral in full or partial satisfaction of the secured obligation – the obligation is discharged. Paragraphs (2) through (4) indicate the effects of an acceptance on various property rights and interests. Paragraph (2) follows Section 9-504(n) in providing that the secured party acquires “all of a debtor's rights in the collateral. Under paragraph (3), the effect of strict foreclosure on holders of junior security interests and liens is the same regardless of whether the collateral is accepted in full or partial satisfaction of the secured obligation: all junior encumbrances are discharged. Subsection (i) makes clear that this is the effect regardless of whether a notification was required or, if required, sent. Paragraph (4) provides for the termination of other subordinate interests. Given the breadth of the definition of the term debtor, however, paragraph (2) may render paragraph (4) superfluous.

10. **Applicability of Other Law.** This section does not purport to regulate all aspects of the transaction by which a secured party may become the owner of collateral previously owned by the debtor. For example, a secured party's acceptance of a motor vehicle in satisfaction of secured obligations may require compliance with the applicable motor vehicle certificate of title law. State legislatures should conform those laws so that they mesh well with this section and Section 9-504 and courts should construe those laws and this section harmoniously. A secured party's acceptance of collateral in the possession of the debtor also may implicate statutes dealing with a seller's retention of possession of goods sold. See, e.g., Cal. Civ. Code § 3440.1 - .9.

11. **Accounts, Chattel Paper, and General Intangibles.** If the collateral is accounts, chattel paper, or general intangibles, then a secured party's acceptance of the collateral in satisfaction of secured obligations would constitute a sale to the secured party. That sale would give rise to a new security interest (the ownership interest) under Sections 1-201(37) and 9-102. The new security interest would remain perfected by a filing that was effective to perfect the secured party's original security interest. However, the procedures for acceptance of collateral under this section satisfy all necessary formalities and that a new security agreement signed by the debtor would not be necessary.

**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 an 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 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 a 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 of payment under subsection (b) restores to the debtor and a consumer obligor who is 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' Comments

1. **Redemption.** Subsection (a) follows former Section 9-506 but extends the right of redemption to holders of nonconsensual liens. Most of the other changes are not substantive.

Section 9-207 generally permits a secured party to create a security interest in the collateral. As explained in the Comments to that section, the debtor's right (as opposed to its practical ability) to redeem collateral is not affected by and does not affect the priority of a security interest created by the debtor's secured party.

2. **Reinstatement.** Subsection (b) is new and applies only to

consumer secured transactions. For its status, see Reporters' Prefatory Comment 3.g.

3. **Waiver.** Subsection (f) sets forth separately the rules governing waiver for both redemption and reinstatement.

SECTION 9-507. SECURED PARTY'S FAILURE TO COMPLY WITH THIS PART.

(a) If it is established that a secured party is not proceeding in accordance with this part, a court may order or restrain collection, enforcement, or disposition of collateral 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), 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 on the collateral has a right to recover damages for its loss under this subsection. A debtor whose deficiency is eliminated under subsection (c)(2) may recover damages for the loss of any surplus, but a debtor or consumer obligor whose deficiency is eliminated or reduced under subsection (c)(2) 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, 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, an obligor's liability for a deficiency is limited to an 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.

Reporters' Comments

1. **Injunctions.** Subsection (a) is the first sentence of former subsection (1), with the addition of the references to “collection” and “enforcement.”

2. **Damages.** Subsection (b) derives from the second sentence of former subsection (1) and sets forth the basic remedy for failure to comply with Part 5: a damage recovery in the amount of loss caused by the noncompliance. This article affords a remedy to any aggrieved person that is a secondary obligor or that holds a competing security interest or lien, regardless of whether the aggrieved person is entitled to notification under Part 5. The remedy would be available even to holders of senior security interests and liens. The exercise of this remedy is subject to the normal rules of pleading and proof. A person that has delegated the duties of a secured party but that remains obligated to perform them is liable under this subsection. The last sentence of subsection (b) eliminates the possibility of double recovery or other over-compensation arising out of noncompliance with Section 9-502, 9-504, or 9-505. Assuming no double recovery, a debtor whose deficiency is reduced or eliminated under subsection (c) can pursue a claim for a surplus.

3. **Rebuttable Presumption Rule.** The basic remedy under subsection (b) is subject to the special rules contained in subsection (c). This subsection addresses situations in which the amount of a deficiency or surplus is in issue, i.e., situations in which the secured party has collected, enforced, disposed of, or accepted the collateral. Subsection (c) contains special rules applicable to a determination of the amount of a deficiency or surplus. Under subsection (c)(1), the secured party need not prove compliance with Section 9-502, 9-504, or 9-505 as part of its prima facie case. If, however, the debtor raises the issue (in accordance with the forum's rules of pleading and practice), then the secured party bears the burden of proving that the collection, enforcement, or disposition complied. In the event the secured party is unable to meet this burden, then subsection (c)(2) explains how to calculate the deficiency. For most cases, a rule popularly known as the “rebuttable presumption rule” applies. Under this rule, the debtor or obligor is to be credited with the greater of the actual proceeds of the disposition and the proceeds that would have been realized had the secured party complied with Section 9-502, 9-504, or 9-505. If a deficiency remains, then the secured party is entitled to recover it. See subsection (c)(2)(ii). The references to “the secured obligation, expenses, and attorney's fees” in subsection (c) embrace the application rules in Sections 9-502(e)(1)(i) and (ii) and 9-504(b)(1) and (2).

The second sentence of subsection (c)(2)(ii) provides that, unless the secured party proves that compliance with Part 5 would have yielded a smaller amount, the amount that a complying collection, enforcement, or disposition would have yielded is deemed to be equal to the amount of the secured obligation, together with expenses and attorneys' fees. Thus, the secured party may not recover any deficiency unless it meets this burden of proof.

