

D R A F T
FOR DISCUSSION ONLY

**REVISION OF UNIFORM COMMERCIAL CODE
ARTICLE 9 – SECURED TRANSACTIONS;
SALES OF ACCOUNTS AND CHATTEL PAPER**

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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**REVISION OF UNIFORM COMMERCIAL CODE
ARTICLE 9 – SECURED TRANSACTIONS;
SALES OF ACCOUNTS AND CHATTEL PAPER**

WITH PREFATORY NOTE AND COMMENTS

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**DRAFTING COMMITTEE TO REVISE
UNIFORM COMMERCIAL CODE ARTICLE 9 –
SECURED TRANSACTIONS; SALES OF ACCOUNTS AND CHATTEL PAPER**

WILLIAM M. BURKE, 20th Floor, Standard Chartered Bank Building, 4 Des Voeux Road, Hong Kong, *Chair*
MARION W. BENFIELD, JR., Wake Forest University, School of Law, P.O. Box 7206, Winston-Salem, NC 27109
DALE G. HIGER, Suite 1015, One Capital Center, 999 Main Street, Boise, ID 83702
WILLIAM C. HILLMAN, U.S. Bankruptcy Court, Room 1101, 10 Causeway Street, Boston, MA 02222
MICHAEL HOUGHTON, P.O. Box 1347, 18th Floor, 1201 N. Market Street, Wilmington, DE 19899
RANDAL C. PICKER, University of Chicago Law School, 1111 E. 60th Street, Chicago, IL 60637
DONALD J. RAPSON, Room 3338, 650 CIT Drive, Livingston, NJ 07039, *The American Law Institute Representative*
HARRY C. SIGMAN, P.O. Box 67E08, Los Angeles, CA 90067, *The American Law Institute Representative*
BRADLEY Y. SMITH, 20th Floor, 450 Lexington Avenue, New York, NY 10017, *The American Law Institute Representative*
EDWIN E. SMITH, 21st Floor, 150 Federal Street, Boston, MA 02110
SANDRA S. STERN, 509 Madison Avenue, Suite 2004, New York, NY 10022
STEVEN L. HARRIS, Chicago-Kent College of Law, 565 W. Adams Street, Chicago, IL 60661-3691, *Co-Reporter*
CHARLES W. MOONEY, JR., University of Pennsylvania, School of Law, 3400 Chestnut Street, Philadelphia, PA 19104, *Co-Reporter*

EX OFFICIO

BION M. GREGORY, Office of Legislative Counsel, State Capitol, Suite 3021, Sacramento, CA 95814-4996, *President*
HENRY M. KITTLESON, P.O. Box 32092, 92 Lake Wire Drive, Lakeland, FL 33802, *Chair, Division E, National Conference*

EXECUTIVE DIRECTOR

FRED H. MILLER, University of Oklahoma, College of Law, 300 Timberdell Road, Norman, OK 73019, *Executive Director*
WILLIAM J. PIERCE, 1505 Roxbury Road, Ann Arbor, MI 48104, *Executive Director Emeritus*

Copies of this Act may be obtained from:

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS
676 North St. Clair Street, Suite 1700
Chicago, Illinois 60611
312/915-0195

**REVISION OF UNIFORM COMMERCIAL CODE
ARTICLE 9 – SECURED TRANSACTIONS;
SALES OF ACCOUNTS AND CHATTEL PAPER**

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REVISION OF UNIFORM COMMERCIAL CODE

ARTICLE 9 – SECURED TRANSACTIONS; SALES OF ACCOUNTS AND CHATTEL PAPER

REPORTERS' 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 ("NCCUSL"), 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 NCCUSL acted favorably upon the Report's principal recommendation. The Drafting Committee was organized in 1993.

2. Status and Schedule

The Drafting Committee has met eleven times (November, 1993; March, 1994; September-October, 1994; December, 1994; March, 1995; June, 1995; December, 1995; March, 1996; June, 1996; November, 1996; March, 1997). Meetings of the ALI Members Consultative Group on Article 9 were held on December 16-17, 1994, November 17, 1995, and October 31, 1996. NCCUSL considered the 1995 Annual Meeting Draft of revised Article 9 at its Annual Meeting in August, 1995, and the 1996 Annual Meeting Draft of revised Article 9 at its Annual Meeting in July, 1996. The ALI Council reviewed Council Draft No. 1 (November 15, 1995) at its meeting on December 8, 1995, and reviewed Council Draft No. 2 (November 15, 1996) at its meeting on December 13, 1996. The Chair of the Drafting Committee and the Reporters made informational reports to the membership of the ALI during its Annual Meetings in May, 1995, and May, 1996. Future meetings of the Drafting Committee are scheduled for November, 1997, and February, 1998. We expect the Article 9 revisions to be substantially completed in 1997 and presented to the sponsors for approval in 1998.

3. Reorganization and Renumbering

The 1996 NCCUSL Annual Meeting Draft was the last draft to follow the organization and numbering of current Article 9. The drafts subsequent to the 1996 NCCUSL Annual Meeting, including this one, reflect a material

reorganization and renumbering. The restructuring was necessitated in part by the NCCUSL Style Committee's conclusion that the earlier drafts contained sections that were too long and included too many diverse provisions. (For example, Sections 9-312 and 9-402 of the 1996 Annual Meeting Draft each contained 17 subsections and Section 9-504 contained 19 subsections.) Accordingly, the number of sections has increased substantially, requiring most sections to be renumbered. Since the reorganization and renumbering first occurred, it became necessary to add a few sections. In order to limit the number of substantial renumberings, the additional sections were designated with an uppercase A (e.g., Section 9-308A). This usage is temporary and will not appear in the draft presented for the second reading.

The reorganization achieves more than a reduction of the length and scope of sections. It also arranges the substantive provisions in a more coherent structure and order. New Subpart 1 of Part 1 contains the required "short title." New Subpart 2 includes the definitions. Subpart 3 then addresses issues of scope and applicability. Part 2 is divided into Subpart 1, provisions relating to the validity and attachment of security interests, and Subpart 2, provisions that address various rights and duties of the parties. Part 3 of this draft, like Part 3 of earlier drafts and of current Article 9, deals with perfection and priority. Subpart 2 deals with perfection; Subpart 3, priority. Subpart 4 covers certain rights of depositary institutions with respect to deposit accounts. These subparts are preceded by Subpart 1, which contains the choice-of-law rules applicable to those topics (formerly found in Section 9-103). A new Part 4 covers other third-party issues. Part 4 of the 1996 Annual Meeting draft, dealing with filing, is Part 5 of this draft, and consists of two subparts. Subpart 1 covers the filing rules, and Subpart 2 deals with the duties and operation of the filing office. Finally, the former Part 5, dealing with default, is Part 6 of this draft. It also is divided into two subparts. Subpart 1 addresses default and enforcement generally, and Subpart 2 covers noncompliance with the provisions of Article 9.

The coherent structure of this draft will make it easier for both practitioners and judges to find and understand the rules. Of course, transition costs will accompany the benefits of the changes. But, judging from the consistently favorable responses we have received to the restructuring of Article 9, the benefits will vastly outweigh the costs.

4. Summary of Revisions

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

a. Scope of Article 9.

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

Deposit accounts. The draft includes within Article 9's scope deposit accounts as original collateral, except in consumer secured transactions. Current Article 9 deals with deposit accounts only as proceeds of other collateral.

Payment intangibles. 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.

Commercial tort claims. The draft expands the scope of Article 9 to include commercial tort claims. However, the draft continues to exclude tort claims for bodily injury or other non-business tort claims of a natural person, as well as tort claims that are not generally assignable under other law. A security agreement must describe commercial tort claims with specificity. An after-acquired property clause does not reach after-acquired commercial tort claims.

Transfers by governmental entities. The draft narrows the exclusion of transfers by governmental entities. It excludes only transfers covered by another statute (other than a statute generally applicable to security interests), to the extent the statute governs the creation, perfection, priority, or enforcement of security interests.

Nonpossessory statutory agricultural liens. 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 Subcommittee on Agricultural and Agri-Business Financing, Committee on Commercial Financial Services, Section of Business Law, American Bar Association (“Agricultural Financing Task Force”).

Other nonpossessory statutory liens. The draft also includes in Article 9’s scope other, non-agricultural statutory liens, but in a more limited fashion than for agricultural liens. These other statutory liens are subject to Article 9’s perfection (filing) rules, but the priority rules address only the relative priorities between a statutory lien and a security interest. Other priority contests are left to other law.

Consignments. 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 and are governed by the priority rules in Section 9-114.

Support obligations. 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.

Nonassignable general intangibles. 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 third parties against any adverse effect of the creation or attempted enforcement of the security interest.

b. Choice of Law.

Where to file: Location of debtor. The draft changes the choice-of-law rule governing perfection (i.e., where to file) 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.

Determining debtor's location. As a general matter, the draft follows current law, under which the location of the debtor is the debtor's place of business (or chief executive office, if the debtor has more than one place of business). There are three exceptions. First, a "registered entity, such as a corporation or limited liability company, is located in the jurisdiction under whose law the debtor is organized, e.g., a corporate debtor's State of incorporation. Second, an individual debtor (i.e., human being) is located at his or her principal residence. Third, the United States and its governmental entities are located in the District of Columbia.

Location of non-U.S. debtors. If, using the foregoing rules, a debtor is located in a jurisdiction whose laws do not require public notice as a condition of perfection of a security interest, the entity is deemed located in the District of Columbia. Thus, to the extent that revised Article 9 applies to non-U.S. debtors, perfection could be accomplished in many cases by a domestic filing.

Priority. For tangible collateral such as goods and instruments, the law applicable to priority and the effect of perfection or nonperfection remains the law of the jurisdiction where the collateral is located, as under current law. For intangible collateral, such as accounts, the applicable law will be that of the jurisdiction in which the debtor is located.

Goods covered by certificates of title; deposit accounts. The draft 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. Duties of Secured Party.

The draft provides for expanded duties of secured parties.

Release of control. The draft imposes upon a secured party with control over a deposit account, investment property, or a letter of credit the duty to release control when there is no secured obligation and no commitment to give value.

Release of account debtors. Under the draft, a secured party that has notified account debtors to make payments to it must release the account debtors from that obligation when there is no secured obligation and no commitment to give value.

Information. The draft expands a secured party's duties to provide the debtor with information concerning the collateral and the obligations it secures.

d. Perfection.

Deposit accounts and letters of credit: Control. 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.

Instruments, statutory liens, and commercial tort claims: Filing. The draft expands the types of collateral in which a security interest may be perfected by filing to include instruments. Agricultural liens, other statutory liens, and security interests in commercial tort claims also are perfected by filing, under the draft.

Sales of payment intangibles: Automatic perfection. Current Article 9 covers the outright sale of accounts and chattel paper. The Drafting Committee recognizes that sales of most other types of receivables likewise are financing transactions to which Article 9 should apply. Accordingly, the draft expands the definition of "account" to include many types of receivables that Article 9 currently classifies as "general intangibles." It thereby subjects to Article 9's filing system sales of more types of receivables than does current law. Certain sales of payment intangibles—primarily bank loan participation transactions—should not be subject to the Article 9 filing rules. These transactions fall in a residual category of collateral, "payment intangibles (general intangibles under which the account debtor's principal obligation is the payment of money), the sale of which is exempt from the filing requirements of Article 9.

Possessory security interests. 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, the draft resolves a number of uncertainties under current law. It 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 agrees otherwise. 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.

Automatic perfection. The draft lists in a separate section the types of security interests as to which no public-notice step is required for perfection (e.g., purchase money security interests in consumer goods other than automobiles). The draft also 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, and that a perfected security interest in an obligation secured by a real property mortgage also is a perfected security interest in the mortgage.

e. Priority.

The draft includes several new priority rules.

Deposit accounts. 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 depositary institution's security interest and one held by another secured party, the depositary institution's security interest is senior. A corresponding rule makes a depositary institution's right of setoff generally senior to a security interest held by another secured party.

Letters of credit. 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 Drafting Committee has asked the Reporters to reconsider whether the control priority may intrude unnecessarily on the priority of a financier of an underlying receivable supported by a letter of credit. The Drafting Committee plans to revisit this issue.

Purchase money 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. The draft treats consignments as if they were purchase money security interests in inventory.

Purchase money security interests in livestock; production money security interests. The draft follows the Agricultural Financing Task Force's recommendation to provide a special PMSI priority for livestock. The draft also follows the Task Force's recommendations on special priority rules for agricultural liens. It also includes, in brackets, a new priority rule for "production money security interests" for secured parties that give new value used in the production of crops. No consensus has emerged on this issue within the Task Force, the Drafting Committee, or the agricultural financing community. For this reason, the Drafting Committee is inclined to include this priority rule, with certain refinements, as an optional provision that each State could consider during the legislative enactment process. Under this approach, the UCC sponsors would make no recommendation one way or the other.

Chattel paper and instruments. The draft continues to afford priority to certain purchasers of chattel paper or instruments who take possession of the collateral. For chattel paper, it maintains the distinction between priority over a

security interest in chattel paper claimed merely as proceeds of a competing security interest and priority over a security interest in chattel paper claimed other than merely as proceeds. With respect to the former, a purchaser of chattel paper that takes possession in the ordinary course of its business takes priority over a competing security interest unless the chattel paper indicates that it has been assigned to an identified secured party. With respect to the latter, a purchaser of chattel paper that takes possession in the ordinary course of its business takes priority over a competing security interest 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. The Drafting Committee agrees that Article 9 should continue to afford priority to purchasers of instruments who take possession; however, it has not reached agreement as to the substance of the rule.

Miscellaneous. The draft also includes (i) revised priority rules for security interests in goods covered by a certificate of title, (ii) clarifications of selected good-faith-purchase issues, (iii) a special priority rule under which a senior security interest in receivables takes priority in a check constituting proceeds of the receivables even if the junior secured party is a holder in due course of the check, (iv) 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, (v) a provision enabling most transferees of money to take free of a security interest, (vi) 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, (vii) 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, and (viii) substantially rewritten and refined priority rules dealing with accessions and commingled goods.

f. 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 nonconformity of, defects in, or damage to collateral. The term also includes collections on account of “support obligations,” such as guarantees.

g. Filing.

Part 5 (formerly 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.

Medium-neutrality. 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.

Financing statement formal requisites. The draft provides that a super-generic description (e.g., “all assets” or “all personal property”) in a financing

statement is a sufficient indication of the collateral. (Note, however, that the draft retains the requirement that a security agreement contain a description of collateral that reasonably identifies it.) It also contains provisions clarifying when a debtor's name is correct and when an incorrect name is insufficient. To facilitate electronic filing, the draft does not require that the debtor's signature appear on a financing statement. Instead, it prohibits the filing of unauthorized financing statements and imposes liability upon those who violate the prohibition.

“Open drawer. The draft incorporates what has come to be known as the “open drawer” approach. This convention encompasses several aspects of filing office operations. First, the filing office may not reject a financing statement or other record for a reason other than one of the few set forth in the draft. Second, the filing office is obliged to link all subsequent records (e.g., amendments adding collateral, assignments, etc.) to the initial financing statement to which they relate. Third, the filing office may delete a financing statement and related records from the files only upon lapse (i.e., five years after the filing date), and then only if a continuation statement has not been filed. Thus, a financing statement and related records would be discovered by a search of the files even after the filing of a termination statement. This approach helps eliminate filing office discretion and also eases problems associated with multiple secured parties and multiple partial assignments.

Correction of Records: Missing secured parties and fraudulent filings. In some areas of the country, serious problems have arisen from fraudulent financing statements that are filed against public officials and other prominent persons. To deter fraudulent filings of all kinds, the draft adds a requirement that the filing office communicate to each debtor and secured party of record on a financing statement the information contained in the financing statement and in each related record. The draft 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. In addition, the draft permits the debtor to file a request for termination of a financing statement. If a secured party fails to object to a debtor's filed request within a specified period following the filing office's communication of the request to the secured party, the financing statement will terminate. Although this last provision remains controversial within and outside the Drafting Committee, it represents the Drafting Committee's attempt to address both the problem of fraudulent filings and the problem of secured parties that simply disappear through mergers or liquidations.

Filing office operations. The draft mandates performance standards for filing offices and requires filing offices to sell filing data to the public. It provides as well for the promulgation of administrative rules to deal with details best left out of the statute.

h. Default and Enforcement.

Part 6 (formerly Part 5) of Article 9 has been extensively revised. Some of the draft provisions described below are affected by or subject to special draft consumer-protection provisions discussed in the next section.

Debtor, secondary obligor; waiver. The draft clarifies the identity of persons who have rights and persons to whom a secured party owes duties under Part 6. 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, whether primary or secondary, 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.

Rights of collection and enforcement of collateral. 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. It also sets forth the enforcement rights of a depository institution holding a security interest in a deposit account maintained with the institution.

Disposition of collateral: Warranties of title. 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.

Disposition of collateral: Notification and effects. 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 also clarifies the effects of a disposition by a secured party, including the rights of transferees of the collateral.

Transfer of record or legal title. 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 6. This rule applies regardless of the circumstances under which the transfer of title occurs.

Strict foreclosure. The draft permits a secured party to accept 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 an acceptance of collateral on the rights of junior claimants. The draft rejects the approach taken by some courts—deeming a secured party to have constructively retained collateral in satisfaction of the secured obligations—in the case of a secured party’s unreasonable delay in the disposition of collateral. Instead, unreasonable delay is relevant when determining whether a disposition is commercially reasonable.

Effect of noncompliance: “Rebuttable presumption” test. The draft adopts the “rebuttable presumption” test for the failure of a secured party to

proceed in accordance with certain provisions of Part 6. 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 6, e.g., in a commercially reasonable manner. The draft rejects the “absolute bar” test that some courts have imposed; that approach bars a noncomplying secured party from recovering any deficiency, regardless of the loss (if any) the debtor suffered as a consequence of the noncompliance.

“Low-price dispositions: Calculation of deficiency and surplus. The draft provides a special method for calculating a deficiency if the proceeds of a disposition of collateral to a secured party, an affiliate of the secured party, or a secondary obligor are “unreasonably low. Instead of calculating a deficiency (or surplus) based on the actual net proceeds, the deficiency (or surplus) is calculated based on the proceeds that would have been received in a disposition to an unrelated person.

i. Consumer Transactions.

The draft includes several new and revised provisions applicable only to consumer transactions. Many, but not all, of these provisions deal with the enforcement of a security interest. In formulating these provisions, the Drafting Committee and the Reporters relied to a considerable extent on the work of a Subcommittee on Consumer Transactions. This subcommittee, which was established in 1995, made recommendations that the Drafting Committee considered at its June, 1996, November, 1996, and March, 1997, meetings. A summary of the principal provisions follows. Many of these provisions remain highly controversial.

Definition of “consumer secured transaction” and “consumer goods secured transaction. Nearly all the consumer-protection rules apply to “consumer goods secured transactions. These are transactions in which individual incurs an obligation primarily for personal, family, or household purposes and a security interest in consumer goods secures the obligation. A few provisions apply more broadly to “consumer secured transactions. These are transactions in which an individual incurs an obligation primarily for personal, family, or household purposes and the obligation is secured by collateral held or acquired primarily for personal, family, or household purposes.

Description of investment property. The draft provides that, in consumer secured transactions, a security agreement must describe a security entitlement, securities account, or commodity account with specificity. A description by type alone (e.g., “all my security entitlements”) is not sufficient. If a specific securities account is described, after-acquired securities entitlements with respect to the account are covered.

Allocations of payments for determination of purchase money status. The draft contains alternative allocation rules for purposes of determining the portion of purchase money and non-purchase money obligations included in consolidated obligations. If a State has a non-Article 9 allocation formula, that formula

applies. If a State lacks an otherwise applicable allocation formula, payments are applied to the obligations in the order in which they were incurred.

Notification of disposition of collateral. The draft contains a safe-harbor form of notification, in “plain English, for consumer goods secured transactions.

Notification of calculation of deficiency. The draft requires a secured party to provide a debtor with a notification of how it calculated a deficiency at or before the time it first undertakes to collect the deficiency in a consumer goods secured transaction.

Acceptance of collateral in satisfaction of obligation; “strict foreclosure. Strict foreclosure in a consumer goods secured transaction is conditioned on the debtor’s having been dispossessed of the collateral. Partial strict foreclosure is not permitted, however, when a disposition is mandatory (i.e., after the debtor has paid 60 percent or more of the secured debt).

Reinstatement of secured obligation without acceleration. For payment defaults, the draft provides a one-time right of reinstatement of an accelerated obligation if a debtor has paid 60 percent or more of the secured debt and if the debtor cures the default.

Noncompliance: Absolute bar versus rebuttable presumption. The draft provides for application of the absolute bar rule for a secured party’s noncompliance with Part 6 as an alternative to the rebuttable presumption rule. Each State would be expected to select one or the other during the enactment process.

Noncompliance: Minimum damages; good faith error defense; limits on damages in class actions. The draft provides for the imposition of minimum damages in the event of a secured party’s noncompliance with Part 6 in a consumer goods secured transaction. No damages can be recovered in the case of unintentional, good faith errors, such as clerical and calculation errors. The draft limits the statutory minimum damages in a class action to the lesser of \$500,000 or one percent of the secured party’s net worth.

j. Good Faith.

The draft contains a new definition of “good faith” that 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.

5. Style and Citation Conventions

a. Unresolved Substantive Issues.

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 necessarily indicate that the provisions are optional or that the States are to choose one of the alternatives. Brackets that do indicate optional or alternative text are noted in the draft or the Reporters' Comments.

b. Minor Style Changes.

A few sections have been changed to reflect NCCUSL's currently applicable style requirements, but have not been changed substantively. These sections contain the following notation in their captions: [MINOR STYLE CHANGES ONLY].

c. Unresolved Style Issues.

The Drafting Committee thinks that certain style conventions may not be well suited for an Act of the length and complexity of revised Article 9. In particular, a few contemporary style conventions conflict with certain features of current Article 9 which have proven their utility over the past decades. For example, current Article 9 contains several sections of definitions, each of which contains related terms. See, e.g., Section 9-109 (definitions of the four types of goods). This approach enables a user whose collateral is, say, goods an easy way to find all the classification possibilities for the collateral and to choose among them. The Drafting Committee prefers this approach, which several recently promulgated articles of the Uniform Commercial Code adopt, to one in which the types of goods are scattered among more than 60 definitions in a single section.

The draft retains this and other style conventions pending resolution of these issues. In some cases, the draft uses brackets to indicate disagreement over style issues and notes the disagreement in the Reporters' Comments.

d. Reference to Current Law.

The Reporters' Comments refer to current Article 9 as "former Article 9."

6. 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 include additional provisions designed to protect consumers? Are the new provisions included in the draft appropriate?

b. Should the revised Article 9 change the choice-of-law rule for perfection to the location of the debtor? If so, should the location of the debtor be changed to the jurisdiction where an individual debtor resides and where certain other debtors are organized? Is the draft's distinction between law governing perfection and law governing priority appropriate?

- c. 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?
- d. 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?
- e. Should the revised Article 9 include within its scope security interests in existing, specifically described, commercial tort claims?
- f. Should the revised Article 9 narrow the exclusion of security interests created by governmental debtors?
- g. Should the revised Article 9 include provisions governing the relative priority of security interests and statutory liens? If so, are the draft provisions appropriate?
- h. Should the revised Article 9 include special rules for security interests in instruments secured by real property mortgages?
- i. Should the revised Article 9 adopt the “open drawer” policy, which limits the discretion of filing offices to reject and delete filed records?
- j. Should the revised Article 9 afford a nonjudicial means by which a debtor can cause a disputed financing statement to become ineffective?

7. Source Table

The following table lists the sections of the 1996 NCCUSL Annual Meeting Draft and the corresponding sections and subsections of this draft. Note that the organization of the 1996 Annual Meeting Draft substantially followed that of the Official Text of Article 9.

1996 Annual Meeting Draft	1997 Annual Meeting Draft
§ 9-101. Short Title.	§ 9-101
§ 9-102. Scope of Article.	§ 9-112(a), (b)
§ 9-103. Multiple State Transactions.	
(a)(1)-(3) (non-possessory)	§ 9-301
(a)(4)-(5)	§ 9-307
(a)(6)	§ 9-314(a)
(b)(1)-(2) (possessory)	§ 9-301
(b)(3)-(4) (agricultural lien)	§ 9-302
(b)(5)	§ 9-314(b)
(c)(1)-(4) (cert. of title)	§ 9-303

(c)(5)	§ 9-314(c)
(c)(6)	§ 9-334
(d)(1)-(2) (deposit accounts)	§ 9-304
(d)(3)	§ 9-314(d)
(e) (minerals)	§ 9-306
(f) (investment property)	§ 9-305
§ 9-104. Exclusions.	§ 9-112(c)
§ 9-105. Definitions.	§ 9-102
§ 9-106. Definitions: “Account, etc.	§ 9-103
§ 9-107. Definitions: “PMSI, etc.	§ 9-104
§ 9-107A. Definitions: “PrMSI, etc.	§ 9-105
§ 9-108. Antecedent Debt.	[Deleted]
§ 9-109. Classification of Goods.	§ 9-106
§ 9-110. Sufficiency of Description.	§ 9-111
§ 9-111. Applicability of Article 6.	[Deleted]
§ 9-112. Collateral Owned by Nondebtor.	[Deleted]
§ 9-113. S/I Under Article 2 or 2A.	§ 9-116
§ 9-114. Rights of Consignee and Receivables Seller.	§ 9-315A
§ 9-115. Investment Property.	
(a) (definitions)	§ 9-107
(b) (attachment)	§ 9-203(e)
(b) (perfection)	§ 9-308(e)
(c) (description)	§ 9-111(c)
(d)(1) (perfection by control)	§ 9-312
(d)(2) (perfection by filing)	§ 9-310(a)
(d)(3)-(4) (automatic perfection)	§ 9-308A(6)
(e) (priority)	§ 9-324
(f) (certificate in reg form)	

(attachment)	§ 9-203(a)
(perfection)	§ 9-311(a)
(priority)	§ 9-324
§ 9-116. Security Interest in Financial Asset.	§ 9-206
rules re: automatic perfection	§ 9-308A(5)
§ 9-117. “Control (Deposit Account).	
(a)-(b) (definition)	§ 9-109
(c) (no obligation to disclose)	§ 9-339
(d) (obligation to release)	§ 9-208
(e) (failure to release)	§ 9-624(d)
§ 9-118. “Control (Investment Property).	§ 9-108
§ 9-119. “Control (Letter of Credit).	§ 9-110
§ 9-201. General Validity.	§ 9-201
§ 9-202. Title to Collateral.	§ 9-202
§ 9-203. Attachment.	§ 9-203
(e) (conflict with other statute)	§ 9-115
§ 9-204. After-Acq’d Property; Future Adv.	§ 9-204
§ 9-205. Anti-Benedict v. Ratner.	§ 9-205
§ 9-206. Waiver of Defenses.	§ 9-403
§ 9-207. Collateral in SP’s Possession.	§ 9-207
§ 9-208. Statement of Account.	§ 9-209
(b) (estoppel rule)	§ 9-624(f)
§ 9-209. SP/DI’s Right of Set-Off.	§ 9-337(b)
§ 9-301. Unperfected S/I.	
(a)-(b) (basic priority rules)	§ 9-315

(d) (future advances)	§ 9-320(b)
§ 9-302. Perfection by Filing.	§ 9-309
automatic perfection	§ 9-308A
(c)-(d) (certificates of title; treaties)	§ 9-309A
§ 9-303. When Security Interest Is Perfected.	§ 9-308
§ 9-304. Perfection (Instr., Chattel Paper, etc.)	§ 9-310
§ 9-305. Perfection by Possession.	§ 9-311
§ 9-305A. Perfection by Control.	§ 9-312
§ 9-306. Proceeds.	§ 9-313
§ 9-307. Buyers of Goods.	
(a)-(c) (basic rules)	§ 9-316
(d) (future advances)	§ 9-320(c)
§ 9-308. Purchase of Chattel Paper and Instr.	§ 9-327
§ 9-308A. Transfer of Money and Funds.	§ 9-329
§ 9-309. Purchasers of Instrument, etc.	§ 9-328
§ 9-310. Liens Arising by Law.	§ 9-330
§ 9-311. Alienability of Debtor's Rights.	§ 9-401
§ 9-312. Conflicting Security Interest.	
(a), (m)-(n) (first-to-file rule)	§ 9-319
(b), (f), (l) (PrMSI)	§ 9-321
(k) (ag lien)	§ 9-319(c)
(c)-(e), (g) (PMSI)	§ 9-322
(h) (collateral transferred to 2d debtor)	§ 9-323

(i) (after-acquired property of new debtor)	§ 9-323A
(j) (deposit accounts)	§ 9-325
(o) (future advances)	§ 9-320(a)
(p) (letters of credit)	§ 9-326
§ 9-312A. Set-Off Against Deposit Account.	§ 9-337
§ 9-313. Fixtures.	
(a)-(g) (priority)	§ 9-331
(h) (enforcement)	§ 9-604(c)
§ 9-314. Accessions.	§ 9-332
§ 9-315. Commingled & Processed Goods.	§ 9-333
§ 9-316. Subordination.	§ 9-336
§ 9-317. SP Not Obligated on D's Contract.	§ 9-402
§ 9-318. Rights Acquired by Assignee.	§ 9-404
§ 9-318A. DI's Disposition of Funds.	§ 9-338
§ 9-318B. Restrictions on Assignment.	§ 9-406
§ 9-401. Place of Filing.	§ 9-501
§ 9-402. Financing Statement.	
(a)-(b), (m) (contents)	§ 9-502
(c)-(f) (name of debtor & secured party)	§ 9-503
(g) (indication of collateral)	§ 9-504
(h) (minor errors)	§ 9-506
(i)-(k) (name & other changes)	§ 9-507
(l) (amendment)	§ 9-509
(n)-(o) (authorization)	§ 9-508

(p) (remedy for violation of secured party's duty)	§ 9-624(d)
§ 9-402A. New Debtor.	§ 9-510
§ 9-403. Filing.	
(a)-(b), (e), (g) (effectiveness)	§ 9-515
(c)-(d), (h)-(i) (refusal)	§ 9-521
(f) (incorrect "optional information)	§ 9-335
(j)-(k), (l) (2d & 3d sent.), (m) (duration and lapse)	§ 9-516
(l) (1st sent.) (continuation)	§ 9-517
(l) (last 3 sent.) (lapsed financing)	§ 9-522
(n)-(p) (indexing)	§ 9-520(a)-(c), (e)
(q)-(r) (indexing errors)	§ 9-518
§ 9-404. Termination Statement.	§ 9-511
(c) (remedy for violation)	§ 9-624(d)
§ 9-405. Assignment.	
(a)-(c) (how to)	§ 9-512
(d)-(e) (indexing)	§ 9-520(d), (e)
§ 9-406. Multiple Secured Parties.	§ 9-513
§ 9-406A. Successor of Secured Party.	§ 9-514
§ 9-407. Information From Filing Office.	§ 9-523
§ 9-408. Filing for Leases, etc.	§ 9-505
§ 9-409. Registered Agent.	§ 9-525
§ 9-410. Assignment of Functions.	§ 9-526
§ 9-411. Delay by Filing Office.	§ 9-524
§ 9-412. Fees.	§ 9-527
§ 9-413. Administrative Rules.	§ 9-528

§ 9-414. Duty to Report.	§ 9-529
§ 9-415. Claim re: Inaccurate Record.	§ 9-519
§ 9-501. Secured Party's Rights & Duties; Waiver, etc.	
(a)-(b), (h), (j) (rights & remedies)	§ 9-601
(c), (d) (waiver)	§ 9-602
(e) (standards re: duties)	§ 9-603
(f)-(g) (real estate)	§ 9-604
(i) (unknown debtor or secondary obligor)	§ 9-605
(k) (time of default for ag lien)	§ 9-606
§ 9-502. Collection and Enforcement.	
(a)-(d) (generally)	§ 9-607
(e), (g) (application of proceeds)	§ 9-608
(f) (jr's right to proceeds)	[Deleted]
§ 9-503. Right to Take Possession.	§ 9-609
§ 9-504. Disposition of Collateral.	
(a), (f) (general; commercial reasonableness)	§ 9-610
(b)-(e) (application of proceeds)	§ 9-614
(g)-(h) (whom to notify)	§ 9-611
(i) (waiver)	§ 9-623
(j) (timeliness of notice)	§ 9-612
(k)-(l) (contents of notice)	§ 9-613
(m) (pre-collection accounting)	[Deleted]
(n)-(o) (rights of transferee)	§ 9-615
(p) (rights of guarantor, etc.)	§ 9-616
(q) (title clearing)	§ 9-617

§ 9-504A. Limitation on Deficiency. [Deleted]

§ 9-505. Acceptance of Collateral.

(a)-(e), (k), (l) (general) § 9-618

(f)-(g) (notification) § 9-619

(h)-(i) (effect of acceptance) § 9-620

(j), (m) (waiver) § 9-623

§ 9-506. Redemption; Reinstatement.

(a) (redemption) § 9-621

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**REVISION OF UNIFORM COMMERCIAL CODE
ARTICLE 9 – SECURED TRANSACTIONS;
SALES OF ACCOUNTS AND CHATTEL PAPER**

**PART 1
GENERAL PROVISIONS**

[SUBPART 1. SHORT TITLE]

SECTION 9-101. SHORT TITLE. *[MINOR STYLE CHANGES ONLY]*

This article may be cited as Uniform Commercial Code–Secured Transactions.

[SUBPART 2. DEFINITIONS AND CONCEPTS]

SECTION 9-102. DEFINITIONS AND INDEX OF DEFINITIONS.

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

(1) “Account debtor” means a person obligated on an account, chattel paper, [instrument other than a negotiable instrument,] or general intangible. The term does not include a person obligated to pay a negotiable instrument even if the instrument constitutes part of chattel paper.

(2) “Accounting” means a record authenticated by a secured party indicating the aggregate unpaid secured obligations as of a date not more than [] days earlier than the date of the record reasonably identifies the components of the obligations.

(3) “Agricultural lien” means a statutory lien 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.

(4) “Authenticate” means to sign or to execute or adopt a symbol, including a digital identifier, or encrypt a record in whole or in part with present

intent to adopt, establish the authenticity of, or signify a party's acceptance of a record or term that contains the authentication or to which a record containing the authentication refers.

(5) "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 the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.

(6) "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. If a transaction is evidenced both by a security agreement or lease and by an instrument or series of instruments, the group of writings taken together constitutes chattel paper.

(7) "Collateral" means the property subject to a security interest or statutory lien. The term includes proceeds to which a security interest attaches under Section 9-313, proceeds as to which a statutory lien becomes effective, and accounts, chattel paper, and payment intangibles that have been sold.

(8) "Commercial tort claim" means a claim arising in tort if the claim is generally assignable under applicable law and:

(A) the claimant is an organization; or

(B) the claimant is an individual, the claim does not include damages arising out of [bodily] [personal] injury to or the death of an individual, and the claim arose in the course of the claimant's business or profession.

(9) "Communicate" means to send a written or other tangible record, transmit a record by any means agreed upon by the persons sending and receiving

the record, or, in the case of transmission of a record to or by a filing office, transmit a record by any means prescribed by the rules.

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

(11) “Consumer goods secured transaction” means a transaction in which an individual incurs an obligation primarily for personal, family, or household purposes, and a security interest in consumer goods secures the obligation.

(12) “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.

(13) “Consumer secured transaction” means a transaction in which an individual incurs an obligation primarily for personal, family, or household purposes, a security interest secures the obligation, and the collateral is held or acquired primarily for personal, family, or household purposes.

(14) “Debtor” means:

(A) 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;

(B) a seller of accounts, chattel paper, or payment intangibles; or

(C) a consignee.

(15) “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.

(16) “Depository institution” means an organization that is engaged in the business of banking. The term includes a bank, savings bank, savings and loan association, credit union, and trust company.

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

(18) “Encumbrance” includes a real property mortgage, other lien on real property, and any other right in real property other than an ownership interest.

(19) “Filing office” means an office designated in Section 9-501 as the place to file a financing statement. [The term includes the filing officer and other personnel of the office.]

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

(21) “Fixture filing” means a filing in the office where a mortgage on the real property [is] [would be] filed or recorded of a financing statement covering goods that are or are to become fixtures and which satisfies the requirements of Section 9-502(a).

(22) “Fixtures” means goods that have become so related to particular real property that an interest in them arises under real property law.

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

(24) “Goods” includes all things that are movable when 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, commercial tort claims, and minerals or the like, including oil and gas, before extraction.

(25) “Governmental entity” means:

(A) the United States, a State, a foreign country, or

(B) a governmental subdivision, agency, department, commission, board, authority, instrumentality, public benefit corporation, or other governmental unit of the United States, a State, or a foreign country.

(26) “Instrument” means a negotiable instrument 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 in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include investment property or a writing that evidences a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

(27) “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.

(28) “Manufactured home” means [to come].

(29) “Manufactured home transaction” means a transaction [in which the collateral includes a manufactured home].

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

(31) “New debtor” means a person that becomes bound as debtor under Section 9-203(c) by a security agreement previously entered into by another person.

(32) “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.

(33) “Obligor means a person that owes, has provided property other than the collateral to secure, or is otherwise accountable in whole or in part for, payment or other performance of an obligation secured by a security interest in or a statutory lien on the collateral.

(34) “Original debtor means a person that, as debtor, entered into a security agreement to which a new debtor has become bound under Section 9-203(c).

(35) “Public finance transaction means [to come].

(36) “Pursuant to commitment, with respect to an advance made or other value given by a secured party, means pursuant to the secured party’s obligation, whether or not a subsequent event of default or other event not within the secured party’s control has relieved or may relieve the secured party from its obligation.

(37) “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.

[(38) “Registered agent means a registered agent of a debtor designated under Section 9-525.]

(39) “Registered entity means an organization organized under the law of a State and as to which the State maintains a public record showing the organization to have been organized.

(40) “Rule means a rule adopted pursuant to Section 9-528.

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

(42) “Secured party means a person that holds a security interest or a statutory lien. The term includes a consignor and a person to whom accounts,

chattel paper, or payment intangibles have been sold. If a security interest [or statutory lien] is created in favor of a trustee, indenture trustee, agent, collateral agent, or other representative, the representative is the secured party.

(43) “Secured party of record means a person stated to be the secured party or a representative of the secured party in a financing statement that has been filed in the filing office.

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

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

(46) “State of organization, with respect to a registered entity, means the State under whose law the entity is organized.

(47) “Statutory lien means an interest in personal property which secures payment or performance of an obligation, which is created by statute [in favor of a person that in the ordinary course of its business furnishes goods or services,] and [whose effectiveness] [the effectiveness of which] does not depend on the person’s possession of the personal property. The term does not include a security interest.

(48) “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.

(49) “Transmitting utility means a person primarily engaged in the business of operating a railroad, subway, street railway, or trolley bus; transmitting

electric or electronic communications; transmitting goods by pipeline or sewer; or transmitting or producing and transmitting electricity, steam, gas, or water.

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

“Account	Section 9-103.
“Attach	Section 9-203.
“Becomes Bound	Section 9-203.
“Cash proceeds	Section 9-313.
“Commodity account	Section 9-107.
“Commodity contract	Section 9-107.
“Commodity customer	Section 9-107.
“Commodity intermediary	Section 9-107.
“Construction mortgage	Section 9-331.
“Consumer goods	Section 9-106.
“Control (deposit account)	Section 9-109.
“Control (investment property)	Section 9-108.
“Control (letter of credit)	Section 9-110.
“Crops	Section 9-106.
“Equipment	Section 9-106.
“Farm products	Section 9-106.
“General intangibles	Section 9-103.
“Inventory	Section 9-106.
“Investment property	Section 9-107.
“Livestock	Section 9-106.
“Noncash proceeds	Section 9-313.
“Payment intangible	Section 9-103.

“Proceeds	Section 9-313.
[“Production money crops	Section 9-105.]
[“Production money obligation	Section 9-105.]
[“Production money security interest	Section 9-105.]
[Production of crops	Section 9-105.]
“Purchase money security interest	Section 9-104.
“Purchase money collateral	Section 9-104.
“Purchase money obligation	Section 9-104.
“Request for an accounting	Section 9-209.
“Request regarding a list of collateral	Section 9-209.
“Request regarding a statement of account	Section 9-209.
“Transfer statement	Section 9-617.

(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.
“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.
“Issuer	Section 5-102.
“Lease	Section 2A-103.
“Lease agreement	Section 2A-103.
“Lease contract	Section 2A-103.
“Leasehold interest	Section 2A-103.
“Lessee	Section 2A-103.
“Lessee in ordinary course of business	Section 2A-103.
“Lessor	Section 2A-103.
“Lessor’s residual interest	Section 2A-103.
“Letter of credit	Section 5-102.
“Negotiable instrument	Section 3-104.
“Nominated person	Section 5-102.
“Note	Section 3-104.
“Proceeds of a letter of credit	Section 5-114.
“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.]

Legislative Note: States that do not enact Sections 9-105 and 9-321 should delete the bracketed definitions in subsection (b).

Reporters' Comments

1. **Source.** Many definitions derive from those in former Section 9-102; others are new.

2. **“Account Debtor.”** As a general matter, Article 3, and not Article 9, governs obligations on negotiable instruments. Accordingly, the definition in a prior draft has been revised to exclude from the “account debtor” category obligors on negotiable instruments constituting part of chattel paper. The principal effect of this change is that Sections 9-403 and 9-404, dealing with the rights of an assignee, do not apply to an assignee of chattel paper in which the obligation to pay is evidenced by a negotiable instrument. Rather, the assignee’s rights are governed by Article 3. The bracketed language would have the effect of subjecting the rights of an assignee of a non-negotiable instrument to Sections 9-403 and 9-404. It is discussed in the Comments to Section 9-404.

3. **“Agricultural Lien.”** This term is new. The definition accommodates the inclusion of agricultural liens within the scope of Article 9. An agricultural lien is a “statutory lien.”

4. **“Authenticate.”** This definition is new. It replaces and broadens the former definition of “sign” to encompass authentication of all records, not just writings.

5. **“Collateral.”** The revised definition of “collateral” includes property subject to a statutory lien. It also makes clear that “collateral” includes proceeds.

6. **“Commercial Tort Claim.”** This term is new. Only commercial tort claims may serve as collateral under this Article. See Section 9-113(12).

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

8. **Consumer-related Definitions.** The definitions of “consumer debtor,” “consumer obligor,” “consumer goods secured transaction,” and “consumer secured transaction” have been added in connection with various new (and old) consumer-protection rules. For the most part, the rules appear in Part 6 and apply to “consumer goods secured transactions,” i.e., to consumer transactions in which the some or all of the collateral consists of consumer goods. However, certain rules apply to consumer secured transactions, in which the collateral may be of any type. See, e.g., Sections 9-111(d); 9-112(b)(17).

9. **“Debtor”; “Obligor”; “Secondary Obligor.”** Determining whether a person is a “debtor” under the definition in former Section 9-105(1)(d) requires a close examination of the context in which the word is used. To reduce the need for this examination, this Article redefines “debtor” and adds new defined terms, “secondary obligor” and “obligor.” In the context of Part 6, these definitions distinguish among three classes of persons: (1) those persons who may have a stake in the proper enforcement of a security interest by virtue of their non-lien

property interest (typically, an ownership interest) in the collateral, (2) those persons who may have a stake in the proper enforcement of the security interest because of their obligation to pay the secured debt, and (3) those persons who have an obligation to pay the secured debt but have no stake in the proper enforcement of the security interest. Persons in the first class are debtors. Persons in the second class are secondary obligors if any portion of the obligation is secondary. 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 revised definition of “debtor” renders unnecessary former Section 9-112, governing situations in which collateral is not owned by the debtor.

As revised, the definition of “debtor” includes a “consignee.” A new definition of the term appears in the Appendix, Section [2-102].

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 6 protect the secured party in that circumstance. See Sections 9-605 and 9-627.

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.

10. **“Deposit Account”; “Depository Institution.”** The revised definition of “deposit account” incorporates the definition of “depository institution,” which is new. The definition derives from the definitions of “bank” in Sections 4-105(1) and 4A-105(a)(2), which focus on whether the organization is “engaged in the business of banking.” The Drafting Committee will consider whether the term “depository institution” should be replaced in the draft by the term “bank.”

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 “instrument” as defined in this section (a question that turns on whether the non-negotiable CD is “of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment.”)

A deposit account evidenced by an instrument is subject to the rules applicable to instruments generally. As a consequence, a security interest in such a deposit account cannot be perfected by “control” (see Section 9-109), and the special priority rules applicable to deposit accounts (see Sections 9-325 and 9-337) do not apply.

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.

11. **Filing-related Definitions.** Several of the definitions in this section are used exclusively or primarily in the filing-related provisions in Part 5. These include “filing office,” “financing statement,” “original debtor,” “new debtor,” and “rule.” Most of these definitions are self-explanatory, and many are discussed in the Comments to Part 5.

12. **“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).

13. **“Governmental Entity.”** This new term is used in Section 9-113, dealing with excluded transactions, and in Part 3, Subpart 1, dealing with choice of law. The definition derives from New York’s nonuniform amendment to former Section 9-104(e). The term “governmental unit,” which appears in the definition, is not used there in the same sense as in the Bankruptcy Code.

14. **“Instrument.”** The definition of “instrument” has been modified to make clear that it does not include rights to payment arising out of credit card

transactions. The bracketed phrase refers to transactions in which the card itself is not used, e.g., purchases on credit over the telephone. The Drafting Committee has yet to consider whether the language is necessary.

15. **“Manufactured Home; Manufactured Home Transaction.”** A financing statement filed in a manufactured home transaction may remain effective for a longer period of time than other financing statements. We have not yet formulated a definition of “manufactured home” and we expect to receive input from the manufactured home industry.

16. **“New Value.”** This Article deletes former Section 9-108. Its broad formulation of new value, which embraces the taking of after-acquired collateral for a pre-existing claim, is unnecessary, counterintuitive, and ineffective for its original purpose of sheltering after-acquired collateral from attack as a voidable preference in bankruptcy. The new definition of “new value” derives from § 547(a) of the Bankruptcy Code. The term is used in with respect to temporary perfection of security interests in instruments, certificated securities, or negotiable documents under Section 9-310(d), with respect to chattel paper priority in Section 9-327, and with respect to production money security interests in Sections 9-105(a) and 9-321(a) and (b).

17. **“Public Finance Transaction.”** A financing statement filed in a public finance transaction may remain effective for a longer period of time than other financing statements. We have not yet formulated a definition of “public finance transaction.” However, municipal bond and industrial revenue bond transactions are examples of transactions that should be included.

18. **“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 authenticated. See Section 9-102(a)(3). 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. In such cases, even if this Article permits the filing of an electronic record, compliance with those statutes or rules is necessary. Similarly, a filer must comply with a statute or rule that requires a particular type of encoding or formatting for an electronic record.

This Article occasionally uses the terms “for record,” “real estate records,” “interest of record,” and “record owner.” These are terms traditionally used in real estate law. These contexts “otherwise require[]” that the definition of “record” in this section is not applicable.

19. **“Registered Agent.”** This new term is explained in the Comments to Section 9-501.

20. **“Registered Entity.”** This new term is explained in the Comments to Section 9-307.

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

As revised, the definition of “secured party” includes a “consignee,” as newly defined. See the Appendix, Section [2-102].

22. **“Secured Party of Record.”** This new term refers to the person named in a financing statement as a secured party or a representative. This person is entitled to take action under Part 5 concerning the financing statement. The person may or may not actually be a “secured party,” as defined in this section. For example, no security interest may have been created, in which case no person is a secured party, or the person named as the secured party in the financing statement may be a representative, not the actual secured party.

23. **“State of Organization.”** This new term is explained in the Comments to Section 9-307.

24. **“Statutory Lien.”** The somewhat limited inclusion of statutory liens within the scope of this draft, see the Comment to Section 9-112, follows the recommendations made in the Report of the ABA Section of Business Law,

Committee on Uniform Commercial Code, Subcommittee on Relation to Other Law (October, 1996). The bracketed language in the definition would limit the term to liens in favor of persons who furnish goods and services in the ordinary course of business. The Drafting Committee should consider whether to retain this limitation. “Agricultural lien” is a subset of “statutory lien.”

25. **“Support Obligation.”** This new term covers the most common types of credit enhancements—suretyship obligations (including guarantees) and letters of credit that support one of the specified types of collateral. The phrase “insurance policy” is bracketed for further consideration by the Drafting Committee, in light of the limited inclusion of rights under insurance policies as original collateral.

This Article contains rules explicitly governing attachment and perfection of security interests in support obligations. See Sections 9-203, 9-308, and 9-309. 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).

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

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

SECTION 9-103. DEFINITIONS: “ACCOUNT”; “GENERAL INTANGIBLES”; “PAYMENT INTANGIBLE.”

(a) “Account” means a right to payment, whether or not earned by performance, for property other than money 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, arising out of the use of a credit or charge card or information contained on or for use with the card, or for the use or hire of a vessel under a charter or other contract. The term does not include a right to payment evidenced by an instrument[,] [or] chattel paper[, or a deposit account].

(b) “General intangible” means any personal property other than goods, accounts, chattel paper, commercial tort claims, 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. **Source.** Subsections (a) and (b) derive from former Section 9-106. Subsection (c) is new.

2. **“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. Thus, if they are sold, a financing statement must be filed to perfect the buyer’s interest in them.

3. **“General Intangible.”** The definition in subsection (b) has been revised to establish deposit accounts and commercial tort claims as separate types of collateral. One important consequence is that neither the depository institution nor the tortfeasor is an “account debtor” having the rights and obligations set forth in Section 9-404. In particular, neither is obligated to pay an assignee (secured party) upon receipt of the notification described in Section 9-404(e). Another important consequence relates to the adequacy of the description in the security agreement. See Section 9-111.

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.”

4. **“Payment Intangible.”** Subsection (c) creates a sub-category of general intangibles the sale of which is subject to this Article. See Section 9-112(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 rights 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 9-104. 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” :

(1) 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; and

(2) if the security interest is in inventory that is or was purchase money collateral, also to the extent that the security interest secures a purchase money obligation incurred with respect to other inventory in which the secured party holds or held a purchase money security interest.

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

(c) Except in a consumer goods secured transaction, if 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 must 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.

Subsection (d)—Alternative A

(d) In a consumer goods secured transaction, if the extent to which a security interest is a purchase money security interest depends on the application of a payment to a particular obligation, [cite any applicable statute of a State] governs

application of the payment to the extent applicable. To the extent the statute is not applicable, the payment must be applied to obligations secured by purchase money security interests in the order in which those obligations were incurred, and any agreement to the contrary is ineffective.

Subsection (d)—Alternative B

(d) In a consumer goods secured transaction, if 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 must be applied to obligations secured by purchase money security interests in the order in which those obligations were incurred. This subsection may not be varied by agreement.

[End of Alternatives]

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

(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, consolidated, 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] [A] secured party claiming a purchase money security interest has the burden of establishing [whether and] the extent to which the security interest is a purchase money security interest.

Legislative Note: States that have an applicable statute dealing with allocation of payments should enact Alternative A of subsection (d). Other States should enact Alternative B.

Reporters' Comments

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

2. **“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 second sentence of former Section 9-115(5)(f) made the purchase money priority rule (former Section 9-312(4)) inapplicable to investment property. This section's limitation makes that sentence unnecessary.

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)(1), 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.

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

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

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

4. **“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)(1) and (a)(2) (“to the extent”) and is made explicit in subsection (e). The Article rejects the “transformation” rule adopted by some cases, under which any cross-collateralization, refinancing, or the like destroys the purchase-money status entirely.

Consider, for example, what happens when a \$10,000 loan secured by a purchase money security interest is refinanced by the original lender, and, as part of the transaction, the debtor borrows an additional \$2,000 secured by the collateral. Subsection (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 (c)(1) expresses the overriding principle for determining the extent to which a security interest is a purchase money security interest under these circumstances, in cases other than consumer goods secured transactions: 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 (c)(1). In the absence of agreement, subsection (c)(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 (c)(3). Once these obligations are paid, there are no purchase money security interests, and so there is no need for additional allocation rules.

The Drafting Committee thinks that freedom of contract with respect to allocation of payments is likely to be illusory in the consumer setting. Accordingly, it would adopt a statutory allocation rule that cannot be varied by agreement. Subsection (d) presents two versions of a mandatory rule. Alternative A enables a State to incorporate another applicable statutory allocation rule by reference. If the statutory rule is inapplicable, then payments are to be applied to purchase money obligations in the order incurred. Under Alternative B, payments are to be applied to purchase money obligations in the order incurred, regardless of whether a statutory allocation rule otherwise would apply. States that have adopted a statutory allocation rule select Alternative A and other States should select Alternative B.