Subsection (c)(2)(i) provides an “absolute bar” rule for consumer secured transactions. For its status, see Reporters’ Prefatory Comment 3.g.

4. Scope of Subsection (c). The rules in subsection (c) apply only to noncompliance under Section 9-502, 9-504, or 9-505. For other types of noncompliance with Part 5 the general rule for the recovery of actual damages under subsection (b) applies. Consider, for example, a repossession that does not comply with Section 9-503 for want of a default. The debtor's remedy is under subsection (b). In a proper case the secured party also may be liable for conversion under non-UCC law. If the secured party thereafter disposed of the collateral, however, it would violate Section 9-504 at that time and subsection (c) would apply.

5. Delay in Applying Subsection (c). There is an inevitable delay between the time a secured party engages in noncomplying collections or dispositions and the time of a subsequent judicial determination that the secured party did not comply with Part 5. During the interim, the secured party, believing that the secured debt is larger than it ultimately is determined to be, may continue to make collections on and dispositions of collateral. If the secured indebtedness is discharged thereafter by the operation of the rebuttable presumption rule, a reasonable application of Section 9-507 would impose liability on the secured party for the amount of the excess, unwarranted recoveries.

6. Relationship of Price to Commercial Reasonableness. Subsections (d), (e), and (f) contain rules addressing whether a disposition was commercially reasonable. They are borrowed from former Section 9-507(2), with some slight modifications.

Some observers have found the notion contained in subsection (d) (the fact that a better price could have been obtained does not establish lack of commercial reasonableness) to be inconsistent with that found in Section 9-504(d) (every aspect of the sale, including its terms, must be commercially reasonable). The Drafting Committee perceives no inconsistency, but it favors an explanation of the relationship between price and commercial reasonableness in the Official Comments. In most cases there is a range of commercially reasonable prices that collateral will fetch. Disposing of collateral for a price within that range may be commercially reasonable even though the particular price is not the best price. The draft does not define fully the relationship between the two sections. In particular, it leaves open the question of how courts are to evaluate a disposition that is procedurally commercially reasonable (e.g., advertising, preparation of collateral, etc.) but which yields an extremely low price.

One approach would begin from the premise that the price is one of the “terms” that, under Section 9-504(d), must be commercially reasonable. Under that approach, the trier of fact could predicate a finding that a procedurally sound disposition was noncomplying solely on the basis of a low price. Others assert that a low price is relevant to whether a disposition has been commercially reasonable only to the extent that a low price suggests the need for careful judicial scrutiny of other aspects of the disposition. Under the latter approach, commercial reasonableness is exclusively a question of process. Those who advocate the latter approach would acknowledge that where the price is extremely low, other aspects

of the disposition (e.g., the time and manner) might well have been commercially unreasonable. But if they were not, then those who take the latter approach would not find fault with the disposition.

A third approach would recognize that a secured party may credit the obligor with an amount that is greater than the actual net proceeds that otherwise would be used to calculate a deficiency. A secured party might wish to do so, for example, if a procedurally commercially reasonable disposition yields a nominal price. Recognition of this alternative method of calculating a deficiency could be added to the statute or explained in the Official Comments.

The Drafting Committee has not determined which approach to take.

7. **“Recognized Market.”** The concept of a “recognized market” in subsection (e)(1) and (2) is quite limited; it applies only to markets where there are standardized price quotations for property that is essentially fungible, such as stock exchanges.

8. **Waiver.** A waiver of rights or duties by a debtor, secured party, or other lien holder carries with it, by implication, a waiver of any right to a remedy or recovery under that section arising out of noncompliance with the right or duty that has been waived.

9. **Exculpatory Provisions.** Subsections (i), (j), and (k) are exculpatory provisions that should be read in conjunction with Section 9-501(i). Without this group of provisions, a secured party could incur liability to unknown persons and under circumstances that would not allow the secured party to protect itself. The broadened definition of the term “debtor” underscores the need for these provisions.

APPENDIX

SECTION 1-201. GENERAL DEFINITIONS. 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 sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller’s own usual or customary practices. A person that sells 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.

* * *

Reporters' Comments

1. **“Buyer in Ordinary Course of Business.”** Many of the revisions to the definition of “buyer in ordinary course of business” in subsection (9) are for clarification and style. The second sentence of the subsection is new. It provides that the “ordinary course” requirement is met only if the sale is in the ordinary course of the seller's business. The third sentence, which tracks Section 6-102(1)(m), explains when a sale is in the ordinary course of the seller's business.

The penultimate sentence of subsection (9) also is new. It prevents a buyer that does not have the right to possession against the seller from taking free of the rights of third parties. The Article 2 sections referred to would be Sections 2-707 (specific performance) and 2-724 (prepaying buyer) of the March 1, 1996, Article 2 draft.

2. **“Security Interest.”** The definition of “security interest” in subsection (37) has been revised to turn the interests of all “consignors” (as defined in draft Section [2-102]) into “security interests.” See generally the Comments to Section 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' Comment

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 Section [2-406(a)]. This conforms with the approach of the Article 2 draft. The definition excludes, in clauses (i), (ii), and (iii), transactions for which filing would be inappropriate or of insufficient benefit to justify the costs. 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.

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) Goods held on approval are not subject to claims of a buyer’s creditors until acceptance.

(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' Comment [2-406]

The revisions to this section accommodate the inclusion of the rules for consignments (including sale or return transactions) in Article 9.

Reporters' Comment [2-408]

The material from this section has been moved elsewhere. See Sections [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' Comments

1. This section is new. It gives 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 Section 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 Section 9-305. Unlike Section 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 Sections 2-506 and 4-210. We have solicited further input on this point from specialists in the transactions that this section addresses.