By determining whether a security interest is a “purchase money security interest,” the dual-status rule and allocation formula affect only issues under this Article—primarily perfection and priority. See, e.g., Sections 9-309(a)(7); 9-322. Whether a security interest is a “purchase money security interest” under other law, however, is determined by that law. For example, decisions under Bankruptcy Code § 522(f) have applied both the dual-status and the transformation rules. The Bankruptcy Code does not expressly adopt the state law definition of “purchase money security interest.” Where federal law does not defer to this Article, this Article does not, and could not, determine a question of federal law.

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).

5. **Consignments.** Under former Section 9-114, the priority of the consignor’s interest is similar to that of a purchase money security interest. Subsection (b) 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 applicable priority rules generally applicable to inventory, such as Sections 9-315, 9-316, 9-319, and 9-322.

**[SECTION 9-105. 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 crops (“production money crops”) secure an obligation incurred by an obligor for new value given to enable the debtor to produce the production

money crops (“production money obligation”) if the value is in fact used for the production of the production money 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) If 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 must 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 if:

(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] [A] secured party claiming a production money security interest has the burden of establishing [whether and] the extent to which the security interest is a production money security interest.]

Legislative Note: This section is optional. States that do not enact this section also should not enact Section 9-321.

Reporters' Comments

1. **Source.** New.

2. **Production Money Priority; “Production Money Security Interest.”**

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. However, after years of discussion, no consensus concerning the rule has arisen among those who engage in agricultural financing. The issue remains controversial, and opinions differ strongly over whether to replace the rule with one that affords greater protection to providers of production inputs or whether to eliminate the rule without replacing it.

Section 9-321 contains a revised production money priority rule. The brackets surrounding it reflect the likely division of views among state legislatures as to the desirability of the rule. In conjunction with the new priority rule, this section—also bracketed—provides a definition of “production money security interest.” It is patterned closely on Section 9-104, which defines “purchase money security interest.” Subsection (b) makes clear that a security interest can obtain production-money status only to the extent that it secures value that actually can be traced to the direct production of crops. To the extent that a security interest secures indirect costs of production, such as general living expenses, the security interest is not entitled to production-money treatment.

SECTION 9-106. 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 nonprofit organization or a governmental subdivision or agency. The term includes goods] other than inventory, farm products, or consumer goods.

(c)(1) “Farm products, with respect to debtor engaged in raising, cultivating, propagating, fattening, grazing, or other farming, livestock, or aquacultural operations, means:

(A) crops grown, growing, or to be grown, including crops produced on trees, vines, and bushes;

(B) livestock, born or unborn;

(C) supplies used or produced in farming, livestock, or aquacultural operations; or

(D) products of crops or livestock in their unmanufactured states.

(2) The term does not include equipment or inventory.

(3) For purposes of paragraph (1), the terms “crops” and “livestock” include aquatic goods produced in aquacultural operations.

(d) “Inventory” means goods that are leased by a person, held by a person for sale or lease or to be furnished under contracts of service, furnished by a person under contracts of service, or raw materials, work in process, or materials used or consumed in a business. [The term does not include equipment.]

Reporters’ Comments

1. **Source.** Former Section 9-109.

2. **“Equipment.”** Brackets inserted in the definition of equipment reflect the Drafting Committee’s division over whether the first sentence is necessary or useful. If the bracketed language in that definition is deleted, the brackets around the final sentence of the definition of inventory indicate that it also should be deleted.

3. **“Farm Products.”** The primary revision to the definition of “farm products” is to clarify the status of aquaculture.

4. **“Inventory.”** 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.

**SECTION 9-107. DEFINITIONS: “COMMODITY ACCOUNT”;
“COMMODITY CONTRACT”; “COMMODITY CUSTOMER”;
“COMMODITY INTERMEDIARY”; “INVESTMENT PROPERTY.”**

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

(b) “Commodity contract means a commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract that, in each case, is:

(1) 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 federal commodities laws; or

(2) 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.

(c) “Commodity customer means a person for which a commodity intermediary carries a commodity contract on its books.

(d) “Commodity intermediary means:

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

(2) 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.

(e) “Investment property means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.

Reporters’ Comments

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

2. **Rules Governing Investment Property.** Section 9-115 was added in conjunction with Revised Article 8 and contains a variety of rules applicable to security interests in investment property. These rules have been relocated to the appropriate sections of Article 9. See, e.g., Sections 9-203(a), (d) (attachment); 9-324 (priority).

3. **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. The Drafting Committee attempted to formulate a single set of rules to cover both types of collateral, so that very little will turn on the distinction. However, the provisions applicable to deposit accounts differ from those applicable to investment property in several important respects. For example, 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 9-108. CONTROL OVER INVESTMENT PROPERTY.

(a) A person has control of a certificated security, uncertificated security, or security entitlement as provided in Section 8-106.

(b) A secured party has control over a commodity contract if:

(1) the secured party is the commodity intermediary with which the commodity contract is carried; or

(2) the commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer.

(c) A secured party that has control over all security entitlements or commodity contracts carried in a securities account or commodity account has control over the securities account or commodity account.

Reporters' Comment

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

2. **“Control” under Article 8.** As lawyers have attempted to craft agreements that give secured parties “control” under Section 8-106(d)(2), some uncertainty has arisen concerning the effect of a securities intermediary’s agreement that it will comply with a secured party’s entitlement orders only if certain conditions are met. For a discussion of this issue, see Section 9-109, Comment 3.

SECTION 9-109. 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 debtor, secured party, and depository institution have agreed in an authenticated record that that the depository institution will comply with instructions originated by the secured party directing disposition of the funds in the account without further consent by the debtor; or

(3) the secured party becomes the depository institution's customer with respect to the deposit account.

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

Reporters’ Comments

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

2. **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 9-310(a)(2).

3. **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 authenticated agreement that it will comply with the secured party's instructions without further consent by the debtor. The analogous provision in Section 8-106 does not require that the agreement be authenticated. As the Comments to Section 9-108 indicate, some uncertainty has arisen concerning the requirements of Section 8-106(d)(2), particularly when a securities intermediary has agreed that it will comply with a secured party's entitlement orders only if certain conditions are met. An agreement to comply with the secured party's instructions suffices for "control" of a deposit account under this section even if the 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 Drafting Committee may reconsider whether this resolution is appropriate and, if necessary, will adjust the text of this section and the analogous provision in Section 8-106. For now, a suggested revision to Official Comment 7 to Section 8-106 appears in the Appendix.

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 available for accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are not "deposit accounts."

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

SECTION 9-110. 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 and any nominated person have consented to an assignment of proceeds of the letter of credit under Section 5-114(c), or

(2) the secured party is a transferee beneficiary of the letter of credit [and the issuer may not refuse to recognize or carry out the transfer under Section 5-112(b)].

Reporters' Comments

1. **Source.** New.

2. **Why “Control” Matters.** 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 9-326. 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.

3. **“Proceeds of a Letter of Credit.”** Section 5-114 follows traditional banking terminology by referring to a letter of credit beneficiary's assignment of its right to receive payment thereunder as an assignment of the “proceeds of a letter of credit. 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.

4. **“Transfer” vs. “Assignment.”** 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.

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

SECTION 9-111. SUFFICIENCY OF DESCRIPTION.

(a) Except as otherwise provided in subsections (c), (d), and (e), a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.

(b) Except as otherwise provided in subsections (c), (d), and (e), a description of collateral reasonably identifies the collateral if it identifies the collateral by specific listing, category, use of a term defined in this [Act], quantity, a computational or allocational formula or procedure, or any other method, if the identity of the collateral is objectively determinable.

(c) Subject to subsection (d), a description of a security entitlement, securities account, or commodity account is sufficient if it describes the collateral by those terms or as investment property, or if it describes the underlying financial asset or commodity contract.

(d) In a consumer secured transaction, a description of a security entitlement, securities account, or commodity account is sufficient only if it is specific. A description by type alone is not sufficient.

(e) A description of a commercial tort claim is sufficient only if it is specific. A description by type alone is not sufficient.

Reporters' Comment

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

2. **General Rules; After-acquired Collateral.** Subsection (a) retains substantially the same formulation as former Section 9-110. In retaining this formulation, the draft adopts the view that an “all assets” or “all personal property” description for purposes of a *security agreement* is *not* sufficient. Note, however, that under Section 9-504, a *financing statement* sufficiently indicates the collateral if it “covers all assets or all personal property.” Subsection (b), which was applicable only to investment property under former Section 9-115(3), has been made applicable to all kinds of collateral.

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

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

4. **Consumer Investment Property; Tort Claims.** Subsections (d) and (e) require greater specificity of description in order to prevent debtors from inadvertently encumbering property. Subsection (d) requires that a description of a security entitlement, a securities account, or a commodity account be specific. A description by “type” (e.g., “all existing and after-acquired investment property” or “all existing and after-acquired security entitlements”) is insufficient. If the collateral consists of a securities account or a commodity account, a specific description of the account is sufficient to cover all existing and future security entitlements or commodity entitlements carried in the account. See Section 9-203(e)(3), (4).

Subsection (d) likewise requires a more exacting description of commercial tort claims than one by “type.” However, under Section 9-204, an after-acquired collateral provision in a security agreement will not reach future commercial tort claims. It follows that when an effective security agreement covering a commercial tort claim is entered into the claim already will exist.

[SUBPART 3. APPLICABILITY OF ARTICLE]

SECTION 9-112. SCOPE.

(a) Except as otherwise provided in subsection (c), this article applies to:

- (1) any transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;
- (2) a statutory 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.

(c) 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 transfer by this State or by a governmental entity of this State to the extent that another statute of this State [expressly] governs the creation, perfection, priority, or enforcement of the security interest created by the transfer;

(3) a transfer by another State, a foreign country, or a governmental entity of another State or a foreign country, to the extent that a statute of the State or country, other than a statute generally applicable to security interests, [expressly] governs creation, perfection, priority, or enforcement of the security interests created by the transfer;

(4) a landlord's lien;

(5) a non-statutory lien given by rule of law for services or materials, except as provided in Section 9-330 with respect to priority of the lien;

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

(7) a sale of accounts, chattel paper, or payment intangibles as part of a sale of the business out of which they arose;

(8) an assignment of accounts, chattel paper, or payment intangibles which is for the purpose of collection only;

(9) an assignment of a right to payment under a contract to an assignee that is also obliged to perform under the contract;

(10) an assignment of a single account or payment intangible to an assignee in whole or partial satisfaction of a preexisting indebtedness;

(11) a transfer of an interest in or claim under any policy of insurance, except[:

(A) a transfer by a healthcare provider of a right to payment arising out the furnishing of healthcare goods or services; and

(B)] as provided in Sections 9-313 and 9-319 with respect to proceeds and priorities in proceeds;

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

(13) a right of recoupment or set-off, except as provided in Section 9-337 with respect to the effectiveness of rights of recoupment or set-off against deposit accounts and in Section 9-404(a) with respect to defenses or claims of an account debtor;

(14) the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for fixtures in Section 9-331;

(15) a transfer of any claim arising in tort, except:

(A) a transfer of a commercial tort claim; and

(B) as provided in Sections 9-313 and 9-319 with respect to proceeds and priorities in proceeds;

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

(17) a transfer of an interest in a deposit account in a consumer secured transaction, except as provided in Sections 9-313 and 9-319 with respect to proceeds and priorities in proceeds.

Reporters' Comments

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

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

3. **Statutory Liens.** Subsection (a)(2) is new and expands the scope of this Article to cover statutory liens, as defined in Section 9-102. Certain provisions,

such as Section 9-315, relate only to agricultural liens and not to statutory liens generally. In general, the draft deals with more aspects of agricultural liens than is the case with other statutory liens. For example, it covers priority contests between and among *all* statutory liens and security interests, but only those contests between and among *agricultural* liens and other persons, such as lien creditors and buyers. Also, part 6 excludes statutory liens (other than agricultural liens) from its scope. See Section 9-601(e).

4. 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 9-103(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, sales of payment intangibles are treated differently from sales of other receivables. See, e.g., Section 9-406. 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.

5. 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 for the purpose of sale). 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 9-315A. The interest of a consignor is defined to be a security interest, see Section 1-201(37) (reproduced in the Appendix), more specifically, a purchase money security interest in the consignee’s inventory. See Section 9-104(b). Thus, the rules pertaining to lien creditors, buyers, and attachment, perfection, and priority of competing security interests apply to consigned goods.

Sometimes parties characterize transactions that secure an obligation (other than the bailee’s obligation to return bailed goods) as “consignments. These transactions are not “consignments” within the meaning of Section 9-112(a)(4). See Section [2-102] (last clause of the definition of “consignment”). This Article applies also to these transactions, by virtue of Section 9-112(a)(1). They create a security interest within the meaning of the first sentence of Section 1-201(37).

6. Federal Preemption. Former Section 9-104(a) excludes from Article 9 “a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property. Some may read the former section (erroneously) to suggest that Article 9 defers to federal law even when federal law does not preempt

Article 9. Subsection (c)(1) recognizes explicitly that the Article defers to federal law only when and to the extent that it must—i.e., when federal law preempts it.

7. Governmental Debtors. At the suggestion of the International Secured Transactions Task Force, the exclusion of former Section 9-104(e), concerning security interests created by governmental debtors, has been revised and replaced by the exclusions in new paragraphs (2) and (3) of subsection (c). These paragraphs reflect the view that Article 9 should apply to security interests created by a “governmental entity (as defined in Section 9-102) except to the extent that another statute governs the issue in question. Under paragraph (2), this Article defers to all statutes of the forum State. (A forum cannot determine whether it should consult the choice-of-law rules in the forum’s UCC unless it first determines that its UCC applies to the transaction before it.) Paragraph (3) defers to statutes of another State or a foreign nation only to the extent that those statutes contain rules applicable specifically to security interests created by the governmental entity in question.

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

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

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

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

Example: A Belgian governmental entity grants a security interest in its equipment to a Swiss secured party. The equipment is located in Belgium. A dispute arises and, for some reason, an action is brought in a New York state court. Inasmuch as the transaction bears no “appropriate relation” to

New York, New York's UCC, including its Article 9, is inapplicable. See Section 1-105(1). New York's Section 9-113 on excluded transactions should not come into play. Even if the parties agreed that New York law would govern, the parties' agreement would not be effective because the transaction does not bear a "reasonable relation" to New York. See Section 1-105(1).

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

An alternative or supplemental approach, which the Drafting Committee did not pursue, is to make certain specified parts or provisions of Article 9 (e.g., part 6, dealing with enforcement; or Section 9-609, dealing with self-help repossession) inapplicable to governmental entities, regardless of the existence of conflicting law.

8. Sales of Payment Intangibles. Former Section 9-104(f) excludes certain sales and assignments of accounts and chattel paper. Subsection (c)(7) adds to the exclusion similar sales of payment intangibles.

9. Insurance. Subsection (c)(8) narrows somewhat the broad exclusion of interests in insurance policies under former Section 9-104(g). This Article now covers transfers by a healthcare provider of rights to payment arising out of the furnishing of healthcare goods or services. These rights to payment are the equivalent of accounts receivable for other types of businesses. The Drafting Committee recognizes that insurance policies can be important items of collateral in many other business contexts and that the "cash" or "loan" value of life insurance policies also can be a useful source of collateral for borrowing by individuals. Nevertheless, it decided that other law should continue to govern security interests in insurance policies.

10. Setoffs. Subsection (c)(10) adds two exceptions to the general exclusion of setoff rights from Article 9 under former subsection (i). The first takes account of new Section 9-337, which regulates the effectiveness of a setoff against a deposit account that stands as collateral. The second recognizes Section 9-404, which affords the obligor on an account, chattel paper, or general intangible the right to raise claims and defenses against an assignee/secured party.

11. Tort Claims. Subsection (c)(12) narrows somewhat former broad exclusion of transfers of tort claims under former Section 9-104(k). This Article now applies to transfers of "commercial tort claims," as defined in Section 9-102, as well as to security interests in tort claims that constitute proceeds of other collateral (e.g., a right to payment for negligent destruction of the debtor's inventory). The Official Comments should make clear that once a claim arising in tort has been settled and reduced to a contractual obligation to pay, the right to payment becomes a payment intangible and no longer is a claim arising in tort.

The Article contains two special rules governing creation of a security interest in tort-claim collateral. First, a tort claim must be described with specificity in a security agreement as a condition of attachment. See Section 9-111(e). Second, no security attaches under an after-acquired property clause to a tort claim. See Section 9-204(b)(2). In addition, this Article does not determine whom the tortfeasor must pay to discharge its obligation. Inasmuch as a tortfeasor is not an “account debtor,” the rules governing waiver of defenses and discharge of an obligation by an obligor (Sections 9-403; 9-404) are inapplicable to tort-claim collateral.

12. Deposit Accounts. With certain exceptions set forth in paragraphs (16) and (17) of subsection (c), 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, because “deposit accounts” is a separate type of collateral, a security agreement must specifically mention deposit accounts in order for a security interest to attach in the deposit accounts. See Section 9-111. 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 9-310(a)(2); 9-109. 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 9-304, priority of conflicting security interests in a deposit account, see Sections 9-325; 9-337, the rights of transferees of funds from an encumbered deposit account, see Section 9-329, the obligations of the depository institution, see Section 9-338, and enforcement of security interests in a deposit account. See Section 9-607(c).

SECTION 9-113.

[deleted]

SECTION 9-114.

[deleted]

Reporters’ Comments

Reason for Deletion. This section, which tracked former Section 9-111, provided that the creation of a security interest is not a bulk sale under Article 6. It would have served no function in the majority of States, which have repealed Article 6. In the few States that adopted Revised Article 6, this section would be superfluous. See Section 6-103(3)(a) (containing similar provision). The same is true even in those States in which old Article 6 is in effect. See old Section 6-103(1) (containing similar provision). Accordingly, this section has been deleted.

SECTION 9-115. APPLICABILITY OF OTHER STATUTES. A

transaction subject to this article may also be subject to [insert reference to any local statute regulating small loans, retail installment sales and the like]. 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.

Reporters' Comments

1. **Source.** Former Section 9-203(4)

2. **Purpose.** This section makes clear that certain transactions, although subject to this Article, also must comply with other applicable legislation.

SECTION 9-116. SECURITY INTERESTS ARISING UNDER ARTICLES 2 OR 2A. [MINOR STYLE CHANGES ONLY] A security interest arising solely under Article 2 or 2A is subject to this article. However, to the extent that, and as long as, the debtor does not have or does not lawfully obtain possession of the goods:

(1) a security agreement is not necessary to make the security interest enforceable;

(2) filing is not required to perfect the security interest; and

(3) the rights of the secured party on default by the debtor are governed by Article 2 or 2A in the case of a security interest arising solely thereunder.

Reporters' Comments

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

2. **Status.** The Article 2 Drafting Committee has yet to determine whether any rights arising under Article 2 will be characterized as security interests and, if so, which ones. Once that determination is made, the Article 9 Drafting Committee will consider how to address those security interests, and any security interests arising under revised Article 2A, in this Article.

PART 2
**VALIDITY OF SECURITY AGREEMENT;
ATTACHMENT OF SECURITY INTEREST;
RIGHTS OF PARTIES TO SECURITY AGREEMENT**

[SUBPART 1. VALIDITY AND ATTACHMENT]

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

(a) Except as otherwise provided in 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 the statute or regulation to a transaction not otherwise subject to it.

Reporters' Comments

Source. Former Section 9-201.

SECTION 9-202. TITLE TO COLLATERAL IMMATERIAL. Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, or payment intangibles, the provisions of this article with regard to rights, obligations, and remedies apply whether title to collateral is in the secured party or in the debtor.

Reporters' Comments

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

2. **When Title Matters.** This section explicitly acknowledges two circumstances in which the effect of certain Article 9 provisions turns on ownership (title). First, the remedies of a consignor under a true consignment and, for the most part, the remedies of a buyer of accounts, chattel paper, or payment intangibles are determined by other law and not by part 6. See Section 9-601(d). Second, in some respects sales of accounts, chattel paper, and payment intangibles receive special treatment. See, e.g., Sections 9-207(a); 9-209(b); 9-607(b). Buyers

of receivables under the former Article are treated specially, 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], Section 9-206 [on security interests in investment property], Section 9-116 [on a security interest arising under Article 2 or 2A], 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 under Section 9-311 pursuant to the debtor's agreement, the collateral is investment property, a deposit account, or a letter of credit and proceeds of the letter of credit and the secured party has control pursuant to the debtor's agreement, or the debtor has authenticated a security agreement that contains a description of the collateral and in addition, if the security interest covers 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 the power to transfer rights in the collateral to a secured party.

(b) If a new debtor becomes bound as debtor by a security agreement entered into by another person, the agreement satisfies the requirements 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 another agreement is not necessary to make a security interest in the property enforceable.

(c) A person becomes bound as debtor by a security agreement entered into by another person if, by operation of other law or by contract:

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

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

(d) 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 the time of attaching is postponed by express agreement.

(e) Unless otherwise agreed:

(1) a security agreement gives the secured party the rights to proceeds provided by Section 9-313;

(2) attachment of a security interest in collateral is also attachment of a security interest in a support obligation with respect to the collateral;

(3) attachment of a security interest in a securities account is also attachment of a security interest in all security entitlements carried in the securities account;

(4) attachment of a security interest in a commodity account is also attachment of a security interest in all commodity contracts carried in the commodity account; and

(5) attachment of a security interest in a right to payment or performance secured by a [mortgage on real property] [lien on property] gives the secured party a security interest in the [mortgage] [lien].

Reporters' Comments

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

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 an authenticated security agreement. However, once the security interest has become enforceable and has attached, it is not impaired by the fact that the secured party's possession is maintained without the agreement of a subsequent debtor (e.g., a transferee). Second, possession as contemplated by Section 9-311 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 an authenticated security agreement under subsection (a).

Subsection (a)(1) also provides that control of investment property, a deposit account, or a letter of credit and proceeds of a letter of credit pursuant to the debtor's agreement is sufficient as a substitute for an authenticated 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 5, explained in former Section 9-402, Official Comment 3. When perfection is achieved by compliance with the requirements of a statute or treaty described in Section 9-309(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 9-111. 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. **Exception to General Rule.** Section 5-118, mentioned in subsection (a), is found in the Appendix.

5. **Attachment to Limited Rights.** Subsection (a)(3) conditions attachment on the debtor's having "rights in the collateral or the power to transfer rights in the collateral to a secured party." A debtor's limited rights in collateral, short of full ownership, are sufficient for a security interest to attach. However, in accordance with basic personal property conveyancing principles, the baseline rule is that a security interest attaches only to whatever rights a debtor may have, broad or limited as those rights may be.

6. **Attachment to Greater Rights than Debtor Has.** Certain exceptions to this baseline rule enable a debtor to transfer, and a security interest to attach to, greater rights than the debtor has. The bracketed phrase, "or the power to transfer rights in the collateral to a secured party," accommodates those exceptions. In

some cases, a debtor may have power to transfer another person's rights to a class of transferees that excludes secured parties. See, e.g., Section 2-403(2) (giving certain merchants power to transfer an entruster's rights to a buyer in ordinary course of business). Under those circumstances, the debtor would not have the power to create a security interest in the other person's rights.

7. 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. 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.

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

This subject is discussed in more detail in the Comments to Section 9-510.

8. Support Obligations. Under new subsection (d)(2), a security interest in a "support obligation (defined in Section 9-102) automatically follows from a security interest in the underlying, supported collateral. We believe this to be implicit in current law.

9. Real Estate Mortgages. Subsection (e)(5) codifies the common-law rule that a transfer of an obligation secured by a mortgage also transfers the mortgage. See Restatement of the Law of Property (Mortgages) § 5.4(a), Tent. Draft No. 5 (March 18, 1996). The Drafting Committee has not yet considered whether this approach should be extended beyond real estate mortgages to any other "lien on property.

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) A security interest does not attach under an after-acquired property clause to:

(1) consumer goods, other than an accession when given as additional security, unless the debtor acquires rights in them within 10 days after the secured party gives value; or

(2) a commercial tort claim.

(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.

Reporters' Comments

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

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

3. **Commercial Tort Claims.** New subsection (b)(2) provides that an after-acquired collateral provision in a security agreement does not reach future commercial tort claims. In order for a security interest in a tort claim to attach, the claim must be in existence when the security agreement is authenticated. In addition, the security agreement must describe the tort claim with specificity. See Section 9-111(e).

SECTION 9-205. USE OR DISPOSITION OF COLLATERAL WITHOUT ACCOUNTING PERMISSIBLE.

(a) A security interest is not invalid or fraudulent against creditors merely because:

(1) the debtor has the right or ability:

(A) to use, commingle, or dispose of all or part of the collateral, including returned or repossessed goods;

(B) to collect, compromise, enforce, or otherwise deal with collateral;

(C) to accept the return of collateral or make repossessions; or

(D) to use, commingle, or dispose of proceeds; or

(2) the secured party fails to require the debtor to account for proceeds or replace collateral.

(b) This section does not relax the requirements of possession for attachment, perfection, or enforcement of a security interest which depend upon possession of the collateral by the secured party.

Reporters' Comments

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

2. **Extent of Permissible Freedom for Debtor.** This section recognizes the broader rights of a debtor 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 debtor 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. 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.

(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 under 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.

(c) A security agreement is not required for attachment or enforceability of a security interest arising under this section.

Reporters' Comments

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

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

[SUBPART 2. RIGHTS AND DUTIES]

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 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] [previous] parties unless otherwise agreed.

(b) Unless otherwise agreed, 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) If a security interest secures an obligation, the secured party may use or operate collateral for the purpose of preserving the collateral or its value or as permitted by 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. **Source.** Former Section 9-207.

2. **Statutory Liens.** The revised definitions of “collateral,” “debtor,” and “secured party” in Section 9-102 would make this section applicable to collateral subject to a statutory lien if the collateral is in the statutory lienholder’s possession. The Drafting Committee has not yet considered whether that result is appropriate.

3. **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 promissory notes or checks.) The meaning of “recourse” in this respect is limited to recourse arising out of the account debtor’s failure to pay or other default 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.

4. **“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 9-621, and this section need not address it. For example, if the collateral is a negotiable note that the secured party (SP-1) repledges to SP-2, nothing in this section suggests that the debtor (D) does not retain the right to redeem the note upon payment to SP-1 of all obligations secured by the note. But, as explained below, the debtor's unimpaired right to redeem as against the debtor's original secured party nevertheless may not be enforceable as against the new secured party.

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

Whether SP-2 would be liable to D depends on the priority of SP-2's security interest. Normally, the *nemo dat* principle will apply, and SP-2's security interest, which is a security interest in SP-1's security interest, will be defeated if the debtor discharges its secured obligations under Section 9-621 or otherwise. If so, and if SP-2 fails to deliver the note to D, then D will have a right to replevy the note from SP-2 or recover damages from SP-2 in conversion. In some circumstances, however, SP-2's security interest will survive discharge of SP-1's security interest. This will be the case, for example, if SP-2 is a holder in due course. See Sections 9-328, 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 9-328, 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.

SECTION 9-208. DUTIES OF SECURED PARTY HAVING CONTROL OVER COLLATERAL.

(a) If there is no outstanding secured obligation and the secured party has no commitment to make advances, incur obligations, or otherwise give value, as

soon as reasonably practicable but not more than 3 days after receiving an authenticated demand by the debtor:

(1) a secured party that has control over a investment property under Section 8-106(d)(2) or 9-108(b) shall send the securities intermediary or commodity intermediary with which the security entitlement or commodity contract is maintained an authenticated record that releases the securities intermediary or commodity intermediary from any further obligation to comply with entitlement orders or directions originated by the secured party;

(2) a secured party that has control over a deposit account under Section 9-109(a)(2) shall send the depository institution with which the deposit account is maintained an authenticated statement that releases the depository institution from any further obligation to comply with instructions originated by the secured party;

[(3) a secured party that has control over a deposit account under Section 9-109(a)(3) shall pay the debtor all funds on deposit in the account;] and

(4) a secured party that has control over a letter of credit and proceeds of the letter of credit under Section 9-110(1) shall send the issuer of the letter of credit and any nominated person an authenticated release of the issuer from any further obligation to pay or deliver proceeds of the letter of credit to the secured party.

(b) Within [a reasonable time] [10 days] after receiving an authenticated demand by the debtor, a secured party that has control over a letter of credit and proceeds of the letter of credit under Section 9-110(2) shall take such actions as the debtor may reasonably request with respect to the letter of credit.

Reporters' Comments

1. **Source.** New.

2. **Scope.** This section imposes duties on a secured party that has control over investment property, a deposit account, or a letter of credit and proceeds of the letter of credit. The duty to terminate the secured party's control is analogous to the duty to file a termination statement, imposed by Section 9-511.

The requirements of this section can be varied by agreement under Section 1-102(3). For example, a debtor could by contract agree that the secured party may release its control over investment property under subsection (a)(1) more than 3 days following demand. Also, these requirements should not be read to conflict with the terms of the collateral itself. In this connection, subsection (a)(3), which appears in brackets, may be problematic. If the collateral is a time deposit account, for example, subsection (a)(3) should not require a secured party with control to make an early withdrawal of the funds (assuming that is even possible) in order to pay them over to the debtor. Moreover, we doubt that subsection (a)(3) is necessary. Once a security interest disappears, the terms of the deposit contract itself should be adequate to govern the relationship between a former secured party/depositary institution and the former debtor/depositor.

3. Letters of Credit and Proceeds of Letters of Credit. Paragraph (5) is problematic. For example, one cannot safely assume that a letter of credit that has been transferred to a secured party is (re)transferable by the secured party to the debtor. Although it is appropriate to place some duties on the secured party-transferee, the details may best be left to the agreement of the parties.

4. Remedy for Failure to Relinquish Control. If the secured party fails to comply with the requirements of subsection (a), the debtor has the remedy set forth in Section 9-624(d). This remedy is identical to that applicable to failure to provide or file a termination statement under Section 9-511.

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

6. Duty to “Send.” This section and Sections 9-208A and 9-209 impose a duty to “send” certain items or information to the debtor. The Drafting Committee may wish to consider whether that term should be replaced in these sections by the new term “communicate,” as defined in Section 9-102.

SECTION 9-208A. DUTIES OF SECURED PARTY [WHEN] [IF] ACCOUNT DEBTOR HAS BEEN NOTIFIED OF ASSIGNMENT.

(a) If there is no outstanding secured obligation and the secured party has no commitment to make advances, incur obligations, or otherwise give value, as soon as reasonably practicable but not more than 3 days after the secured party receives an authenticated demand by the debtor, the secured party shall send to an

account debtor that has received notification of an assignment to the secured party as assignee under Section 9-404(e) an authenticated record that releases the account debtor from any further obligation to the secured party.

(b) This section does not apply to an assignment constituting the sale of an account, chattel paper, or payment intangible.

Reporters' Comments

1. **Source.** New.

2. **Scope.** Like Sections 9-208 and 9-511(c), which require a secured party to relinquish control of collateral and to file or provide a termination statement for a financing statement, this section requires a secured party to free up collateral when there no longer is any outstanding secured obligation or any commitment to give value in the future. This section addresses the case in which account debtors have been notified to pay a secured party to whom the receivables have been assigned. It requires the secured party (assignee) to inform the account debtors that they no longer are obligated to make payment to the secured party.

SECTION 9-209. REQUEST FOR ACCOUNTING; REQUEST REGARDING LIST OF COLLATERAL OR STATEMENT OF ACCOUNT.

(a) In this section:

(1) "Request for an accounting" means a record authenticated by a debtor requesting that the recipient provide an accounting of the unpaid obligations secured by collateral and reasonably identifying the transaction or relationship that is the subject of the request;

(2) "Request regarding a list of collateral" means a record authenticated by a debtor requesting that the recipient approve or correct a list of what the debtor believes to be the collateral securing an obligation and reasonably identifying the transaction or relationship that is the subject of the request; and

(3) "Request regarding a statement of account" means a record authenticated by a debtor requesting that the recipient approve or correct a statement indicating what the debtor believes to be the aggregate amount of unpaid

obligations secured by collateral as of a specified date and reasonably identifying the transaction or relationship that is the subject of the request.

(b) Subject to subsections (c), (d), and (e), a secured party other than a buyer of accounts, chattel paper, or payment intangibles shall comply with a request for an accounting, or a request regarding a list of collateral or statement of account within two weeks after receipt by sending to the debtor an authenticated correction or approval or an accounting, as applicable.

(c) A secured party that claims a security interest in all of a particular type of collateral owned by the debtor may comply with a request regarding a list of collateral by sending to the debtor an authenticated statement to that effect within two weeks after receipt.

(d) A person that receives a request regarding a list of collateral and claims no interest in the collateral shall comply with the request within two weeks after receipt by sending to the debtor an authenticated statement disclaiming any interest in the collateral and, if known to the recipient, containing the name and mailing address of any assignee of or successor to the recipient's security interest in the collateral.

(e) A person that claims no interest in the obligations when it receives a request for an accounting or a request regarding a statement of account shall comply with the request within two weeks after receipt by sending to the debtor an authenticated statement disclaiming any interest in the obligations and, if known to the recipient, containing the name and mailing address of any assignee of or successor to the recipient's interest in the obligations.

(f) A debtor is entitled without charge to an approval or correction or an accounting under this section once during any six-month period. The secured party

may require payment of a charge not exceeding \$[] for each additional response to a request.

Reporters' Comments

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

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

Subsection (a) contemplates that the debtor can request three types of information from the secured party. First, under subsection (a)(1), the debtor can request the secured party to prepare and send an “accounting” as defined in Section 9-102. Second, under subsection (a)(2), the debtor can submit to the secured party a list of collateral for the secured party’s approval or correction. Third, under subsection (a)(3), the debtor can submit to the secured party for its approval or correction a statement of the aggregate amount of unpaid secured obligations. Inasmuch as a secured party may have numerous transactions and relationships with a debtor, each request must identify the relevant transactions or relationships. Problems may arise for secured parties that have many places of business and who may receive a request at a place of business having no relation to the secured transaction. We believe that problem could be addressed best by modifications to Section 1-201(26) and (27). Those provisions should be expanded to address not only notifications but also demands and other records that may be received by an organization.

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

4. **Remedy for Failure to Comply.** Section 9-624(e) sets forth the remedy for noncompliance with the requirements of this section.

PART 3

PERFECTION AND PRIORITY OF SECURITY INTERESTS

[SUBPART 1. LAW GOVERNING PERFECTION AND PRIORITY]

Reporters' Prefatory Comment

1. **Scope of Choice-of-Law Rules.** Part 3, Subpart 1 contains choice-of-law rules similar to those of former Section 9-103. Former Section 9-103 generally addresses which State's law governs "perfection and the effect of perfection or non-perfection of security interests. See, e.g., former Section 9-103(1)(b). This Article follows the broader and more precise formulation in former Section 9-103(6)(b), which was revised in connection with the recent promulgation of Revised Article 8: "perfection, the effect of perfection or non-perfection, and the priority of security interests. Priority, in this context, subsumes all of the rules in Part 3, including "cut off" or "take free" rules such as Sections 9-315(a), (b), and (c), 9-316, and 9-328. This subpart does not address choice of law for other purposes. For example, the law applicable to issues such as attachment, validity, characterization (e.g., true lease or security interest), and enforcement would be governed by the rules in Section 1-105; that governing law typically is specified in the security agreement. And, another jurisdiction's law may govern other third-party matters addressed in Article 9. See Part 4, Reporters' Prefatory Comment.

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

Example: Litigation over the priority of a security interest in accounts arises in State X. State X has adopted the Official Text of this Article, which sends one to the local law of the jurisdiction in which the debtor is located. See Section 9-301(3). The debtor is located in State Y. Even if State Y has enacted a nonuniform choice-of-law rule (e.g., one that provides that perfection is governed by the law of State Z), a State X court should look only to the substantive law of State Y. State Y's substantive law indicates that financing statements should be filed in State Y. Note, however, that if the identical perfection issue were to be litigated in State Y, the court would look to State Y's nonuniform 9-103 and conclude that a filing in State Y is ineffective. Revision of the Official Text cannot eliminate this problem. A complete solution would require complete uniformity in the enacted text.

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 9-301 (i.e., in most jurisdictions

other than State Y). The burden now falls on the litigators to file the lawsuit in the “correct place.

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

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

SECTION 9-301. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS. Except as otherwise provided in Sections 9-303 through 9-306, the following rules determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:

(1) Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest.

(2) While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest.

(3) While goods, chattel paper, instruments, money, or negotiable documents are located in a jurisdiction, the local law of that jurisdiction governs the effect of perfection or nonperfection and the priority of a nonpossessory security interest.

(4) While goods are located in a jurisdiction, the local law of that jurisdiction governs perfection of a security interest in the goods by filing a fixture filing.

Reporters' Comments

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

2. **Law Governing Perfection: General Rule.** Paragraph (1) contains the general rule: the law governing perfection of security interests in both tangible and intangible collateral, whether perfected by filing or automatically, is the law of the jurisdiction of the debtor's location, as determined under Section 9-307. This paragraph substantially simplifies the choice-of-law rules. It eliminates former Section 9-103(1)(c) and (d), which concern nonpossessory security interests in tangible collateral that is removed from one jurisdiction to the other. It is likely to reduce the frequency of cases in which the governing law changes after a financing statement is properly filed. (Presumably, debtors change their own location less frequently than they change the location of their collateral.) The approach taken in paragraph (1) also eliminates some difficult priority issues and the need to distinguish between "mobile" and "ordinary" goods, and it reduces the number of filing offices in which secured parties must file or search.

There are potential drawbacks, as well. Arguably, determining the location of the debtor is a less certain enterprise than is generally assumed. Purchase-money equipment 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. The expansion of the scope of this Article, although modest, is likely to exacerbate the difficulties in applying choice-of-law rules during the transition.

3. **Law Governing Perfection: Exceptions.** The general rule is subject to several exceptions. It does not apply to goods covered by a certificate of title (see Sections 9-102; 9-303), deposit accounts (see Section 9-304), investment property (see Section 9-304), or minerals (see Section 9-305). Nor does it apply to possessory security interests, i.e., security interests in which the secured party is in possession, or to security interests perfected by a fixture filing.

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

The distinction between nonpossessory and possessory security interests creates the potential for the same jurisdiction to apply two different choice-of-law rules to determine perfection in the same collateral. For example, were a secured

party in possession of an instrument or document to relinquish possession in reliance on temporary perfection, the applicable law immediately would change from that of the location of the collateral to that of the location of the debtor.

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

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

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

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

Particularly serious confusion may arise when the choice-of-law rules of a given jurisdiction result in each of two competing security interests in the same collateral being governed by a different priority rule. The potential for this confusion exists under former Section 9-103(4) with respect to chattel paper:

Perfection by possession is governed by the law of the location of the paper, whereas perfection by filing is governed by the law of the location of the debtor. Consider the mess that would be created if the language or interpretation of former Section 9-308 were to differ in the two relevant States, or if one of the relevant jurisdictions (e.g., a foreign state) had not adopted Article 9. The potential for confusion could be exacerbated when a secured party perfects both by taking possession in the State where the collateral is located (State A) and by filing in the State where the debtor is located (State B)—a common practice for some chattel paper financiers. By providing that the law of the jurisdiction in which the collateral is located governs priority, paragraph (3) substantially diminishes this problem.

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

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

This Article applies the same choice-of-law rules to all debtors, foreign and domestic. For example, it adopts the bifurcated approach for determining the law applicable to goods and other tangible collateral. See Comment 4, above. The Article contains a new rule governing the location of non-U.S. debtors. The rule appears in Section 9-307 and is explained in the Reporters’ Comments following that section.

SECTION 9-302. LAW GOVERNING PERFECTION AND PRIORITY OF STATUTORY LIENS.

(a) While a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection of a statutory lien on collateral.

(b) While collateral is located in a jurisdiction, the local law of that jurisdiction governs the effect of perfection or nonperfection and the priority of a statutory lien on the collateral.

Reporters’ Comments

1. **Source.** New.

2. **Statutory Liens.** This section provides choice-of-law rules for statutory liens. Like Section 9-301, they divorce perfection from priority. Under paragraph (1), the law of the jurisdiction of the debtor's location governs perfection—i.e., filing, which is the sole means of perfecting a statutory lien (other than the special rules for proceeds in Section 9-313). Under paragraph (2), 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 statutory 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.

**SECTION 9-303. LAW GOVERNING PERFECTION AND PRIORITY
OF SECURITY INTERESTS IN GOODS COVERED BY A CERTIFICATE
OF TITLE.**

(a) Goods become covered by a certificate of title when a valid application for the certificate of title and the applicable fee are delivered to the appropriate authority.

(b) The local law of the jurisdiction under whose certificate of title the goods are covered governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in goods covered by a certificate of title from the time the goods become covered by the certificate until the earlier of the time the certificate becomes ineffective under the law of that jurisdiction or the time the goods become covered subsequently by a certificate of title from another jurisdiction. After that time, the goods are not covered by the certificate of title.

(c) This section applies to goods covered by a certificate of title even if there is no other relationship between the jurisdiction under whose certificate of title the goods are covered and the goods or the debtor.

Reporters' Comments

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

2. **External Constraints on This Section.** This section, like former Section 9-103(2), proceeds from the premise that, for goods covered by a certificate of title on which a security interest may be indicated, compliance with the

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

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

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

Normally, under the law of the relevant jurisdiction, the perfection step would consist of compliance with that jurisdiction’s certificate-of-title act and a resulting notation of the security interest on the certificate of title. See Section 9-309A(c). In the typical case of an automobile or over-the-road truck, a person who wishes to take a security interest in the vehicle can ascertain whether it is subject to any security interests by looking at the certificate of title. But certificates of title cover certain types of goods in some States but not in others. A secured party who does not realize this may extend credit and attempt to perfect by filing in the jurisdiction where the debtor is located. If the goods had been titled in another jurisdiction, the lender would be unperfected.

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

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

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

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

5. Continued Perfection. The fact that the law of one State ceases to apply under subsection (a) does not necessarily mean that a security interest perfected under that law automatically becomes unperfected. See Section 9-314(d).

6. Inventory. Compliance with a certificate-of-title act generally is *not* the method of perfecting security interests in inventory. Section 9-309A(b) 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 following example explains the subtle relationship between this rule and the choice-of-law rules in Section 9-303(b) and former Section 9-103(2):

Example: Goods are located in State A and covered by a certificate of title issued under the law of State A. The State A certificate of title is “clean” : it does not reflect a security interest. Owner takes the goods to State B and sells (trades in) the goods to Dealer, who is located (within the meaning of Section 9-307) in State B. As is customary, Dealer retains the duly assigned State A certificate of title pending resale of the goods. Dealer’s inventory financier, SP-B, obtains a security interest in the goods under its after-acquired property clause.

Under Section 9-309A(b) 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 9-303(b) 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 9-501. That result would be anomalous, to say the least, since the principle underlying Section 9-309A(b) is that the inventory should be treated as ordinary goods.

Section 9-303(b) (and former Section 9-103(2)) should be read as providing that the law of State B, not State A, applies. A court looking to the forum’s Section 9-303(b) would find that the subsection applies only if two conditions are met: (i) the goods were “covered” by the certificate as defined in Section 9-102, i.e., application had been made for a State (here, State A) to issue a certificate of title covering the goods and (ii) the certificate is a “certificate of title” as defined in Section 9-102, i.e., a statute 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 9-303(b) applies only when compliance with a certificate-of-title statute, and not filing, is the appropriate method of perfection. Under the law of State A, *for purposes of perfecting SP-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 9-303(b) does not apply to the goods. Instead, Section 9-301 applies, and the applicable law is that of State B, where the debtor (dealer) is located.

7. Relation Back. 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 9-309A, Comment 6.

SECTION 9-304. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS IN DEPOSIT ACCOUNTS. 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 depository institution's jurisdiction for purposes of this section:

(1) If an agreement between the depository institution and the debtor expressly specifies a particular jurisdiction as the depository institution's jurisdiction for purposes of this part, this article, or this [Act], that jurisdiction is the depository institution's jurisdiction.

(2) If an agreement between the depository institution and its customer does not specify the depository institution's jurisdiction pursuant to paragraph (1) but expressly specifies that the deposit account is maintained at an office in a particular jurisdiction, that jurisdiction is the depository institution's jurisdiction.

(3) If an agreement between the depository institution and its customer does not specify a jurisdiction pursuant to paragraph (1) or (2), the depository 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.

(4) If an agreement between the depository institution and its customer does not specify a jurisdiction pursuant to paragraph (1) or (2) and an account statement does not identify an office serving the customer's account pursuant to paragraph (3), the depository institution's jurisdiction is the jurisdiction in which is located the chief executive office of the depository institution.

Reporters' Comments

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

2. **Deposit Accounts.** Under this section, the law of the “depository institution’s jurisdiction” governs perfection and priority of a security interest in deposit accounts. Paragraphs (1) through (4) contain rules for determining the “depository institution’s jurisdiction.” The substance of these rules is substantially similar to that of the rules determining the “security intermediary’s jurisdiction” under Section 8-110(e), except that paragraph (1) provides more flexibility than the analogous provision in Section 8-110(e)(1). Paragraph (1) permits the parties to choose the law of one jurisdiction to govern perfection and priority of security interests and a different governing law for other purposes. Section 8-110(e)(1)

(included in the Appendix to this draft) has been conformed to paragraph (1) of this section, and Section 9-305(a)(4)(A), concerning a commodity intermediary's jurisdiction, makes a similar departure from former Section 9-103(6)(e)(i).

3. **Style.** This section departs stylistically from Section 8-110(e) in several ways. If these departures are retained, Section 8-110(e) probably should be conformed.

SECTION 9-305. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS IN INVESTMENT PROPERTY.

(a) Except as otherwise provided in subsection (b), the following rules apply to a security interest in investment property:

(1) While a security certificate is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in the certificated security represented thereby.

(2) The local law of the issuer's jurisdiction as specified in Section 8-110(d) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in an uncertificated security.

(3) The local law of the securities intermediary's jurisdiction as specified in Section 8-110(e) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a security entitlement or securities account.

(4) The local law of the commodity intermediary's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a commodity contract or commodity account. The following rules determine a commodity intermediary's jurisdiction for purposes of this paragraph and Section 9-314:

(A) If an agreement between the commodity intermediary and commodity customer expressly specifies the commodity intermediary's jurisdiction

for purposes of this part, this article, or this [Act], that jurisdiction is the commodity intermediary's jurisdiction.

(B) If an agreement between the commodity intermediary and commodity customer does not specify the commodity intermediary's jurisdiction pursuant to subparagraph (A) but expressly specifies that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(C) If an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction pursuant to subparagraph (A) or (B), 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.

(D) If an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction pursuant to subparagraph (A) or (B) and an account statement does not identify an office serving the commodity customer's account pursuant to subparagraph (C), the commodity intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the commodity intermediary.

(b) The local law of the jurisdiction in which the debtor is located governs 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.

Reporters' Comments

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

2. **Change from Former Law.** Subsection (a)(4)(A) has been revised to provide more flexibility for the parties to select the security intermediary's

jurisdiction. See also Section 9-304(1) (depository institution's jurisdiction); Section 8-110(e)(1) (securities intermediary's jurisdiction) (included in the Appendix to this draft).

3. **Style.** This section departs stylistically from Section 8-110(e) in several ways. If these departures are retained, Section 8-110(e) probably should be conformed.

SECTION 9-306. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS IN MINERALS. [MINOR STYLE CHANGES ONLY] The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest that is created by a debtor having an interest in minerals or the like, including oil and gas, before extraction, and which attaches to the collateral as extracted or which attaches to an account resulting from the sale of the collateral at the wellhead or minehead.

Reporters' Comments

1. **Source.** Former Section 9-103(5).

2. **Status.** Although the Drafting Committee held a preliminary discussion of the provisions relating to security interests in minerals, the draft does not reflect the deliberations.

SECTION 9-307. LOCATION OF DEBTOR.

(a) Except as otherwise provided in this section, for purposes of this part, an individual debtor is located at the individual's residence, any other debtor having only one place of business is located at its place of business, and any other debtor having more than one place of business is located at its chief executive office, but only if the residence, place of business, or chief executive office, as applicable, is located either in a State or in a jurisdiction, other than a State, whose law requires information concerning the [possible] existence of a security interest to be made publicly available as a condition or result of the security interest's obtaining priority

over the rights of a lien creditor with respect to the collateral. In other cases, the debtor is located in the District of Columbia.

(b) For purposes of this part, a registered entity is located in its State of organization.

(c) For purposes of this part, the United States and its governmental entities are located in the District of Columbia.

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

Reporters' Comments

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

2. **General Rule.** As a general matter, the location of the debtor determines the jurisdiction whose law governs perfection of a security interest or a statutory lien. See Sections 9-301(1), 9-302(b), and 9-305(b). This section determines the location of the debtor. Subsection (a) states the baseline rules: An individual debtor is deemed to be located at the individual's residence with respect to both personal and business assets. Any other debtor is deemed to be located at its place of business if it has only one, or at its chief executive office if it has more than one place of business. As used in this subsection, "business" is meant to include the activities of eleemosynary institutions. The Drafting Committee may wish to consider whether the statutory text adequately expresses this expansive view of "business" activity. The baseline rule is subject to four exceptions, each of which is discussed below.

3. **Registered Entities.** Under subsection (b), "a registered entity is located in its State of organization. Section 9-102 defines a "registered entity" as "an organization organized 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 "State of organization" as the "State 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.

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).

4. United States as Debtor. To the extent that Article 9 governs (see Sections 1-105; 9-112(c)), the United States and its subdivisions, instrumentalities, and other governmental entities are located in the District of Columbia. See subsection (c).

Example: Debtor is an instrumentality of the United States, having its chief executive office in New York City. Debtor creates a security interest in its equipment, which is located in Boulder, Colorado. Assuming Article 9 applies, subsection (c) provides that Debtor is located in the District of Columbia. Under Section 9-301(1), perfection is governed by the law of the debtor's location, i.e., the District of Columbia, whereas under 9-301(3), the law of the jurisdiction in which the collateral is located—here, Colorado—governs priority.

We are informed that the filing office of the District of Columbia is not as efficient as one might like. The Drafting Committee continues to consider whether another office would be preferable.

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

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

to goods and other tangible collateral, these issues are governed by the law of the jurisdiction in which the collateral is located. See Section 9-301(3).

A “registered entity” is located in its State of organization. See subsection (b). Inasmuch as “registered entity” is defined to exclude entities that are not organized under the law of a “State,” both foreign individuals and foreign corporations may be deemed located in the District of Columbia.

Example: Debtor is an English corporation with its chief executive office in London. Debtor creates a security interest in its accounts. Subsection (a) provides that Debtor is located in London if English law conditions perfection on giving public notice. Otherwise, Debtor is located in the District of Columbia. Under Section 9-301(1), perfection, the effect of perfection, and priority are governed by the law of the jurisdiction of the debtor’s location—here, England or the District of Columbia (depending on the content of English law).

Example: Debtor is an English corporation with its chief executive office in London. Debtor creates a security interest in its equipment. Subsection (a) provides that Debtor is located in London if English law conditions perfection on giving public notice. Otherwise, Debtor is located in the District of Columbia. Under Section 9-301(1), perfection is governed by the law of the jurisdiction of the debtor’s location, whereas the law of the jurisdiction in which the collateral is located—here, England—governs priority. See Section 9-301(3).

The foregoing discussion assumes that each transaction bears an appropriate relation to the forum State. In the absence of an appropriate relation, the forum State’s entire UCC, including the choice-of-law provisions in Article 9 (Sections 9-301 through 9-307), will not apply. See Section 9-112, Comment 6..

6. Foreign Air Carriers. Subsection (d) follows former Section 9-103(3)(d).

[SUBPART 2. PERFECTION]

SECTION 9-308. WHEN SECURITY INTEREST OR STATUTORY LIEN IS PERFECTED; CONTINUITY OF PERFECTION.

(a) Except as otherwise provided in this section and in Section 9-308A, a security interest is perfected if it has attached and all of the applicable requirements for perfection in Sections 9-309 through 9-313 have been satisfied. If the

requirements are satisfied before the security interest attaches, it is perfected when it attaches.

(b) A statutory lien is perfected if it has become effective and all of the applicable requirements for perfection in Sections 9-309 and 9-313 have been met. If the requirements are satisfied before the statutory lien becomes effective, it is perfected when it becomes effective.

(c) If a security interest or statutory lien is originally perfected in one manner 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 statutory lien is perfected continuously.

(d) Perfection of a security interest in an account, chattel paper, document, instrument, [insurance policy,] general intangible, or security also perfects a security interest in a support obligation for the collateral.

(e) Perfection of a security interest in a securities account also perfects a security interest in all security entitlements carried in the securities account. Perfection of a security interest in a commodity account also perfects a security interest in all commodity contracts carried in the commodity account.

(f) Notwithstanding other law to the contrary, perfection of a security interest in a right to payment or performance, other than a right to payment evidenced by chattel paper, also perfects a security interest in a [mortgage on real property] [lien on property] securing the right.

Legislative Note: To avoid confusion, any statute conflicting with subsection (f) should be made expressly subject to that subsection.

Reporters' Comments

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

2. **General Rule.** Subsection (a) explains that a security interest is perfected only when it has attached and when a required “perfection” or “public notice” step has been taken. The “except” clause refers to the automatic perfection

rules appearing in Section 9-308A. It also reflects that other subsections of this section, e.g., subsection (d), contain perfection steps.

3. **Statutory Liens.** Subsection (b) is new. It describes the elements of perfection of a statutory lien.

4. **Support Obligation.** 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.

Example: Buyer is obligated to pay Debtor for goods sold. Buyer's president guarantees the obligation. Perfection of a security interest in Debtor's right to payment (an account) constitutes perfection of a security interest in Debtor's rights under the guarantee.

5. **Investment Property.** Subsection (e) follows former Section 9-115(2).

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

The primary consequence of the rules in Section 9-203(e)(5) and subsection (f) is that, by acquiring a perfected security interest in a mortgage note, the secured party acquires a security interest in the mortgage that is senior to the rights of a person who becomes a lien creditor of the mortgagee (Article 9 debtor). See Section 9-315(a)(2). This result helps prevent the separation of the mortgage from the note. As a comment to the Restatement of Mortgages observes, "when the ownership of the note and mortgage are split, the note becomes, as a practical matter, unsecured. This result is economically wasteful and confers an unwarranted windfall on the mortgagor. Restatement of the Law of Property (Mortgages) § 5.4(a), Comment a., Tent. Draft No. 5 (March 18, 1996).

SECTION 9-308A. SECURITY INTEREST PERFECTED UPON

ATTACHMENT. The following security interests are perfected when they attach:

(1) a purchase money security interest in consumer goods except as otherwise provided in Section 9-309A(c) with respect to consumer goods that are subject to a statute or treaty described in Section 9-309A(a);

- (2) an assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles;
- (3) a sale of a payment intangible;
- (4) a security interest of a collecting bank arising under Section 4-210 or Article 2 or 2A;
- (5) a security interest arising in the purchase or delivery of a financial asset under Section 9-206;
- (6) a security interest in investment property created by a broker or securities intermediary;
- (7) a security interest in a commodity contract or a commodity account created by a commodity intermediary;
- (8) an assignment for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder;
- (9) a security interest created by an assignment of a beneficial interest in a trust unless the beneficial interest constitutes investment property;
- (10) a security interest created by an assignment of a beneficial interest in a decedent's estate; and
- (11) a security interest arising under Article 2 or 2A.

Reporters' Comments

1. **Source.** Derived from former Sections 9-302(1); 9-115(4)(c), (d); 9-116.
2. **Automatic Perfection.** This section contains the automatic perfection rules previously located former Sections 9-302(1), 9-115(4)(c), (d), and 9-116. Rather than continue to state the rule by indirection, this section explicitly provides for perfection upon attachment.
3. **Purchase Money Security Interest in Consumer Goods.** Former Section 9-302(1)(d) has been revised and appears here as paragraph (1). No filing or other step is required to perfect a purchase money security interest in consumer goods, other than goods that are subject to a statute or treaty described in Section 9-309A(a). However, filing is necessary to prevent a buyer of the goods from

taking free of the security interest under Section 9-316(b), and a fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9-331.

4. **Payment Intangibles.** Paragraph (2) expands upon former subsection (1)(e) by affording automatic perfection to certain assignments of payment intangibles. Paragraph (3), which is new, 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 paragraph (2) covers outright sales of payment intangibles, which automatically are perfected under paragraph (3), the exception is redundant.

5. **Investment Property.** Paragraphs (5) replaces the last clause of each subsection of former Section 9-116. Paragraphs (6) and (7) replace former Section 9-115(4)(c) and (d). The last two indicated that, with respect to certain security interests created by a securities intermediary or commodity intermediary, “[t]he filing of a financing statement . . . has no effect for purposes of perfection or priority with respect to that security interest. No change in meaning is intended by the deletion of the quoted phrase.

6. **Beneficial Interests in Trusts.** The formulation of paragraph (9) is new. It explicitly limits automatic perfection in a beneficial interest in a trust to those beneficial interests that do not constitute investment property. Thus, a collateral assignment of the beneficial interest in a business trust would not be automatically perfected, whereas a collateral assignment of the beneficial interest in a family trust would be.

SECTION 9-309. WHEN FILING REQUIRED TO PERFECT SECURITY INTEREST OR STATUTORY LIEN; SECURITY INTERESTS AND STATUTORY LIENS TO WHICH FILING PROVISIONS DO NOT APPLY.

(a) A financing statement must be filed to perfect all security interests and statutory liens other than a security interest:

- (1) in a support obligation under Section 9-308(d);
- (2) that is perfected when it attaches (Section 9-308A);
- (3) in property subject to a statute, regulation, or treaty described in Section 9-309A(a);

(4) in instruments, certificated securities, chattel paper, or documents perfected without filing or possession under Section 9-310(d) or (e);

(5) in collateral in the secured party's possession under Section 9-311;

(6) in investment property, a deposit account, or a letter of credit and proceeds of the letter of credit which is perfected without filing under Section 9-312;

(7) in or statutory lien on proceeds under Section 9-313(e); or

(8) perfected under Section 9-314(a), (c), or (d).

(b) If a secured party assigns a perfected security interest, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

Reporters' Comments

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

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

3. **Support Obligations.** New subsection (a)(1) reflects the rule in new Section 9-308(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.

4. **Automatic Perfection.** The automatic perfection rules of former Section 9-302(1) have been relocated to new Section 9-308A, to which subsection (a) now makes reference.

5. **Preemptive Federal Law; Certificate of Title Acts.** New subsection (a)(3) excepts from the filing requirement property covered by a statute, regulation, or treaty described in Section 9-309A(a). Perfection as to this property is governed by Section 9-309A(c).

6. **Statutory Liens.** Statutory liens may be perfected only by filing, except to the extent that Section 9-313(e) provides otherwise with respect to proceeds. Thus agricultural liens are not mentioned in subsection (a)(5) or Section 9-311, which deal with possessory security interests. The priority rule in Section 9-330 remains applicable to possessory statutory liens.

7. **Investment Property; Letters of Credit; Deposit Accounts.** Subsection (a)(6) is new. It reflect that a security interest in investment property, a

letter of credit and proceeds of the letter of credit, and a deposit account may be perfected by control under Section 9-312.

8. Assignments of Perfected Security Interests. Subsection (b) concerns assignment of a perfected security interest. It provides that no filing is necessary in connection with an assignment of a perfected security interest by a secured party to an assignee in order to maintain perfection as against creditors and transferees of the debtor. Although subsection (b) addresses explicitly only the absence of an additional filing requirement, the same result normally will follow in the case of an assignment of a security interest perfected in a manner other than by filing, such as by control, by possession, or by compliance with a statute, regulation, or treaty under Section 9-309A(c). For example, as long as possession of collateral is maintained by an assignee or by the assignor or another person on behalf of the assignee, no further perfection steps need be taken on account of the assignment. Of course, additional action may be required for perfection of the assignee's interest as against creditors and transferees of the *assignor*.

SECTION 9-309A. PERFECTION OF SECURITY INTERESTS IN PROPERTY SUBJECT TO CERTAIN STATUTES, REGULATIONS, AND TREATIES.

(a) Except as otherwise provided in subsection (b), 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 Section 9-309(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] [; 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].

(b) 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, subsection[s] (a)(2) [does] [and (a)(3) do] not apply to a security interest in that collateral created by that person as debtor.

(c) Compliance with the requirements prescribed by a statute, regulation, or treaty described in subsection (a) 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 9-311 and 9-314(c) for goods covered by a certificate of title, a security interest in property subject to a statute, regulation, or treaty described in subsection (a) may 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 9-314(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. **Source.** Former Section 9-302(3), (4).

2. **Federal Statutes, Regulations, and Treaties.** Subsection (a)(1) provides explicitly that the filing requirement of this Article defers only to federal statutes, regulations, or treaties whose requirements for a security interest's obtaining priority over the rights of a lien creditor preempt Section 9-309(a). The provision eschews reference to the term "perfection, inasmuch as Section 9-308 specifies the meaning of that term and a preemptive rule may use other terminology.

3. **Forum's Certificate-of-title Statute.** The description of certificate-of-title statutes in subsection (a)(2) has been revised to track the language of Section 9-303.

4. **Foreign Jurisdiction's Certificate-of-title Statute.** Subsection (a) retains paragraph (3) (former Section 9-302(3)(c)), with appropriate revisions to conform that paragraph to Section 9-303. However, paragraph (3) appears in brackets because Section 9-303 apparently makes the paragraph unnecessary.

Assume that a court is applying Section 9-309A 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 9-309A(a)(2), will apply. Once application is made for a State B certificate, State B's law will apply, including State B's Sections 9-303(b) and 9-309A(a)(2). There seems to be no room for a security interest to be perfected *under the law of State B* through compliance with *State A's certificate-of-title act*. Note, however, that State B's 9-314(c) does terminate perfection if perfection would have lapsed under the law of State A.

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

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

The phrase “held for sale or lease or leased by a person who is in the business of selling or leasing goods” is intended to include inventory in the possession of a lessee from a dealer. The definition of “inventory” (former Section 9-101(4)) contains a similar phrase, but omits any reference to goods that are “leased. Section 9-106(d) conforms the definition of inventory to Section 9-309A(a)(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.”)

6. Compliance with Perfection Requirements of Other Statute. Subsection (c) clarifies former Section 9-302(4) by providing that compliance with the perfection requirements (i.e., the requirements for obtaining priority over a lien creditor), but not other requirements, of a statute, regulation, or treaty described in subsection (a) 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 9-303 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 9-303 and 9-309A(c). 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), subsection (c) provides that compliance with a statute or treaty described in subsection (a) (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 9-515(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 9-309(b) and Section 9-505. 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 9-309A(c). 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 9-309A(c). In the alternative, the Official Comments to Section 9-309A 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 Section 9-314(c) 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 9-314(c), 9-309A(c), and 9-311(b) to provide that a security interest that remains perfected solely by virtue of Section 9-314(c) can be (re)perfected by the secured party’s taking possession of the collateral. These sections contemplate only that taking possession of goods covered by a certificate of title will work as a method of perfection. None of these sections creates a right to take possession. Section 9-609 and the agreement of the parties define the secured party’s right to take possession.

SECTION 9-310. PERFECTION OF SECURITY INTERESTS IN INSTRUMENTS, CHATTEL PAPER, INVESTMENT PROPERTY, 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, investment property, or negotiable documents may be perfected by filing. Except as otherwise provided in Section 9-313(e) for cash proceeds:

(1) a security interest in money may be perfected only by the secured party’s taking possession under Section 9-311;

(2) a security interest in a deposit account may be perfected only by control under Section 9-312; and

(3) except as otherwise provided in Section 9-308(d) for support obligations, a security interest in a letter of credit and proceeds of the letter of credit may be perfected only by control under Section 9-312.

(b) While goods are in the possession of a bailee that has issued a negotiable document under Section 7-104(1) [or federal law] 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 subordinate to the security interest perfected in the document.

(c) A security interest in goods in the possession of a bailee that has issued a non-negotiable document under Section 7-104(2) [or federal law] 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 an authenticated security agreement.

(e) A security interest remains perfected for 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 9-322; 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 period specified in subsection (d) or (e) expires, perfection depends upon compliance with this article.

Reporters' Comments

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

2. **Instruments.** Under subsection (a), a security interest in instruments may be perfected by filing. This security interest is subject to defeat by subsequent purchasers (including secured parties). Section 9-328 provides that filing a financing statement does not constitute notice that would preclude a subsequent purchaser from becoming a holder in due course and taking free of all claims under Section 3-306. Moreover, if Section 9-327 is made applicable to instruments, 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.

3. **Deposit Accounts.** Under new subsection (a)(2), 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 9-313 with respect to proceeds. As defined in Section 9-109, “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)(2) 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)(2) accommodates the views of those who think that a secured party who wishes to rely upon a deposit account should take steps to be able to reach the funds upon the debtor’s default without having to resort to the judicial process. It also accommodates those who think that requiring the secured party to achieve absolute dominion and control, to the exclusion of the debtor, would prevent perfection in transactions in which the secured party actually relies on the deposit account and maintains some meaningful control over it.

4. **Letters of Credit and Proceeds of Letters of Credit.** A letter of credit commonly is a “support obligation,” as defined in Section 9-102. If so, and perfection as to the related account, chattel paper, document, instrument, [insurance policy,] general intangible, or investment property will perfect as to the letter of credit and proceeds of the letter of credit. See Section 9-308(d). Those who are familiar with letter-of-credit practice disagree about the circumstances, if any, under which perfection by control should be permitted. Until this issue is resolved, new subsection (a)(3) provides, except for letters of credit that are support obligations, a security interest in a letter of credit or the proceeds of the letter of credit may be perfected only by control.

5. **Goods in Possession of Bailee.** The rule in subsection (c) has been limited to goods in the possession of a bailee that has issued a non-negotiable document of title under Article 7 [or federal law]. Subsection (b) applies to goods in the possession of a bailee that has issued a negotiable document. Section 9-311 governs perfection of a security interest in goods in the possession of a bailee that has not issued a document of title.

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 9-311(c) (perfection by possession as to goods not covered by a document requires bailee's acknowledgment).

6. Maintaining Perfection After Surrendering Possession.

“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.

7. Length of Temporary Perfection. 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 9-311. 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 9-314(c).

(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, the secured party takes possession when the person in possession signs a record acknowledging 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 authenticated a record acknowledging 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 provided in this article.]

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

(e) If a person acknowledges that it holds possession for the secured party's benefit:

(1) the acknowledgment is effective under subsection (c) even if the acknowledgment violates the rights of a debtor; and

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

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

3. **Goods Covered by a Certificate of Title.** Subsection (b) is necessary to effect changes to the choice-of-law rules governing goods covered by a certificate of title. These changes are described in the Reporters' Comments to Section 9-309. Subsection (b), like subsection (a), does not create a right to take possession. Rather, it indicates the circumstances under which the secured party's taking possession of goods covered by a certificate of title is effective to perfect a security interest in the goods.

4. Goods in Possession of a Third Party: Perfection. Former Section 9-305 permits perfection of a security interest by notification to a bailee in possession of collateral. This Article distinguishes between goods in the possession of a bailee that has issued an Article 7 [or federal] document of title covering the goods and goods in the possession of a third party that has not issued a document. Section 9-310(b) or (c) applies to the former, depending on whether the document is negotiable; Section 9-311(c) applies to the latter.

Notification of a third person does not suffice to perfect under Section 9-311(c). Rather, perfection does not occur unless the third person authenticates an acknowledgment that it holds possession of the collateral for the secured party's benefit. Compare Section 9-310(c), under which receipt of notification of the security party's interest by a 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 subsection (c), acknowledgment of notification by a lessee in ordinary course of business (as defined in Section 2A-103) does not suffice for possession. The section thus rejects the reasoning of *In re Atlantic Systems, Inc.*, 135 B.R. 463 (Bankr. S.D.N.Y. 1992) (holding that notification to debtor-lessor's lessee sufficed to perfect security interest in leased goods). See Steven O. Weise, *Perfection by Possession: The Need for an Objective Test*, 29 Idaho Law Rev. 705 (1992-93) (arguing that lessee's possession in ordinary course of debtor-lessor's business does not provide adequate public notice of possible security interest in leased goods). Inclusion of a per se rule concerning lessees is not meant to preclude a court, under appropriate circumstances, from determining that a third person is so closely connected to or controlled by the debtor that the debtor has retained effective possession. If so, the third person's acknowledgment would not be sufficient for perfection.

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

5. Goods in Possession of a Third Party: Consequences of Acknowledgment. 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 an acknowledgment does not give rise to any such duties or responsibilities under this Article.

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

SECTION 9-312. PERFECTION BY CONTROL.

(a) A security interest in investment property, a deposit account, or a letter of credit and proceeds of the letter of credit may be perfected by control of the collateral under Section 9-108, 9-109, or 9-110.

(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 provided 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’ Comments

1. **Source.** New.

2. **Control.** This section provides for perfection by control with respect to letters of credit and proceeds of letters of credit, deposit accounts, and investment property.

SECTION 9-313. “PROCEEDS”; SECURED PARTY’S RIGHTS ON DISPOSITION OF COLLATERAL AND 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 in 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 a statutory lien continues on collateral notwithstanding disposition or becomes effective as to proceeds.

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

(1) if the proceeds are goods, to the extent provided by Section 9-333;

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 a statutory lien on proceeds is a perfected security interest or statutory lien if the interest in or lien on the original collateral was perfected. The security interest in or statutory 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 statutory 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 statutory lien on the proceeds is perfected within 20 days after the security interest attaches to the proceeds or the statutory lien becomes effective as to the proceeds.

(f) Except as otherwise provided in subsection (e), a security interest in or statutory lien on proceeds may 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 statutory lien on proceeds which remains perfected under subsection (e)(1) becomes unperfected when the effectiveness of the filed financing statement lapses under Section 9-516 or is terminated under Section 9-511, but in no event before the 21st day after the security interest attaches to the proceeds or the statutory lien becomes effective as to the proceeds.

Reporters' Comments

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

2. **What Constitutes Proceeds.** Subsection (a) expands the definition of proceeds beyond that contained in former Section 9-306 and resolves ambiguities in the former section.

a. **Distributions on Account of Collateral.** The phrase “whatever is . . . 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 former 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.”

b. 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 9-102) are afforded treatment identical to proceeds collected from or distributed by the obligor 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 9-326 (security interest in letter of credit perfected by control has priority over a conflicting security interest).

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

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

3. 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.

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

5. Automatic Perfection in Proceeds. This Article extends the period of automatic perfection in proceeds from 10 days to 20 days, 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, e.g., Section 9-516(a) (deeming security interest unperfected retroactively).

a. 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.

b. Continuation of Perfection in Cash Proceeds. Former subsection (3)(b) provides that if a filed financing statement covers original collateral, a security interest in cash proceeds of the collateral remains perfected beyond the ten-day period of automatic perfection. Subsection (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.

6. Transferees of Cash Proceeds. The former text of and Official Comments to Section 9-306 do not deal adequately with the rights of a person to whom the debtor has transferred cash proceeds, such as a person who receives payment of a check drawn on a deposit account constituting proceeds. Section 9-329 addresses this issue.

7. Insolvency Proceedings; Returned and Repossessed Goods. This Article deletes former subsection (4), which deals with proceeds in insolvency proceedings, and former subsection (5), which deals with returned and repossessed goods. In the absence of Section 9-306(5), Official Comments to Section 9-327 will explain and clarify the application of priority rules to returned and repossessed goods as proceeds of chattel paper.

8. Proceeds of Collateral Subject to Statutory 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 a statutory lien, other law (e.g. the statute giving rise to the statutory lien), and not subsection (c), determines the extent to which the lien continues in proceeds. Only

if other law provides that the statutory 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.

9. Lapse or Termination of Financing Statement During 20-day Period.

Subsection (g) provides that a security interest in or statutory 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 statutory lien attaches, however, the security interest in or statutory lien on the proceeds remains perfected until the 21st day. Section 9-309A(c) provides that compliance with the perfection requirements of a statute or treaty described in Section 9-309A(a) “is equivalent to the filing of a financing statement. It follows that collateral subject to a security interest perfected by such compliance under Section 9-309A(c) is covered by a “filed financing statement” within the meaning of Section 9-313(e)(1) and (g).

**SECTION 9-314. CONTINUED PERFECTION OF SECURITY
INTEREST OR STATUTORY LIEN FOLLOWING CHANGE IN
APPLICABLE LAW.**

(a) A security interest perfected pursuant to the law designated in Section 9-301(1) or a statutory lien perfected pursuant to the law designated in Section 9-302(1) remains perfected until the earliest of the expiration of four months after a change of the debtor’s location to another jurisdiction, the expiration of four months after a transfer of collateral to a debtor located in another jurisdiction, the expiration of four months after a new debtor located in another jurisdiction becomes bound under Section 9-203(c), or the time perfection would have ceased under the law of the first jurisdiction. If the security interest or statutory lien becomes perfected under the law of the other jurisdiction before the end of that period, it continues perfected thereafter. Otherwise, it becomes unperfected and is deemed never to have been perfected as against a prior or subsequent purchaser of the collateral for value.

(b) A possessory security interest in collateral, other than goods covered by a certificate of title and minerals described in Section 9-306, remains continuously perfected if:

- (1) the collateral is located in one jurisdiction and subject to a security interest perfected under the law of that jurisdiction;
- (2) thereafter the collateral is brought into another jurisdiction; and
- (3) upon entry into the other jurisdiction the security interest is perfected under the law of the other jurisdiction.

Alternative A

(c) A security interest in goods covered by a certificate of title 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 the time the security interest would have become unperfected under the law of the other jurisdiction had the goods not become so covered or the expiration of four months after the goods had become so covered. If the security interest becomes perfected under Section 9-309A(c) or 9-311 before the earlier of that time or the expiration of that period, it continues perfected thereafter. Otherwise, it becomes unperfected and is deemed never to have been perfected as against a prior or subsequent purchaser of the collateral for value.

Alternative B

(c) A security interest in goods covered by a certificate of title 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 under the law of the other jurisdiction had the goods not become so covered. However, if the applicable requirements for perfection under Section 9-309A(c) or 9-311 are not satisfied before the earlier of the time the security interest would have become unperfected

under the law of the other jurisdiction had the goods not become so covered or the expiration of four months after the goods had become so covered, the security interest becomes unperfected as against a purchaser of the goods for value and is deemed never to have been perfected as against a prior or subsequent purchaser of the collateral for value.

End of Alternatives

(d) A security interest in deposit accounts [or investment property] perfected under the law of the depositary institution's jurisdiction[, the securities intermediary's jurisdiction, or the commodity intermediary's jurisdiction, as applicable] remains perfected until the earlier of the expiration of four months after a change of the [depository institution's] jurisdiction or the time perfection would have ceased under the law of the first jurisdiction. If the security interest becomes perfected under the law of the other jurisdiction before the end of that period, it continues perfected thereafter. Otherwise, it becomes unperfected and is deemed never to have been perfected as against a prior or subsequent purchaser of the collateral for value.

[(e) A security interest in investment property perfected under the law of the securities intermediary's jurisdiction or the commodity intermediary's jurisdiction, as applicable, remains perfected until the earlier of the expiration of four months after a change of the intermediary's jurisdiction or the time perfection would have ceased under the law of the first jurisdiction. If the security interest becomes perfected under the law of the other jurisdiction before the end of that period, it continues perfected thereafter. Otherwise, it becomes unperfected and is deemed never to have been perfected as against a prior or subsequent purchaser of the collateral for value.]

Reporters' Comments

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

2. **Retroactive Unperfection.** This section deals with continued perfection of security interests and statutory liens that have been perfected under the law of another jurisdiction. The fact that the law of a particular jurisdiction ceases to govern perfection under Sections 9-301 through 9-307 does not necessarily mean that a security interest or statutory lien perfected under that law automatically becomes unperfected. This section generally provides that a security interest or statutory lien perfected under the law of one jurisdiction remains perfected for four months even though the jurisdiction whose law governs perfection changes.

This section generally follows the approach of former Section 9-103(1)(d) and (3)(e) with respect to the consequences of a secured party's failure to reperfect a security interest within four months after the other jurisdiction's law ceases to apply: the security interest becomes unperfected prospectively and, as against purchasers for value but not as against donees or lien creditors, retroactively. The rule applies to statutory liens, as well. See also Section 9-516 (taking the same approach with respect to lapse). Although this approach creates the potential for circular priorities, the alternative—retroactive unperfection against lien creditors—would create substantial and unjustifiable preference risks.

3. **Goods Covered by a Certificate of Title.** The Drafting Committee has yet to reach consensus on which alternative subsection (c) it prefers. Under both alternatives, the failure to reperfect within four months results in the security interest becoming unperfected both prospectively and retroactively as against purchasers of the goods for value. With respect to prospective unperfection against lien creditors, Alternative A takes the same approach as subsections (a), (d), and (e); i.e., the failure to reperfect results in the security interest becoming unperfected prospectively against lien creditors. However, under Alternative B, a prior perfection under the law of another jurisdiction can remain effective against lien creditors until perfection lapses under the law of the other jurisdiction, which may occur well beyond the four-month period.

4. **Depository Institutions and Securities Intermediaries.** The bracketed language in subsection (d) and the brackets around subsection (e) raise the issue whether one subsection is adequate to address changes in the jurisdiction of a depository institution, securities intermediary, and commodity intermediary, or whether a separate subsection is needed for depository institutions. (A third possibility is to create three separate subsections—one for depository institutions, one for securities intermediaries, and one for commodity intermediaries—each of which would contain the same rule.)

[SUBPART 3. PRIORITY]

**SECTION 9-315. INTERESTS THAT TAKE PRIORITY OVER AND
TAKE FREE OF UNPERFECTED SECURITY INTEREST OR
AGRICULTURAL LIEN.**

(a) An unperfected security interest or agricultural lien is subordinate to the rights of:

(1) a person entitled to priority under Section 9-319; and

(2) a person that becomes a lien creditor before the security interest is perfected and before a financing statement covering the collateral is filed.

(b) An unperfected statutory lien other than an agricultural lien is subordinate to the rights of a person entitled to priority under Section 9-319A.

(c) Except as otherwise provided in subsection (g), a buyer of goods, instruments, documents, a security certificate, or chattel paper which is not a secured party takes free of a security interest if the buyer gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected.

(d) Except as otherwise provided in subsection (g), a lessee of goods takes free of a security interest if the lessee receives delivery of the collateral without knowledge of the security interest and before it is perfected.

(e) A buyer of accounts, general intangibles, or investment property other than a security certificate which is not a secured party takes free of a security interest if the buyer gives value without knowledge of the security interest and before it is perfected.

(f) Except as otherwise provided in Section 9-316, 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 delivery of the collateral, the security

interest takes priority over the rights of a buyer, lessee, or lien creditor which arise between the time the security interest attaches and the time of filing.

Reporters' Comments

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

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

On the other hand, this result treats the first secured advance differently from all other advances. The special rule for future advances in Section 9-320(b) (former Section 9-301(d)) affords priority to a discretionary advance made by a secured party within 45 days after the lien creditor's rights arise as long as the secured party is "perfected" when the lien creditor's lien arises—i.e., so long as the advance is not the first one and an earlier advance has been made.

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

3. **Security Interests of Consignors and Receivables Buyers.** "Security interest" is defined in Section 1-201(37) to include the interest of a true consignor and the interest of a buyer of certain receivables (accounts, chattel paper, and payment intangibles). A consignee or a seller of receivables each has rights in the collateral that a lien creditor may reach, as long as the competing security interest of the consignor or buyer is unperfected. This is so even though the debtor-consignee or debtor-seller may not have any rights in the collateral as between it and the consignor or buyer. See Section 9-315A.

4. **Receivables Buyers That Are Not Secured Parties.** A buyer of accounts, chattel paper, or payment intangibles can be a person "which is not a secured party" under subsection (c) or (d) only in a transaction that is excluded from Article 9 by Section 9-112(c)(7), (8), (9), or (10).

5. **Statutory Liens.** Subsection (a) subordinates unperfected agricultural liens in the same fashion that it subordinates unperfected security interests. Subsection (b), which is new, incorporates by reference a priority rule governing competing statutory liens and security interests. See Section 9-319A. This Article does not govern the relative priority of a judicial lien creditor and a holder of a non-agricultural statutory lien.

6. **Bulk Sales; Bulk Transfers.** This section deletes 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.”

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

SECTION 9-315A. 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. **Source.** New.

2. **Consignments.** Revised Section 1-201(37), reproduced in the Appendix, defines “security interest” to include the interest of a consignor of goods under a true consignment. Subsection (a) of this section provides that, for purposes of determining the rights of third parties, the consignee acquires all rights and title that the consignor had, if the consignor's security interest is unperfected. The consignee acquires these rights even though, as between the parties, it purchases a limited interest in the goods (as would be the case, e.g., in a true consignment, under which the consignee acquires only the interest of a bailee). As a consequence of this section, creditors of the consignee can acquire judicial liens and security interests in the goods. Former Section 9-114 contained priority rules applicable to security interests in consigned goods. Under this Article, the priority rules for purchase money security interests in inventory apply to consignments. See Section 9-104(b). Accordingly, a special section containing priority rules for consignments no longer is needed. Section 9-315 determines whether the rights of a judicial lien creditor are senior to the interest of the consignor, Sections 9-319 and 9-322 govern competing security interests in consigned goods, and Sections 9-315, 9-313, and 9-316 determine whether a buyer takes free of the consignor's interest.

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

Insofar as creditors of the consignee are concerned, this Article to a considerable extent reformulates the former law, which appears in Sections 2-326 and former 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. Buyers of Accounts and Chattel Paper. Subsection (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.

Example: D sells accounts or chattel paper to B-1 and retains no interest in them as against B-1. B-1 does not file a financing statement. D then sells the same receivables to B-2. B-2 files a proper financing statement. Having sold the receivables to B-1, D would not appear to have any rights in the collateral so as to permit B-2’s security (ownership) interest to attach. Nevertheless, B-2’s interest attaches, is perfected by the filing, and is senior to B-1’s interest.

4. Effect of Perfection. This section leaves 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.

SECTION 9-316. BUYER OF GOODS.

(a) Subject to subsection (c), a buyer in ordinary course of business [, other than a person buying farm products from a person engaged in farming operations,] takes free of a security interest created by the buyer’s seller, even if the security interest is perfected and even if the buyer knows of its existence.

(b) Subject to subsection (c), a buyer of consumer goods takes free of a security interest, even if perfected, if the buyer buys without knowledge of the security interest, for value, and for the buyer’s own personal, family, or household

purposes, unless before the buyer's purchase the secured party filed a financing statement covering the goods. To the extent that it affects the priority of a security interest over a buyer of consumer goods under this section, the period of effectiveness of a filing made in the jurisdiction in which the debtor is located is governed by Section 9-314(a).

(c) This section does not affect a security interest in goods in the possession of the secured party under Section 9-311.

Reporters' Comments

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

2. **Possessory Security Interests.** Subsection (c) 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 9-315(c), 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 (c) is the holder of the security interest referred to in one of the preceding 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 9-311(c).

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

SECTION 9-317. LESSEE OF GOODS IN ORDINARY COURSE OF BUSINESS. A lessee of goods in ordinary course of business takes the leasehold interest free of a security interest in the goods created by the lessor even if the security interest is perfected and the lessee knows of its existence.

Reporters' Comments

1. **Source.** Section 2A-307(3).

2. **Status.** The Drafting Committee for Articles 2A and 9 will coordinate their work on the issues addressed by this section.

SECTION 9-318. LICENSEE IN ORDINARY COURSE OF BUSINESS.

[To be moved from Article 2B]

Reporters' Comments

Status. The Article 2B Drafting Committee has been developing the rules governing licenses and other transfers of intellectual property rights, including the creation of security interests in intellectual property. We have been communicating with the Reporter for Article 2B, Raymond Nimmer, in an effort to ensure that the provisions of Articles 2B and 9 are consistent.

We anticipate that rules having their principal effect on security interests in intellectual property will appear in Article 9. Although rules of general applicability to transferees or creditors are likely to appear in Article 2B, we expect that the Article 9 Drafting Committee will have an opportunity to review and comment upon them before they are finalized.

SECTION 9-319. PRIORITIES AMONG CONFLICTING SECURITY INTERESTS AND AGRICULTURAL LIENS IN SAME COLLATERAL.

(a) Except as otherwise provided in this part, Section 4-210 [with respect to a security interest of a collecting bank], and Section 5-118 [with respect to a security interest of an issuer or nominated person], priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules:

(1) Conflicting security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the time the security interest or agricultural lien is first perfected, unless there is a period thereafter when there is neither filing nor perfection.

(2) As long as conflicting security interests and agricultural liens are unperfected, the first to attach or to become effective has priority.

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

(c) 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.

Reporters' Comments

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

2. **General Rule.** Subsection (a)(1) contains the basic, first-in-time rule, under which the first security interest that is filed or perfected takes priority. This rule is subject to the other rules contained in Part 3 of this Article, including cases of production money security interests, purchase money security interests, security interests in deposit accounts, and security interests in letters of credit that qualify for the special priorities in Sections 9-321, 9-322, 9-325, and 9-326. This subsection also is subject to Sections 4-210 and 5-118. The latter is new. It affords a security interest in a letter of credit to the issuer or nominated person and appears in the Appendix to the draft. Inasmuch as Section 9-104(b) treats the interest of a consignor to be a purchase money security interest in inventory, the reference to former Section 9-114 has been deleted.

3. **Agricultural Liens.** Subsections (a) and (b) apply the same the same priority rule to agricultural liens as to security interests, regardless of whether they conflict with other agricultural liens or with security interests. New subsection (c) sets forth narrow circumstances under which a non-UCC priority rule may displace the Article 9 priority rule applicable to agricultural liens: a perfected agricultural lien may achieve priority notwithstanding the Article 9 priority rules only if the statute creating the lien so provides.

SECTION 9-319A. PRIORITIES BETWEEN CONFLICTING SECURITY INTERESTS AND STATUTORY LIENS OTHER THAN AGRICULTURAL LIEN IN SAME COLLATERAL.

(a) Except as otherwise provided in this part, priority between a conflicting security interest and a statutory lien other than an agricultural lien in the same collateral is determined according to the following rules:

(1) A conflicting security interest and a statutory lien other than an agricultural lien rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the time the security interest or statutory lien is first perfected, unless there is a period thereafter when there is neither filing nor perfection.

(2) As long as a conflicting security interest and statutory lien other than an agricultural lien are unperfected, the first to attach or to become effective has priority.

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

(c) If a statute under which a statutory lien other than an agricultural lien in collateral is created provides that the statutory lien has priority over a conflicting security interest in the same collateral, the statute governs priority [if the statutory lien is perfected].

Reporters' Comments

1. **Source.** New; derived from Section 9-319.

2. **Non-Agricultural Statutory Liens.** Although this section derives from Section 9-319, its scope is more narrow. Consistent with the apparent recommendation in the Report of the Subcommittee on Relation to Other Law, this section governs priority between a statutory lien (other than an agricultural lien) and a security interest, but does not address priority contests between or among statutory liens. Inasmuch as the approach taken in this section could give rise to circular priorities and statutory liens are being brought into the Article 9 filing regime, the Drafting Committee may wish to consider whether this approach should be abandoned in favor of the approach taken in Section 9-319 for agricultural liens. Also, the bracketed language in subsection (c) invites the Drafting Committee to consider whether an overriding non-Article 9 statutory priority rule should control when a statutory lien is unperfected.

SECTION 9-320. FUTURE ADVANCES.

(a) For purposes of determining the priority under Section 9-319(a) of a security interest that secures an obligation, to the extent that the security interest secures an advance made [other than] [not] pursuant to commitment and made while the security interest is temporarily perfected under Section 9-310(d) or (e) [or is perfected when it attaches under Section 9-308A] and by no other method, perfection of the security interest dates from the time an advance is made.

(b) A security interest that secures an obligation is subordinate to the rights of a person that becomes a lien creditor while the security interest is perfected only to the extent that it secures advances made more than 45 days after the person becomes a lien creditor unless the advance is made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.

(c) 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 advances made after the secured party learns of the buyer's purchase, or more than 45 days after the purchase, whichever occurs first, unless the advance is made pursuant to a commitment entered into without knowledge of the buyer's purchase and before the expiration of the 45-day period. This subsection does not affect a security interest in goods in the possession of the secured party under Section 9-311.

(d) A lessee of goods other than a lessee of goods in ordinary course of business takes the leasehold interest free of a security interest to the extent that it secures advances made after the secured party learns of the lease or more than 45 days after the lease contract becomes enforceable, whichever first occurs, unless the future advances are made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the 45-day period.

Reporters' Comments

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

2. **Competing Security Interests.** This section collects all of the special rules dealing with "future advances." Subsection (a) replaces and clarifies former Section 9-312(7). No substantive change is intended. Former subsection (7) was added by the 1972 Revisions to Article 9 in order to override some decisions that subordinated future advances to intervening interests. Under a proper reading of the first-to-file-or-perfect rule of Section 9-319(a) (and former Section 9-312(5)), it is abundantly clear the time that an advance is made plays no role in determining priorities among conflicting security interests except when the advance is the giving of value as the last step for attachment and perfection. Subsection (a), accordingly, states affirmatively the only other instance when the time of an advance figures in the priority scheme. See UCC, 1972 Official Text, Section 9-312, Reasons for 1972 Change:

The proposed unified priority rule of subsection 9-312(5) would indicate that subsequent advances by the first-filed party have priority, and subsequent advances under a security interest perfected by possession likewise have priority over an intervening filed security interest. These priority rules are expressly stated in subsection (7). That proposal also deals with the rare case of the priority position of a subsequent advance made by a secured party whose security interest is temporarily perfected without either filing or possession, against an intervening secured party. Since there is no notice by the usual method of filing or possession of the existence of the security interest, the subsequent advances rank only from the actual date of making unless made pursuant to commitment.

Although the drafting history of the 1972 amendments suggests that the drafters may have assumed that the special rule under which the priority of future advances differs from that of the first advance would apply only to cases of temporary perfection, former Section 9-312(7) appears to apply to cases of automatic perfection, as well. The addition of the bracketed language in subsection (a), which refers to the automatic perfection provisions of new Section 9-308A, would conform subsection (a) to the former law. The Drafting Committee has yet to consider whether the reference to automatic perfection should be added to subsection (a).

The new formulation in subsection (a) also omits the ambiguous treatment in former subsection (7) of the situation where the initial advance is paid and a new (“future”) advance is made subsequently: Was the new advance “made while a security interest is perfected by filing or the taking of possession”? We think so, but clarification seems worthwhile.

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

4. **Competing Buyers and Lessees.** Subsection (c) replaces former Section 9-307(3) and subsection (d) replaces former Section 2A-307(4). These subsections contain minor style changes only.

5. **Buyers of Receivables.** As drafted, subsections (a) and (b) do not apply to outright sales of accounts, chattel paper, or payment intangibles. They may need refinements to take account of particular financing practices.

[SECTION 9-321. PRIORITY OF PRODUCTION MONEY SECURITY INTERESTS AND AGRICULTURAL LIENS.

(a) Except as otherwise provided in subsection (e), if the requirements of subsection (b) are met, a perfected production money security interest in production money crops has priority over a conflicting security interest in the same crops and, except as otherwise provided in Section 9-325, also has priority in their identifiable proceeds. A production money security interest has priority under this subsection only to the extent that the conflicting security interest secures obligations incurred more than [] months before the production money secured party first gives new value to enable the debtor to produce the crops.

(b) A production money security interest has priority under subsection (a) if:

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

(2) the production money secured party gives an authenticated notification to the holder of the conflicting security interest not less than 10 or more than 30 days before the production money 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 (d), if more than one security interest qualifies for priority in the same collateral under subsection (a), the security interests rank according to priority in time of filing under Section 9-319(a).

(d) To the extent that a person 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.]

Legislative Note: This section is optional. States that do not enact this section also should not enact Section 9-105.

Reporters' Comments

1. **Source.** New.

2. **Legislative Option.** This new section replaces the limited priority in crops afforded by former Section 9-312(2). As explained in Section 9-105, Comment 2, that priority generally has been thought to be of little value for its intended beneficiaries. Neither the Drafting Committee nor the agricultural financing community has been able to reach a consensus on the desirability of including a special production money priority rule in Article 9. For this reason, the rule appears as an optional provision for each State to consider during the legislative enactment process.

3. **Production Money Security Interests.** This section attempts to balance the interests of the production money secured party with those of a secured party who has previously filed a financing statement covering the crops that are to be produced. For example, to qualify for priority under this section, the production money secured party must notify the earlier-filed secured party prior to extending the production money credit. The notification affords the earlier secured party the opportunity to prevent subordination by extending the credit itself. Moreover, the production money security interest does not take priority over all secured obligations owed to the earlier filer. Rather, the production money security interest has priority only over obligations incurred relatively recently, i.e., those incurred during the [] months before the production money secured party first gives new value.

4. **Multiple Production Money Security Interests.** In the case of multiple production money security interests that qualify for priority under subsection (a), the first to file has priority. See subsection (c). Note that only a security interest perfected by filing is entitled to production money priority. See subsection (b)(1). Consequently, subsection (c) does not adopt the first-to-file-or-perfect formulation.

5. **Holder of Agricultural Lien and Production Money Security Interest.** Subsection (d) 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.

SECTION 9-322. PRIORITY OF PURCHASE MONEY SECURITY INTERESTS.

(a) Except as otherwise provided in subsection (e), 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 Section 9-325, also has priority in its identifiable cash proceeds to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer if:

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

(2) the purchase money secured party gives an authenticated notification to the holder of the conflicting security interest, if the holder had filed a financing statement covering the same types of inventory:

(A) before the date of a filing made by the purchase money secured party; or

(B) if the purchase money security interest is temporarily perfected without filing or possession under Section 9-310(e), before the beginning of the 20-day period thereunder;

(3) the holder of the conflicting security interest receives the notification no earlier than five years before the debtor receives possession of the inventory; and

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

(b) If a purchase money security interest in inventory has priority over a conflicting security interest under subsection (a), a security interest held by the

purchase money secured party in chattel paper [or an instrument] constituting proceeds of the inventory has priority over a conflicting security interest in the chattel paper [or instrument] if:

(1) the conflicting security interest in the chattel paper [or instrument] is claimed merely as proceeds of inventory subject to a security interest; and

(A) the purchase money secured party takes possession of the chattel paper [or instrument] in the ordinary course of its business; and

(B) the chattel paper [or instrument] does not indicate that it has been assigned to [an identified assignee] [the person holding the conflicting security interest]; or

(2) the purchase money secured party takes possession of the chattel paper [or instrument] in good faith, in the ordinary course of its business, and without knowledge that its security interest violates the rights of the person holding the conflicting security interest.

(c) Except as otherwise provided in subsection (e), 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 Section 9-325, also has priority in its identifiable proceeds [and identifiable products in their unmanufactured states] if:

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

(2) the purchase money secured party gives an authenticated notification to the holder of the conflicting security interest, if the holder had filed a financing statement covering the same types of livestock:

(A) before the date of a filing made by the purchase money secured party; or

(B) if the purchase money security interest is temporarily perfected without filing or possession under Section 9-310(e), before the beginning of the 20-day period thereunder;

(3) the holder of the conflicting security interest receives the notification no earlier than six months before the debtor receives possession of the livestock; and

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

(d) Except as otherwise provided in subsection (e), a purchase money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same collateral and, except as otherwise provided in Section 9-325, also has priority in its identifiable proceeds if the purchase money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.

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

(1) 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

(2) in all other cases, Section 9-319(a) applies to the qualifying security interests.

Reporters' Comments

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

2. **Purchase Money Security Interests in Inventory.** Subsection (a), which affords a special priority to certain purchase money security interests in

inventory, derives from former Section 9-312(3). No change in meaning is intended.

3. **Consignments.** Subsection (a) also 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 9-104(b), no inference concerning the nature of the transaction should be drawn from the fact that a consignor uses the term "security interest" in its notice under subsection (a)(4). Similarly, a notice stating that the consignor has delivered or expects to deliver goods, properly described, "on consignment" meets the requirements of subsection (a)(4), even if it does not contain the term "security interest" and even if the transaction subsequently is determined to be a security interest. Cf. Section 9-505 (use of "consignor" and "consignee" in financing statement).

4. **Priority in Chattel Paper Proceeds.** Subsection (b) is new. It enables the holder of a purchase money security interest in inventory to obtain priority in chattel paper that constitutes the proceeds of inventory. Unlike Section 9-327, subsection (b) awards priority in chattel paper proceeds to the holder of a purchase money security interest in inventory even if the holder does not give new value.

5. **Purchase Money Security Interests in Livestock.** New subsection (c) provides a purchase money priority rule for farm-products livestock. It is patterned on the purchase money priority rule for inventory found in subsection (a) and includes a requirement that the purchase money secured party notify earlier-filed parties. Two differences between subsections (a) and (c) are noteworthy. First, unlike the purchase money inventory lender, the purchase money livestock lender enjoys priority in *all* proceeds of the collateral. Thus, under subsection (c), the purchase money secured party takes priority in accounts over an earlier-filed accounts financier. Second, the bracketed language in subsection (c) 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.

6. **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 9-106(c) (definition of "farm products"). The definition does not indicate whether aquatic goods are "crops," as to which the (optional) production money security interest priority in Section 9-321 applies, or "livestock," as to which the purchase money priority in subsection (c) of this section 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 resolve this issue.

7. **Purchase Money Priority in Goods Other than Inventory and Livestock.** Subsection (d) 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 also Section 9-104(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 this question and the analogous question under Section 9-315(f) in the Official Comments.

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

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

The first-to-file-or-perfect rule of Section 9-319 applies to multiple purchase money security interests securing enabling loans.

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

SECTION 9-323. PRIORITY OF SECURITY INTERESTS IN

TRANSFERRED COLLATERAL. If a debtor acquires property subject to a security interest created by another person, the security interest is perfected when 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 part. [However, if the security interest created by the other person is unperfected

when the debtor acquires the property or at any time thereafter, the other provisions of this part, as applicable, determine its priority.]

Reporters' Comments

1. **Source.** New.

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

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

Example: A owns an item of equipment subject to a perfected security interest in favor of SP-A. A sells the equipment to B, not in the ordinary course of business. B acquires its interest subject to SP-A's security interest. See Sections 9-201; 9-313(c).

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

4. **Taking Subject to Unperfected Security Interest.** If, in the foregoing Example, 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 9-315(c). 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 the second sentence of this section provides that the normal priority rules govern. Under Section 9-319(a)(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.

5. **Taking Subject to Perfected Security Interest that Becomes Unperfected.** If SP-A's interest is perfected when B acquires the equipment but for some reason SP-A's security interest later becomes unperfected, the second sentence of this section provides that the normal priority rules 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 9-319(a)(1); 9-516(c).

6. **Bracketed Sentence.** The first sentence of this section covers some, but not all, “double debtor” cases. As explained above, if a case falls outside the first

sentence, in the absence of a special “double debtor” rule, the normal priority rules would apply. The second sentence makes this point explicitly. Inasmuch as one could reach the right result without the second sentence, the sentence appears in brackets. However, retaining the explicit statement in the second sentence is likely to make the statute easier to use.

SECTION 9-323A. PRIORITY OF SECURITY INTERESTS CREATED

BY NEW DEBTOR. A security interest that is perfected by a filed financing statement that is effective solely under Section 9-510 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 provisions of this part, as applicable, determine the priority of the subordinated security interests as among themselves.

Reporters’ Comments

1. **Source.** New.

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

The first sentence subordinates the original debtor’s secured party’s security interest perfected under Section 9-510 to security interests in the same collateral perfected in another manner, e.g., by filing against the new debtor.

Example 1: SP-X holds a perfected-by-filing security interest in X Corp’s existing and after-acquired inventory, and SP-Z holds a perfected-by-filing security interest in Z Corp’s existing and after-acquired inventory. Z Corp “becomes bound” as debtor by X Corp’s security agreement (e.g., Z Corp buys X Corp’s assets and assumes its security agreement). Under Section 9-510, SP-X’s financing statement is effective to perfect a security interest in inventory acquired by Z Corp after it becomes bound.

The first sentence of this section provides that SP-X’s security interest is subordinate to SP-Z’s, regardless of which financing statement was filed first.

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

Example 2: Under the facts of Example 1, SP-Y also holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory. SP-Y filed after SP-X.

SP-X has priority over SP-Y. See Section 9-319(a)(1).

SECTION 9-324. PRIORITY OF SECURITY INTERESTS IN

INVESTMENT PROPERTY. Priority among 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) A possessory security interest in a certificated security in registered form has priority over a conflicting security interest perfected by a method other than control.

(3) Except as otherwise provided in paragraphs (4) and (5), conflicting security interests of secured parties each of which has control rank equally.

(4) 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.

(5) 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.

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

(7) In all other cases, priority among conflicting security interests in investment property is governed by Sections 9-319(a) and 9-320(a).

Reporters' Comments

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

2. **Security Interests of Equal Rank.** Former Section 9-115, added recently in conjunction with Revised Article 8, introduced into Article 9 the concept of security interests that rank equally. Some observers have questioned the wisdom of ranking equally the security interests of parties holding adverse interests in the same collateral. The Drafting Committee may reconsider this issue.

SECTION 9-325. PRIORITY OF SECURITY INTERESTS IN DEPOSIT

ACCOUNTS. Priority among conflicting security interests in the same deposit account is governed by the following rules:

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

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

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

(4) A security interest perfected by control pursuant to Section 9-109(a)(3) has priority over a security interest held by the depositary institution with which the deposit account is maintained.

Reporters' Comments

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

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

3. **Control.** Under subsection (1), security interests perfected by control (Section 9-109) take priority over those perfected otherwise, e.g., as identifiable cash proceeds under Section 9-313(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 (2) governs the case (expected to be very rare) in which a depository institution enters into a Section 9-109(a)(2) control agreement with more than one secured party. Subsection (a)(2) provides that the security interests rank equally. If the depository institution is solvent, there often will be no need for a priority rule inasmuch as the depository institution is likely to be liable to each secured party.

4. **Priority of Depository Institution.** Under subsection (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 account, 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 (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 9-336. Additional clarification of subsection (4) or the Official Comments is likely to 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.

5. **Priority in Proceeds.** The priority afforded by this section is not intended to extend to proceeds of a deposit account. Accordingly, Section 9-319(a)(1), 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 9-313(e)

addresses continuation of perfection in proceeds of deposit accounts. As to funds transferred from a deposit account that serves as collateral, see Section 9-329.

SECTION 9-326. PRIORITY OF SECURITY INTERESTS IN LETTERS OF CREDIT. Priority among 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 otherwise 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. **Source.** New; loosely modeled after former Section 9-115(5).

2. **General Rule.** Subsection (1) awards priority to a secured party that perfects its security interest directly 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 (the perfected security interest in the account gives rise to a perfected security interest in collections under the letter of credit). The Drafting Committee has asked the Reporters to reconsider whether the control priority may intrude unnecessarily on the priority of a financier of an underlying receivable supported by a letter of credit. The Drafting Committee plans to revisit this issue.

3. **Transferee Beneficiaries.** Subsection (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 (3) makes the priority explicit in Article 9.

SECTION 9-327. 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] which is claimed merely as proceeds of inventory subject to a security interest and, except as otherwise provided in Section 9-325, in proceeds of the chattel paper, if:

(1) in the ordinary course of the purchaser's business, the purchaser gives new value and takes possession of the chattel paper [or instrument]; and

(2) the chattel paper [or instrument] does not indicate that it has been assigned to [an identified assignee] [the person holding the conflicting security interest]

(b) A purchaser of chattel paper [or an instrument] has priority over a security interest in the chattel paper [or instrument] which is claimed other than merely as proceeds of inventory subject to a security interest and, except as otherwise provided in Section 9-325, in proceeds of the chattel paper [or instrument] 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].

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

[(d) Except as otherwise provided in Section 9-328(c), a [possessory security interest in] [purchaser for value that takes possession of] an instrument has priority over a [nonpossessory security interest in the instrument perfected by means other than filing] [security interest in the instrument perfected by filing].]

Reporters' Comments

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

2. **Chattel Paper.** This section enables purchasers of chattel paper, including secured parties, to obtain priority over earlier-perfected security interests in the chattel paper. It follows former Section 9-308 in distinguishing between earlier-perfected security interests in chattel paper that is claimed merely as proceeds of inventory subject to a security interest and chattel paper that is claimed other than merely as proceeds. Like former Section 9-308, this section does not elaborate upon the phrase “merely as proceeds. For an elaboration, see P.E.B. Commentary No. 8.

This section 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 9-102 a completely different definition of the term “new value.

A possessory security interest in chattel paper that does not qualify for priority under this section may be subordinate to a perfected-by-filing security interest under Section 9-319(a). In this respect, the priority rules applicable to negotiable instruments constituting part of chattel paper differ from those applicable to security certificates. Compare Section 9-324(2) (security interest perfected by possession takes priority over security interest perfected other than by control).

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

4. **Chattel Paper Claimed Other Than Merely as Proceeds.** Subsection (b) revises the rule in former Section 9-308(a) by adding the requirement that the purchaser take in good faith. It also eliminates the requirement that the purchaser take without knowledge that the “specific paper is subject to the security interest and substitutes for it the requirement that the purchaser take “without knowledge that the purchase violates the rights of the secured party. This standard derives from the definition of “buyer in ordinary course of business in Section 1-201(9). The source of the purchaser’s knowledge is irrelevant. Note, however, that “knowledge means “actual knowledge. Section 1-201(25). Thus, without more, a purchaser of chattel paper who has seen a financing statement covering the chattel paper or who knows that the chattel paper is encumbered with a security interest, does not have knowledge that its purchase violates the secured party’s rights. However, under new subsection (c), a legend to the effect that the chattel paper had been assigned to an identified assignee or the person holding the conflicting

security interest would cause a purchaser to have wrongful knowledge for purposes of subsection (b), thereby preventing the purchaser from qualifying for priority under that subsection, even if the purchaser did not have actual knowledge.

5. **“Electronic Chattel Paper.”** The Drafting Committee (with the assistance of the Working Group on Secured Transactions, Committee on the Law of Commerce in Cyberspace, ABA Section of Business Law) is pursuing the possibility of extending subsections (a) and (b) to cover obligations that otherwise would meet the definition of “chattel paper” but are not evidenced by a writing. If this proves feasible (e.g., if a suitable analogue for “possession” can be developed) and desirable, the subsections might be expanded even further to cover accounts.

6. **Instruments.** The bracketed language in subsections (a), (b), and (d) reflects the unresolved status of the priority of security interests in instruments (both negotiable and nonnegotiable) which are perfected by filing. This issue is not significant under current law, inasmuch as security interests in instruments generally can be perfected only by possession.

Bracketed language in the draft presents three possible approaches. One would be to adopt the bracketed language in subsections (a) and (b), thereby affording purchasers of instruments, both buyers and secured parties, the same rights as purchasers of chattel paper. This is the approach of former Section 9-308. Adoption of this approach would eliminate any need for bracketed subsection (d).

Subsection (d) presents two other options for a priority rule. One is to adopt for instruments the priority rule applicable to certificated securities. The 1994 revisions to Articles 8 and 9 marked the first time that Article 9 permitted perfection of security interests in securities by filing. This Article carries forward that approach. See Section 9-310(a). The 1994 revisions recognize that, in order to avoid disruption of existing practices in the securities markets, it is necessary to give perfection by filing a different and more limited effect for securities than for other forms of collateral. In particular, the necessity of conducting a search in order to ensure priority of a security interest would be enormously disruptive and detrimental. Consequently, the revisions provide that a possessory security interest in a security evidenced by a security certificate in registered form has priority over a security interest perfected by filing. Section 9-324(2) of this Article carries this rule forward.

The priority rule stated in Section 9-324(2) may seem anomalous, in that it can afford less favorable treatment to purchasers who buy collateral outright than to those who take a security interest in it. For example, a buyer of a security certificate would cut off a security interest perfected by filing only if the buyer achieves the status of a protected purchaser under Section 8-303. The buyer would not be a protected purchaser, for example, if it does not obtain “control” under Section 8-106 (e.g., if it fails to obtain a proper indorsement of the certificate) or if it had notice of an adverse claim under Section 8-105. As Official Comment 5 to Section 9-115 suggests, however, the priority rule is best understood not as one intended to protect careless or guilty parties, but one that eliminates the need to conduct a search of the public records only insofar as necessary to serve the needs of the securities markets.

The third option, also presented in subsection (d), is to afford priority to all buyers of instruments as well as to secured parties. This approach would protect every purchaser for value who takes possession of an instrument. The purchaser would take priority even if, for example, the purchaser knew of a conflicting claim to the instrument that would disqualify it from becoming a holder in due course under Section 3-302, or the instrument was not negotiable.

It is possible that no single rule will be optimal for all the circumstances in which it might be applied. For example, broad protection of the kind suggested in the third option may be useful with respect to notes secured by real property mortgages, for which there is a secondary market, but considerably less so for bank certificates of deposit that are transferred in non-market transactions.

7 Priority in Proceeds. Subsections (a) and (b) provide 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.

8. Priority in Returned and Repossessed Goods. Returned and repossessed goods may constitute proceeds of chattel paper. The discussion in the Comments below explains the treatment of returned and repossessed goods as proceeds of chattel paper in the context of the following example:

Example: Secured Party 1 (SP-1) has a security interest in all the inventory of a dealer in goods (Dealer); SP-1's security interest is perfected by filing. Dealer sells some of its inventory to a buyer in the ordinary course of business (BIOCOB) pursuant to a conditional sales contract (chattel paper). 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.

9. Assignment of Non-Lease Chattel Paper.

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

(1) **Returned Goods.** If BIOCOB returns the goods to Dealer for repairs, Dealer is merely a bailee and acquires thereby no meaningful rights in the goods to which SP-1's security interest could attach. (Although SP-1's security interest could attach to Dealer's interest as a bailee, that interest is not likely to be of any particular value to SP-1.) Dealer is the owner of the *chattel paper* (i.e., the owner of a right to payment secured by a security interest in the goods); SP-2 has a security interest in the chattel paper, as does SP-1 (as proceeds of the goods under Section 9-313(c)). Pursuant to Section 9-327, SP-2's security interest in the chattel paper is senior to that of SP-1. SP-2 enjoys this priority regardless of whether, or when, SP-2 filed a financing statement covering the chattel paper. Because chattel

paper and goods represent different types of collateral, Dealer does not have any meaningful interest in *goods* to which either SP-1's or SP-2's security interest could attach in order to secure Dealer's obligations to either creditor. See Section 9-102 (defining "chattel paper" and "goods").

Now assume that BIOCOP 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 BIOCOP were entitled to reject or revoke acceptance of the goods. See Sections 2-602 (rejection); 2-608 (revocation of acceptance). Unless BIOCOP has waived its defenses as against assignees of the chattel paper, SP-1's and SP-2's rights against BIOCOP would be subject to BIOCOP's claims and defenses. See Sections 9-403; 9-404. SP-1's security interest would attach again because the returned goods would be proceeds of the chattel paper. Dealer's acquisition of the goods easily can be characterized as proceeds consisting of an "in kind" collection on or distribution on account of the chattel paper. See Section 9-313(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 9-313(e).

Because Dealer's newly reacquired interest in the goods is proceeds of the chattel paper, SP-2's security interest also would attach in the goods as proceeds. If SP-2 had perfected its security interest in the chattel paper by filing (again, assuming that filing against the chattel paper was made in the same office where a filing would be made against the goods), SP-2's security interest in the reacquired goods would be perfected beyond 20 days. See Section 9-313(e). 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 9-313(e). Nevertheless, SP-2's unperfected security interest in the goods would be senior to SP-1's security interest under Section 9-327. 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 9-615.

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 9-327. 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 9-327.

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. 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 9-313(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 9-327 makes no distinction among purchasers of chattel paper on the basis of whether the purchaser is an outright buyer of chattel paper or one whose security interest secures an obligation of Dealer.

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

The analysis with respect to lease chattel paper is similar to that set forth above with respect to non-lease chattel paper. It is complicated, however, by the fact that, unlike the case of chattel paper arising out of a sale, Dealer retains a residual interest in the *goods*. See Section 2A-103(1)(q) (defining "lessor's residual interest"); *In re Leasing Consultants, Inc.*, 486 F.2d 367 (2d Cir. 1973) (lessor's residual interest under true lease is an interest in goods and is a separate type of collateral from lessor's interest in the lease). If Dealer leases goods to a "lessee in ordinary course of business" (LIOCOB), then LIOCOB takes its interest under the lease (i.e., its "leasehold interest") free of the security interest of SP-1. See Sections 2A-307(3); 2A-103(1)(m) (defining "leasehold interest"), (1)(o) (defining "lessee in ordinary course of business"). SP-1 would, however, retain its security interest in the residual interest. In addition, SP-1 would acquire an interest in the lease chattel paper as proceeds. If Dealer then assigns the lease chattel paper to SP-2, Section 9-327 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 9-319.

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 9-327, 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.

SECTION 9-328. [PROTECTION] [RIGHTS] OF PURCHASERS OF INSTRUMENTS, DOCUMENTS, AND SECURITIES UNDER OTHER ARTICLES.

(a) Except as otherwise provided in subsection (c), nothing in this article limits the rights of a holder in due course of a negotiable instrument, a holder to whom a negotiable document of title has been duly negotiated, or a protected purchaser of a security. These holders or purchasers take priority over an earlier security interest, even if perfected, to the extent provided in Articles 3, 7, and 8.

(b) Filing under this Article does not constitute notice of a security interest to the holders or purchasers mentioned in subsection (a).

(c) A security interest in [chattel paper, an account, or a payment intangible] [a right to payment] which has priority over a conflicting security interest in the same [chattel paper, account, or payment intangible] [right to payment] also has priority in a check that is proceeds of the [chattel paper, account, or payment intangible] [right to payment].

Reporters' Comments

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

2. **“Priority.”** In some provisions, this Article distinguishes between claimants that take collateral free of a security interest (in the sense that the security interest no longer encumbers the collateral) and those that take an interest in the collateral that is senior to a surviving security interest. See, e.g., Section 9-315. Whether a holder or purchaser referred to in this section takes free or is senior to a security interest depends on the whether the purchaser is a buyer of the collateral or

takes a security interest in it. The term “priority” is meant to encompass both scenarios, as it does in Section 9-327.

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

4. **Check Constituting Proceeds of Right to Payment.** Subsection (c) contains an exception to the general deference this Article pays to Article 3. It provides that the priority of a security interest in an account, chattel paper, or payment intangible extends to a check that is proceeds of the right to payment. The general rule in subsection (a) leaves open the possibility that the holder of a junior security interest in, say, accounts, might be able to collect the accounts and rightfully refuse to turn them over to the holder of the senior security interest. Receivables financiers are professionals and should know whether their security interest is senior or junior. The holder-in-due-course rules of Article 3 should not enable a junior secured party to improve its position.

SECTION 9-329. 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. **Source.** New.

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

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

Example 1: Debtor maintains a deposit account with Bank A. The deposit account is subject to a security interest in favor of Lender. At Bank B's suggestion, Debtor moves the funds from the account at Bank A to Debtor's deposit account with Bank B. Unless Bank B acted in collusion with Debtor in violating Lender's rights (an unlikely scenario, where, as here, Lender allowed Debtor access to an account sufficient to transfer funds), Bank B takes the funds (the credits running in favor of Bank B) free from Lender's security interest. See subsection (b). However, inasmuch as the deposit account maintained with Bank B constitutes the proceeds of the deposit account at Bank A, Lender's security interest would attach to that account as proceeds. See Section 9-313.

Subsection (b) also would apply if, in the example, Bank A debited Debtor's deposit account in exchange for the issuance of Bank A's cashier's check. Lender's security interest would attach to the cashier's check as proceeds of the deposit account, and the rules applicable to instruments would govern any competing claims to the cashier's check. See Sections 3-306; 9-328.

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

Subsection (b) applies to *transfers of funds from* a deposit account; it does not apply to *transfers of the deposit account* itself or of an interest therein. For example, this section does not apply to the creation of a security interest in a deposit account. Competing claims to the deposit account itself are dealt with by other Article 9 priority rules. See Sections 9-315(a); 9-325; 9-337; 9-338. Similarly, a corporate merger normally would not result in a transfer of funds from a deposit account. Rather, it might result in a transfer of the deposit account itself. The normal rules applicable to transferred collateral would apply; this section would not.

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

reliance on the payment. This section does not put the transferee to the burden of having to make this proof.

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

5. **Other Remedies for Aggrieved Secured Party.** The Drafting Committee 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.

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

Example 2: The facts are as in Example 1, but, in wrongfully moving the funds from the deposit account at Bank A to Debtor’s deposit account with Bank B, Debtor acts in collusion with Bank B. Bank B does not take the funds free of Lender’s security interest under this section. If Debtor grants a security interest to Bank B, Section 9-325 governs the relative priorities of Lender and Bank B. Under Section 9-325(3), Bank B’s security interest in the Bank B deposit account is senior to Lender’s security interest in the deposit account as proceeds. However, Bank B’s senior security interest does not protect Bank B against any liability to Lender that might arise from Bank B’s wrongful conduct. As noted in Example 1, the potential for collusion in violating a secured party’s rights under these circumstances seems more theoretical than real.

SECTION 9-330. 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.

Reporters' Comments

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

2. **Status.** The Drafting Committee has not considered this section. The liens that it covers are possessory liens under common law or statute. It may be necessary to clarify this section to make clear that it does not deal with statutory liens, as defined in Section 9-102. Statutory liens do not depend on possession for their effectiveness.

SECTION 9-331. PRIORITY OF SECURITY INTERESTS IN FIXTURES.

(a) 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 record 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. However 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 property law.

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

(1) except as otherwise provided in subsection (g), 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 10 days thereafter, and the debtor has an interest of record in, or is in possession of, the real property;

(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, or is in possession of, the real property;

(3) the fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real property, 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 property 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 a conflicting interest of an encumbrancer or owner of the real property if:

(1) the encumbrancer or owner has, in an authenticated record, consented to the security interest or 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.

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

(g) Subject to subsections (d)(2) through (4), (e), and (f), 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.

(h) In cases not within subsections (b) through (g), a security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property which is not the debtor.

Reporters' Comments

Source. Former Section 9-313, conformed to Section 2A-309 and to prevailing style conventions

SECTION 9-332. ACCESSIONS.

Alternative A

(a) [In this section,] “accession means goods that are [installed in,] [affixed to,] [attached to,] [assembled with,] [manufactured into,] [processed with,] [or] [processed into] other goods in a manner such that the identity of the original goods is not lost.

Alternative B

(a) [In this section,] “accession means goods that are physically united with other goods in a manner such that the identity of the original goods is not lost.

[End of Alternatives]

(b) A security interest may be created in an accession and continues in collateral that becomes an accession.

(c) If a security interest is perfected when the collateral becomes an accession, the security interest remains perfected in the [collateral] [accession].

(d) Except as otherwise provided in subsection (e), the other provisions of this part determine the priority of a security interest in an accession.

(e) A security interest in an accession is subordinate to a security interest in the whole which is perfected by compliance with the requirements of a certificate-of-title statute under Section 9-309A(b).

(f) Subject to Part 6, on default, a secured party may remove an accession from other goods if[:

(1)] the security interest in the accession has priority over the claims of every person having an interest in the whole[; and

(2) removal will not cause [material] [serious] [irreparable] physical injury to the whole].

(g) [Unless otherwise agreed, a] [A] secured party that removes an accession under subsection (f) shall promptly reimburse any encumbrancer or owner of the whole, other than the debtor, for the cost of repair of any physical injury to the whole. The secured party need not reimburse the encumbrancer or owner for any diminution in value of the whole caused by the absence of the accession removed or by any necessity for replacing it. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation.

Reporters' Comments

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

2. **Status.** The Drafting Committee discussed former Section 9-314 in November, 1997. This section reflects those deliberations. The Drafting Committee has yet to review this section. The Comments below explain the text and indicate specific issues that the Drafting Committee may wish to address.

3. **Background.** Grant Gilmore set forth the pre-UCC rule governing accessions as follows: when accessories were installed in or attached to goods in which a security interest existed (e.g., a radio was installed in an automobile), courts subordinated the security interest in the automobile to the (usually, purchase money) security interest in the accessory; however, when the accessories could be described as “integral parts of the car (e.g., an engine), the security interest in the accessory was not infrequently subordinated to the competing interest in the automobile. Former Section 9-314 was, in Gilmore’s words, “an exact replica of the 1962 version of Section 9-313 on fixtures. As such, it went somewhat beyond the protection that the pre-UCC automobile cases afforded security interests in accessories.

4. **“Accession.”** This section applies to an “accession, as defined, regardless of the cost or difficulty of removing the accession from the other goods, and regardless of whether the original goods have come to form an integral part of

the other goods. This section does not apply to goods whose identity has been lost. Goods of that kind are “commingled goods” governed by Section 9-333. Neither this section nor the following one addresses case of collateral that changes form without the addition of other goods.

The Drafting Committee has yet to choose between the alternative definitions of “accession.” The alternatives are intended to convey the same meaning and differ only in the level of specificity.

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

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

6. **Scope.** This section governs only a few issues concerning accessions. Subsection (b) contains rules governing continuation of a security interest in an accession. Subsection (c) contains a rule governing continued perfection of a security interest in goods that become an accession. Subsection (e) contains a special priority rule governing accessions that become part of a whole covered by a certificate of title. Subsections (f) and (g) govern enforcement of a security interest in an accession. The Drafting Committee may wish to consider whether these disparate provisions should remain together in a single section or should be divided according to topic (e.g., subsections (f) and (g) might fit better in part 6).

7. **Matters Left to Other Provisions of This Article: Attachment and Perfection.** In this connection, consider that other provisions of this Article often will govern accession-related issues. For example, this section does not address whether a secured party acquires a security interest in the whole if its collateral becomes an accession. Normally this will turn on the description of the collateral in the security agreement. The Drafting Committee may wish to consider whether to add a *per se* rule under which a security interest would extend automatically to all accessions, as it does to proceeds.

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

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

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

Example 3: Debtor owns an office computer subject to a security interest in favor of SP-1. Debtor acquires memory and grants a perfected security interest in the memory to SP-2. Debtor installs the memory in the computer, at which time (we assume) SP-1's security interest attaches to the memory. The first-to-file-or-perfect rule of Section 9-319 governs priority in the memory. If, however, SP-2's security interest is a purchase money security interest, Section 9-322(d) would afford priority in the memory to SP-2, regardless of which security interest was perfected first.

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

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

SECTION 9-333. COMMINGLED GOODS.

Alternative A

(a) In this section, "commingled goods" means goods that are manufactured, processed, assembled, or commingled with other goods in such a manner that their identity is lost in a product or mass.

Alternative B

(a) In this section, “commingled goods” means goods that are physically [united with] [related to] other goods in such a manner that their identity is lost in a product or mass.

[End of Alternatives]

Alternative A

(b) Except as otherwise provided in subsection (c), a security interest may not be created in commingled goods.

(c) If collateral becomes commingled goods, the security interest in the collateral is discharged, and a security interest attaches to the product or mass. [The secured party may not enforce the security interest in the product or mass to the extent the value of product or mass at the time of enforcement exceeds the value of the collateral at the time it became commingled goods.]

Alternative B

(b) Except as otherwise provided in subsection (c), no security interest exists [under this Article] in commingled goods.

(c) If collateral becomes commingled goods, a security interest attaches to the product or mass. [The secured party may not enforce the security interest in the product or mass to the extent the value of product or mass at the time of enforcement exceeds the value of the collateral at the time it became commingled goods.]

[End of Alternatives]

(d) If a security interest in collateral is perfected before the collateral becomes commingled goods, the security interest that attaches to the product or mass under subsection (c) is perfected.

(e) Except as otherwise provided in subsection (f), the other provisions of this part, as applicable, determine the priority of a security interest that attaches to the product or mass under subsection (d).

(f) If more than one security interest attaches to the product or mass under subsection (c), the following rules determine priority:

(1) A security interest that is perfected under subsection (d) has priority over a security interest that is unperfected at the time the collateral becomes commingled goods.

(2) If more than one security interest is perfected under subsection (d), the security interests rank equally in proportion to value of the collateral at the time it became commingled goods.

Reporters' Comments

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

2. **Status.** The Drafting Committee discussed former Section 9-315 in November, 1997. This section reflects those deliberations. The Drafting Committee has yet to review this section. The Comments below explain the text and indicate specific issues that the Drafting Committee may wish to address.

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

The Drafting Committee has yet to choose between the alternative definitions of “commingled goods. The alternatives are intended to convey the same meaning and differ only in the level of specificity. The introductory clause, “in this section, appears in brackets pending a determination whether the defined term will appear elsewhere in the Article.

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

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

A security interest in a product or mass that arises under subsection (c) can be enforced only to the extent of the value of the original collateral (or, if it is less,

the amount of the secured obligation). This section leaves the courts free to define “value” in this context.

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

Example 1: SP-1 has a perfected security interest in Debtor’s eggs, which have a value of \$ 300 and secure a debt of \$ 400, and SP-2 has a perfected security interest in Debtor’s flour, which has a value of \$ 500 and secures a debt of \$ 600. Debtor uses the flour and eggs to make cakes, which have a value of \$ 1000. The two security interests rank equally and share in the ratio of 3:5. Applying this ratio to the entire value of the product, SP-1 would be entitled to \$ 375 (i.e., $3/8 \times \$ 1000$), and SP-2 would be entitled to \$ 625 (i.e., $5/8 \times \$ 1000$). However, under subsection (c), SP-1 may enforce its security interest only to the extent of \$ 300, and SP-2 may enforce its security interest only to the extent of \$ 500. This leaves \$ 200 for Debtor.

Example 2: Assume the facts of Example 1, except that SP-1’s collateral, worth \$ 300, secures a debt of \$ 200. Recall that, if the cake is worth \$ 1000, then applying the ratio of 3:5 would entitle SP-1 to \$ 375 and SP-2 to \$ 625. However, SP-1 is not entitled to collect from the product more than it is owed. Accordingly, SP-1’s share would be only \$ 200, SP-2 would receive \$ 500 (the value of its original collateral), and Debtor would keep the remaining \$ 300.

Example 3: Assume that the cakes in the previous examples have a value of only \$ 600. Again, the parties share in the ratio of 3:5. If, as in Example 1, SP-1 is owed \$ 400, then SP-1 is entitled to \$ 225 (i.e., $3/8 \times \$ 600$), and SP-2 is entitled to \$ 375 (i.e., $5/8 \times \$ 600$). Debtor receives nothing. If, however, as in Example 2, SP-1 is owed only \$ 200, then Debtor receives \$ 25.

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

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

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

subsection (f)(1) and Section 9-319, SP-1's perfected security interest has priority over SP-2's unperfected security interest.

If both security interests are unperfected, the residual first-to-attach rule of Section 9-319 would apply.

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

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

For purposes of subsection (f)(2), we suggest that SP-1A and SP-1B be treated like a single secured party. The collective security interest would rank equally with that of SP-2. Thus, the secured parties would share in the ratio of 3 (for SP-1A and SP-1B combined) to 5 (for SP-2). Applying this ratio to the entire value of the product, SP-1A and SP-1B in the aggregate would be entitled to \$ 375 (i.e., $3/8 \times \$ 1000$), and SP-2 would be entitled to \$ 625 (i.e., $5/8 \times \$ 1000$). However, under subsection (c), SP-1A and SP-1B may enforce their security interest only to the extent of \$ 300. (Likewise, SP-2 would be limited to a \$ 500 recovery.)

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

If the Drafting Committee agrees with this approach, we will attempt to draft an appropriate provision. It is possible that an explanation in the Official Comments would suffice.

8. Priority of Security Interests That Attach Other than by Operation of this Section. Normal priority rules determine the priority of a security interest that attaches to the product or mass other than by operation of this section. For example, assume that SP-1 has a perfected security interest in Debtor's existing and after-acquired baked goods, and SP-2 has a perfected security interest in Debtor's flour. When the flour is processed into cakes, subsections (c) and (d) provide that SP-2 acquires a perfected security interest in the cakes. If SP-1 filed against the baked goods before SP-2 filed against the flour, then SP-1 will enjoy priority in the cakes. See Section 9-319 (first-to-file-or-perfect). But if SP-2 filed against the flour before SP-1 filed against the baked goods, then SP-2 will enjoy priority in the cakes to the extent of its security interest.

9. **Organization.** As is the case with Section 9-332, this section contains attachment, perfection, and priority rules. The Drafting Committee may wish to consider whether these disparate provisions should remain together in a single section or should be divided according to topic.

SECTION 9-334. PRIORITY OF SECURITY INTERESTS IN GOODS COVERED BY CERTIFICATE OF TITLE. 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 neither shows that the goods are subject to the security interest nor contains a statement that they may be subject to security interests not shown on the certificate:

(1) 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

(2) the security interest is subordinate to a conflicting security interest in the goods that attaches, and is perfected under Section 9-309A(c), after issuance of the certificate and without the conflicting secured party's knowledge of the security interest.

Reporters' Comments

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

2. **Protection for Buyers and Secured Parties.** This section affords protection to certain good faith purchasers for value who are likely to have relied on a "clean" certificate of title, i.e., one that neither shows that the goods are subject to a particular security interest nor contains a statement that they may be subject to security interests not shown on the certificate. Under this section, a 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 subsection (b).

**SECTION 9-335. PRIORITY OF SECURITY INTEREST OR
STATUTORY LIEN PERFECTED BY EFFECTIVE FINANCING
STATEMENT CONTAINING INCORRECT INFORMATION.**

(a) A security interest or agricultural lien perfected by a filed financing statement complying with Section 9-502(a) but containing information described in Section 9-515(b)(5) that is incorrect is subordinate to the rights of a holder of a perfected security interest in or [another purchaser] [a buyer] of the collateral to the extent that the secured party or [other purchaser] [buyer] gives value in reasonable reliance upon the incorrect information.

(b) A statutory lien, other than an agricultural lien, perfected by a filed financing statement complying with Section 9-502(a) but containing information described in Section 9-515(b)(5) that is incorrect is subordinate to the rights of a holder of a perfected security interest in the collateral to the extent that the secured party gives value in reasonable reliance upon the incorrect information.

Reporters' Comments

1. **Source.** New.

2. **Effect of Incorrect Information in Financing Statement.** Section 9-521(a) requires the filing office to reject financing statements that do not contain information concerning the debtor as specified in Section 9-515(b)(5). A error in this information does not render the financing statement ineffective. On rare occasions, a subsequent purchaser of the collateral (i.e., a buyer or secured party) may rely on the misinformation to its detriment. Subsection (a) of this section subordinates a security interest or agricultural lien perfected by an effective, but flawed, financing statement to the rights of a purchaser to the extent the purchaser gives value in reasonable reliance on the incorrect information. Subsection (b) contains a similar rule subordinating non-agricultural statutory liens, but, in keeping with the limited treatment of statutory liens under this Article, the subordination rule is limited to competing security interests and does not apply to buyers. A purchaser who has not made itself aware of the information in the filing office with respect to the debtor cannot act in "reasonable reliance upon incorrect information.

SECTION 9-336. PRIORITY SUBJECT TO SUBORDINATION.

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

Reporters' Comments

1. **Source.** Former Section 9-316.
2. **Status.** The Drafting Committee has not considered this section.

[SUBPART 4. RIGHTS OF DEPOSITARY INSTITUTION]

SECTION 9-337. EFFECTIVENESS OF RIGHT OF RECOUPMENT OR SET-OFF AGAINST DEPOSIT ACCOUNT.

(a) Except as otherwise provided in subsection (c), 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 or set-off.

(b) Except as otherwise provided in subsection (c), 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.

(c) 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 which is perfected by control under Section 9-109(a)(3).

Reporters' Comments

1. **Source.** New. Subsection (b) is based on a nonuniform Illinois amendment.
2. **Set-off versus Security Interest.** This section resolves the conflict between a security interest in a deposit account and the 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 9-112(c)(13). 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 (c) contains an exception: if the secured party has control under Section 9-109(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 9-325(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 9-109(a)(3). Additional clarification of this section or the of the Official Comments is likely to be needed to cover cases in which both the debtor and the secured party are indebted to the depositary institution.

3. Deposit Evidenced by Instrument. Under Section 9-102, a deposit evidenced by an instrument (e.g., certain certificates of deposit) is not a "deposit account." Accordingly, this section 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 9-328 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.

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

SECTION 9-338. DEPOSITARY INSTITUTION'S RIGHT TO DISPOSE OF FUNDS IN DEPOSIT ACCOUNT. Except as otherwise provided in Section 9-337(c), and unless the depositary institution otherwise agrees in an authenticated record, a depositary institution's rights and duties with respect to a deposit account maintained with the depositary institution are not terminated, suspended, or modified by:

- (1) the creation or perfection of a security interest in the deposit account;
- (2) the depositary institution's knowledge of the security interest; or
- (3) the depositary institution's receipt of instructions from the secured party.

Reporters' Comments

1. **Source.** New.

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

3. **Operation of Rule.** The general rule of this section is subject to Section 9-337(c), under which the setoff rights of the depositary 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 9-337, is the depositary institution's right to follow the debtor's (customer's) instructions (e.g., by honoring checks, permitting withdrawals, etc.) until such time as the depositary institution is served with judicial process or receives instructions with respect to the funds on deposit from a secured party that has control over the deposit account.

4. **Liability of Depositary Institution.** This Article does not determine whether a depositary 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).

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

**SECTION 9-339. DEPOSITARY INSTITUTION'S RIGHT TO REFUSE
TO ENTER INTO OR DISCLOSE EXISTENCE OF CONTROL**

AGREEMENT. This article does not require a depository institution to enter into an agreement of the type described in Section 9-109(a)(2) even if 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.

Reporters' Comments

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

2. **Protection for Depositary Institution.** This section 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.

PART 4

RIGHTS OF THIRD PARTIES

Reporters' Prefatory Comment

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

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

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

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

SECTION 9-401. ALIENABILITY OF DEBTOR'S RIGHTS. A debtor's rights in collateral may be voluntarily or involuntarily transferred notwithstanding

any provision in the security agreement prohibiting a transfer or making a transfer a default.

Reporters' Comments

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

2. **Negative Pledge Covenant.** 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.

3. **Sale of Receivables.** If a debtor sells an account, chattel paper, or payment intangible outright, as against the buyer the debtor may have no remaining rights to transfer. If, however, the buyer fails to perfect its interest, then insofar as the rights of third parties are concerned, the debtor retains its rights and title. See Section 9-315A(b). The debtor has the power to convey these rights to a subsequent purchaser. If the subsequent purchaser (buyer or secured lender) perfects, it will achieve priority over the earlier, unperfected purchaser.

SECTION 9-402. SECURED PARTY NOT OBLIGATED ON CONTRACT OF DEBTOR. The existence of a security interest, statutory lien, or authority given to a debtor to dispose of or use collateral, without more, does not impose contract or tort liability upon a secured party for the debtor's acts or omissions.

Reporters' Comments

Source. Former Section 9-317, expanded to cover statutory liens.

SECTION 9-403. AGREEMENT NOT TO ASSERT DEFENSES AGAINST ASSIGNEE.

(a) In this section, "value" has the meaning provided in Section 3-303(a).

(b) Except as otherwise provided in this section, an agreement 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 enforceable by an assignee that takes an assignment for value, in good faith, 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 under Section 3-305(a).

(c) An agreement 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 under Section 3-305(b).

(d) This section is subject to other law that establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(e) This section does not displace other law that gives effect to an agreement by an account debtor not to assert a claim or defense against an assignee.

Reporters' Comments

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

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

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

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

4. **Relationship to Terms of Assigned Property.** Former Section 9-206(2), concerning warranties accompanying the sale of goods, has been deleted as unnecessary. This Article does not regulate the terms of the account, chattel paper, or general intangible that is assigned, except insofar as the account, chattel paper, or general intangible itself creates a security interest (as often is the case with

chattel paper). Thus, Article 2, and not this Article, determines whether a seller of goods makes or effectively disclaims warranties, even if the sale is secured. Similarly, other law, and not this Article, determines the effectiveness of an account debtor's undertaking to pay notwithstanding, and not to asset, any defenses or claims against an 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.

5. Relationship to Other Law. The reference to “other law,” in subsection (d) encompasses administrative rules and regulations; the reference it replaces (“statute or decision”) arguably would not. However, because Federal Trade Commission Rule 433 (the so-called “anti-holder-in-due-course” rule) requires creditors to preserve defenses by including a notice in the agreement between the assignor and the account debtor, and does not directly render waiver-of-defense agreements ineffective, Section 9-403 may not be “subject to” the FTC rule within the meaning of subsection (d). Regardless, a creditor taking an assignment with knowledge that the documentation does not comply with the FTC rule would not be in good faith and would not qualify for protection under subsection (b).

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

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

SECTION 9-404. 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, and subject to subsections (b) and (i), the rights of an assignee are subject to:

(1) all the terms of the agreement 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 a notification of the assignment authenticated by the assignor or the assignee.

(b) Subject to subsection (i), the claim of an account debtor may be asserted against an assignee under subsection (a) only to reduce the amount owing or for the assignee's fraud.

(c) Subject to subsection (i), to the extent that the right to payment or a part thereof under an assigned contract has not been fully earned by performance, or to the extent that the right to payment or a part thereof has been fully earned by performance and the account debtor has not received notification of the assignment under subsection (d), 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 of contract by the assignor.

(d) Subject to subsections (e), (f), (g), and (i), an account debtor on an account, chattel paper, [instrument other than a negotiable instrument,] or payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.

(e) Subject to subsection (i), a notification is ineffective under subsection (d):

(1) if it does not reasonably identify the rights assigned;

(2) 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; or

(3) at the option of an account debtor, if the notification notifies the account debtor to make less than the full amount of any installment or other periodic payment to the assignee, regardless of whether only a portion of the account, chattel paper, or general intangible has been assigned to that assignee, a portion has been assigned to another assignee, or the account debtor knows that the assignment to that assignee is limited.

(f) Subject to subsection (i), if requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made. Unless the assignee complies, the account debtor may discharge its obligation by

paying the assignor even if the account debtor has received [an effective] [a] notification under subsection (d).

(g) Except as otherwise provided in Sections 2A-303 and 9-405, and subject to subsection (i), a term in an agreement 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 payment intangible. This subsection does not apply to the sale of a payment intangible.

(h) [Subject to subsection (i), an] [An] account debtor may not waive or vary its option under subsection (e)(3).

(i) This section is subject to other law that establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

Reporters' Comments

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

2. **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.

New subsection (b) tracks Section 3-305(a)(3) in limiting the size of the claim that may be asserted by the account debtor. It follows the rule of *Michelin Tires (Canada), Ltd. v. First National Bank*, 666 F.2d 673 (1st Cir. 1981), in permitting an assignee to assert an affirmative claim based on the assignee's fraud as well as a claim to reduce the amount owing.

New subsection (i) makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors.

3. **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 9-406, 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), or the issuer of a security (governed by Article 8). When chattel paper is composed in part of a negotiable instrument, the obligor on the instrument is not an "account debtor," and Article 3 governs the rights of the assignee of the chattel paper with respect to the issues this section addresses. See, e.g., Section 3-601 (dealing with discharge of an obligation to pay a negotiable

instrument). However, bracketed language in the definition of “account debtor” in Section 9-102 would make it clear that an obligor on a non-negotiable instrument is an account debtor; accordingly, this section would be applicable to such an obligor. The Drafting Committee has not yet discussed that issue.

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

4. Modification of Assigned Contract. Subsection (c) changes former Section 9-318(2) by providing that good faith modifications are binding against an assignee except to the extent that the right to payment has been earned and notification has not been given to the account debtor.

5. 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 from former Section 9-318 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 9-102 to include those obligated on all general intangibles.) Although this revision renders subsection (d) more precise, it probably does not change the law. Former Section 9-318(3) refers to the account debtor’s obligation to “pay,” thereby suggesting that the subsection is limited to account debtors on accounts, chattel paper, and other payment obligations.

The bracketed phrase in subsection (d) raises the issue whether this subsection should govern the rights and obligations of an obligor on a non-negotiable instrument. Today, these rights and obligations are governed by common law. Some observers believe that the “notification” rule of subsection (d) is preferable to the traditional common-law “merger” rule, under which the obligation to pay runs to the person in possession of an indispensable instrument. The “merger” rule may have particularly undesirable effects in the case of a real property mortgagor who pays the full amount of the mortgage note to the mortgagee, only to discover that the obligation was not discharged because the note and mortgage had been assigned and delivered to the assignee prior to payment. On the other hand, creating a rule for assignees under Article 9 that may differ from the rule applicable to non-Article 9 assignees (e.g., buyers of non-negotiable notes), carries with it the potential for mischief.

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

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

Subsection (e)(1) tracks former Section 9-318(3) and makes ineffective a notification that does not reasonably identify the rights assigned.

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

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

7. Proof of Assignment. Subsection (f) 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 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.

8. 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 (g) essentially follows former Section 9-318(4), but expands the rule of free assignability to chattel paper (subject to Sections 2A-303 and 9-405), 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 (g) 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.

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

SECTION 9-405. RESTRICTIONS ON CREATION OR ENFORCEMENT OF SECURITY INTEREST IN LEASEHOLD INTEREST OR IN LESSOR’S RESIDUAL INTEREST.

(a) In this section, "creation of a security interest" includes the sale of a lease contract that is subject to this article.

(b) A provision in a lease agreement which prohibits the creation or enforcement of a security interest in an interest of a party under the lease contract or in the lessor's residual interest in the goods, or which makes such a transfer an event of default, is not enforceable unless, and then only to the extent that, there is a transfer by the lessee of the lessee's right of possession or use of the goods in violation of the provision or a delegation of a material performance of either party to the lease contract in violation of the provision. Neither the granting nor the enforcement of a security interest in the lessor's interest under the lease contract or the lessor's residual interest in the goods is a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the lessee within Section

2A-303(5) unless, and then only to the extent that, there is a delegation of a material performance of the lessor.

Reporters' Comments

1. **Source.** Section 2A-303.

2. **Status.** Inasmuch as these provisions deal explicitly with the creation of a security interest, some people think they belong in Article 9. Others disagree and would keep the provisions in Article 2A. We expect that both Drafting Committees will consider the issue. In any event, it is likely that some revision of these provisions will be appropriate.

**SECTION 9-406. RESTRICTIONS ON ASSIGNMENT OF CERTAIN
GENERAL INTANGIBLES INEFFECTIVE.**

(a) A term in a general intangible, including a contract, permit, license, or franchise, between an account debtor and a debtor which 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:

(1) the term would impair the creation, attachment, or perfection of a security interest; or

(2) 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.

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

(c) A provision 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:

(1) the term would impair the creation, attachment, or perfection of a security interest; or

(2) 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, or provision in a statute, rule, or regulation, is ineffective under subsection (a) or (c) but is effective under other law, the creation, attachment, or perfection of a security interest in the general intangible:

(1) is not enforceable against the account debtor;

(2) imposes no duties or obligations on the account debtor; and

(3) 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 prevails 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. **Source.** New.

2. **Free Assignability.** 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 (a)) 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 other party obligated to perform (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 (a) or (c) would be effective under other law.

3. **Terminology: “Account Debtor.”** This section uses the term “account debtor” to refer to the party other than the debtor to a general intangible such as a permit, franchise, or the like. In many cases the principal payment obligation under a general intangible may be a obligation to pay *by* the debtor *to* the account debtor. But the definition of “account debtor” in Section 9-102 does not limit the term to persons who are obligated to *pay* under a general intangible. Because the other party to a general intangible may not have affirmative executory duties or obligations, it has been suggested that another term be used. Alternatively, the Drafting Committee may wish to consider whether the definition of “account debtor” should be expanded to include “a person, other than the debtor, that is a party to a general intangible.”

4. **Scope: Sales of Payment Intangibles and Other General Intangibles.** This section applies to a security interest in payment intangibles only if the security interest arises out of sale of the payment intangibles. Security interests in payment intangibles that secure an obligation are subject to the even broader anti-assignment rule in Section 9-404(g).

This section does not render ineffective any term that restricts outright sales of general intangibles other than payment intangibles. It deals only with restrictions on security interests. The only sales of general intangibles that create security interests are sales of payment intangibles.

5. **Effect in Assignor’s Bankruptcy.** 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 franchisee, secured by the debtor’s “going business” value. To secure the loan, the debtor grants a security interest in all its existing and after-acquired property. The franchise represents the principal value of the business. The municipality refuses to consent to any assignment for collateral purposes. As a consequence, by virtue of other law, the security interest in the franchise does not attach. If the debtor enters bankruptcy and sells the business, the secured party will receive but a fraction of the business’s value. Under this section, however, the security interest would attach to the franchise. As a result, the security interest would attach to the proceeds of any sale of the franchise during bankruptcy. This section would protect the interests of the municipality, by preventing the secured party from enforcing its security interest to the detriment of the municipality.

6. **Contrary Federal Law.** This section does not override federal law to the contrary.

PART 5

FILING

Reporters' Prefatory Comment

The filing system is the heart of Article 9. Part 5, 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. Revised Part 5 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.

Many of the revisions stem from three concepts. First, Part 5 is, by its express terms, "medium-neutral." It recognizes that one can "communicate" a "record" (both newly defined in Section 9-102) 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 9-528 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 the International Association of Corporate Administrators and other participants in the Article 9 Filing Project.

Third, revised Part 5 incorporates what has come to be known as the "open drawer" approach. This convention encompasses several aspects of filing office operations. First, the filing office may not reject a financing statement or other record for a reason other than one of the few set forth in the Article. Second, the filing office is obliged to link all subsequent records (e.g., amendments, assignments, etc.) to the initial financing statement to which they relate. Third, the filing office may delete a financing statement and related records from the files only upon lapse (i.e., five years after the filing date), and then only if a continuation statement has not been filed. Thus, a financing statement and all records relating to it will be discovered by a search of the files even after the filing of a termination statement. This approach helps eliminate filing office discretion and also eases problems associated with multiple secured parties and multiple partial assignments.

In developing Part 5, the Drafting Committee has received valuable assistance from participants in the Article 9 Filing Project, a joint project sponsored by the University of Minnesota with the cooperation of the Conference.

In reviewing Part 5, the reader should keep in mind that Section 9-102 defines the term "financing statement" to include not only the initial financing statement 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.

[SUBPART 1. PLACE OF FILING; CONTENTS AND
EFFECTIVENESS OF FINANCING STATEMENT]

SECTION 9-501. PLACE OF FILING.

(a) If the law of this State governs perfection of a security interest, the place to file a financing statement to perfect the security interest is:

(1) the office designated for the filing or recording of a mortgage on the real property, if the collateral is timber to be cut or is minerals or the like, including oil and gas, or accounts subject to Section 9-306, or the financing statement is filed as a fixture filing and the collateral is goods that are or are to become fixtures;

[and]

[(2) the office of the debtor's registered agent, if the debtor has designated a registered agent under Section 9-525; and]

(3) the office of [] [or any location duly authorized by []] in all other cases, including if the goods are or are to become fixtures and the financing statement is not filed as a fixture filing.

(b) The 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 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 9-526).

Reporters' Comments

1. **Source.** Former Section 9-401, revised as indicated below.

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

3. **Registered Agent.** 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 9-502. CONTENTS OF FINANCING STATEMENT;
MORTGAGE AS FINANCING STATEMENT; TIME OF FILING
FINANCING STATEMENT.**

(a) A financing statement is sufficient only if it provides the name of the debtor and the name and mailing address of the secured party or a representative of the secured party and indicates the collateral covered by the financing statement. If the financing statement covers timber to be cut, minerals or the like including oil and gas, or accounts subject to Section 9-306, or if the financing statement is filed as a fixture filing and the collateral is goods that are or are to become fixtures, the financing statement also must indicate that it covers this type of collateral, indicate that it is to be filed [for record] in the real property records, provide a description of the real property [sufficient if it were contained in a mortgage of the real property 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 property, provide the name of a record owner.

Legislative Note: Language in brackets is optional. Where the State has any special recording system for real property 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 9-520(b) may be necessary. See, e.g., Mass. Gen. Laws Chapter 106, Section 9-410.

(b) If a financing statement states that it is filed in connection with a [public finance transaction] [or] [manufactured home transaction], it also may state that its period of effectiveness is [10, 20, or 30] years after the date of filing.

(c) A real property 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 property described in the mortgage;

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

(4) the mortgage is [duly] recorded.

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

Reporters' Comments

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

2. **Debtor's Signature; Required Authorization.** Subsection (a) omits the requirement that the debtor sign a financing statement. As PEB Commentary No. [] indicates, a paperless financing statement may be filed electronically under existing law. Nevertheless, the elimination of the signature requirement facilitates paperless filing. Elimination of the debtor's signature requirement makes the exceptions provided by former Section 9-402(2) unnecessary.

The fact that this Article does not require that an authenticating symbol be contained in the public record does not mean that all filings are authorized. To the contrary, this Article contains several provisions designed to insure that only authorized records are filed. Section 9-508(a) permits a person to file an initial financing statement or an amendment that adds collateral only if the debtor authorizes the filing, and Section 9-624(d) provides a remedy for unauthorized filings. Sections 9-515(b)(1) and 9-528 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. This Article also contains provisions that assist in the discovery of unauthorized filings and the amelioration of their effect. For example, Section 9-520(a)(6) requires the filing office to communicate the information in each filed record to every debtor and secured party that might be affected. In addition, Section 9-519 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.

3. Certain Other Requirements. This section deletes other formerly required information because it seems unwise (real property description for financing statements covering crops), unnecessary (adequacy of copies of financing statements, address of debtor), 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. Although a mailing address for the debtor no longer is required as a condition of effectiveness, the filing office must reject a financing statement that does not provide that information. See Sections 9-521(a); 9-515(b)(5)(A).

4. Public Finance Transactions; Manufactured Home Transactions. The normal 5-year period of effectiveness is inapplicable to public finance transactions and manufactured home transactions. See Section 9-516 and the Comments thereto. Subsection (b) permits a financing statement filed in connection with a transaction of either kind to indicate its period of effectiveness. The Drafting Committee has yet to consider the specifics of this subsection.

5. Real-Property-Related Filings. The second sentence of subsection (a) contains the requirements for fixture filings and financing statements covering timber, minerals, and certain accounts. Subsection (c) explains when a real property mortgage is effective as a fixture filing.

Subsection (a) contains the following terms: "for record, "real property 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 9-102(a) is not applicable.

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

SECTION 9-503. NAME OF DEBTOR AND SECURED PARTY.

(a) A financing statement sufficiently provides the name of the debtor:

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

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

(3) if the debtor is a trust or a trustee acting with respect to property of a trust, only if the financing statement:

(A) provides the name, if any, specified for the trust in its organic documents or, if no name is specified, states 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

(B) indicates, in the debtor's name or otherwise, that the debtor is a trust; and

(4) in other cases, only if it provides the individual or organizational name of the debtor.

(b) A financing statement that sufficiently provides the name of the debtor is not rendered ineffective by the absence of a trade or other name or names of partners, members, or associates.

(c) A financing statement that provides only the debtor's trade name or only the names of the debtor's partners, members, or associates does not sufficiently provide the name of the debtor.

(d) A financing statement may provide the name of more than one debtor and the name of more than one secured party.

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

Reporters' Comments

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

2. **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 (a) explains what the debtor's name is for purposes of a financing statement. If the debtor is a "registered entity" (defined in Section 9-102 so as to ordinarily include corporations, limited partnerships, and limited liability companies), then the debtor's name is the name shown on the public records of the debtor's "State of organization" (also as defined in Section 9-102). Subsections (a)(2) and (a)(3) contain special rules for decedent's estates and trusts, as to which current law is now silent.

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

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

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

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

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.

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

SECTION 9-504. INDICATION OF COLLATERAL. A description of the collateral pursuant to Section 9-111, 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.

Reporters' Comments

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

2. **Indication of Collateral.** This section 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. A broad statement of this kind would not be a sufficient description for purposes of a security agreement. See Section 9-111. It follows that a somewhat narrower description than "all assets, e.g., "all assets other than automobiles, is sufficient for purposes of this section even if it does not suffice for purposes of a security agreement.

SECTION 9-505. 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 9-309A(a), using the terms

“consignor, “consignee, “lessor, “lessee, “bailor, “bailee, “owner, “registered owner , “buyer, “seller, or the like, instead of the terms “secured party and “debtor. This part applies to a financing statement and, as appropriate, to compliance that is equivalent to filing a financing statement under Section 9-309A(c), 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. **Source.** Former Section 9-408, expanded.

2. **Goods Covered by a Certificate of Title.** This section provides the same benefits for compliance with a statute or treaty described in Section 9-309A(a) that former Section 9-408 provides for filing, in connection with the use of terms such as “lessor, consignor, etc. It also expands the rule to embrace more generally other bailments and transactions. The references to “owner and “registered owner are intended to address, for example, the situation where a putative lessor is the registered owner of an automobile covered by a certificate of title and the transaction is determined to create a security interest. Although this section provides that the security interest is perfected, it may be advisable or necessary to amend the relevant certificate-of-title act in order to ensure that this result will be achieved. The references to “buyer and “seller encompass sales transactions, primarily sales of receivables.

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

4. **Consignments.** Although a “true consignment is a bailment, the filing and priority provisions of former Article 9 apply to it; a consignment “intended as security creates a security interest that is in all respects subject to former Article 9. This Article subsumes 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 9-506. EFFECT OF MINOR ERRORS. A financing statement substantially complying with the requirements of this part is effective, even if it contains minor errors that are not seriously misleading. A financing statement that fails to provide the correct name of the debtor in accordance with Section 9-503(a) contains an error that is seriously misleading unless a search of the records of the filing office under the debtor's correct name, utilizing the filing office's standard search technique, would disclose the financing statement, in which case the incorrect name is not an error that renders the financing statement seriously misleading.

Reporters' Comments

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

2. **Errors.** This section adds to former Section 9-402(8) 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.

**SECTION 9-507. EFFECT OF CERTAIN CHANGES ON
EFFECTIVENESS OF FINANCING STATEMENT.**

(a) 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.

(b) 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 9-313(c), even if the secured party knows of or consents to the disposition.

(c) Except as otherwise provided in subsection (a) and Section 9-510, a financing statement is not rendered ineffective if, after the financing statement is filed, the information contained in the financing statement becomes erroneous and seriously misleading.

Reporters' Comments

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

2. **Post-filing Change in Debtor's Name.** This section deals with situations in which the information in a proper financing statement becomes inaccurate. Subsection (a) 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.

3. **Post-filing Transfer of Collateral.** Subsection (b) 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.

4. **Other Post-filing Changes.** Subsection (c) provides that, except for the four-month rules in subsection (a) ("pure" name change) and Section 9-510 (new debtor that becomes bound by original debtor's security agreement), post-filing changes that render a financing statement inaccurate and seriously misleading have no effect on a financing statement. The financing statement remains effective.

SECTION 9-508. AUTHORIZATION OF FINANCING STATEMENT.

(a) 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 an authenticated record; or

(2) the person holds a statutory lien that has become effective at the time of filing and the financing statement covers only collateral in which the person holds a statutory lien.

(b) By signing a security agreement, a debtor authorizes the secured party to file an initial financing statement and an amendment covering the collateral described in the security agreement.

(c) A financing statement is ineffective to the extent that filing of the financing statement is not permissible under subsection (a).

Reporters' Comments

1. **Source.** New.

2. **Unauthorized Filings.** Subsection (a)(1) 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. A person who files an unauthorized record in violation of subsection (a)(1) is liable under Section 9-624(d) for a statutory penalty and damages.

3. **Authorization in Security Agreement.** Under subsection (b), the authentication of a security agreement *ipso facto* constitutes the debtor's consent to the filing of a financing statement covering the collateral described in the security agreement. The secured party need not obtain a separate authorization. Thus, if an authenticated security agreement covers inventory, and the secured party files a financing statement covering inventory and accounts, the financing statement is authorized insofar as it covers inventory and unauthorized insofar as it covers accounts.

4. **Statutory Liens.** Under subsection (a)(2), an statutory 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, the filing office normally will inform the debtor about the filing pursuant to Section 9-520(a)(6).

5. **Ineffectiveness of Unauthorized or Overbroad Filings.** Subsection (c) provides that a filed financing statement is not effective to the extent that the filing was not permissible under subsection (a).

SECTION 9-509. AMENDMENT OF FINANCING STATEMENT.

(a) Subject to Section 9-513, a secured party of record may add or delete collateral covered by a financing statement or, subject to subsection (d), otherwise

amend the information contained in a financing statement by filing an amendment that identifies the initial financing statement by the file number assigned pursuant to Section 9-520(a) or, if the initial financing statement was filed before the effective date of this [Act], by the date of filing and file number.

(b) An amendment does not extend the period of effectiveness of a financing statement.

(c) If an amendment adds collateral, it is effective as to the added collateral only from the date of filing of the amendment.

(d) Except as otherwise provided in Section 9-510(b), a filed record that adds a debtor is not effective as an amendment. However, if the record otherwise is sufficient as a financing statement under Section 9-502(a), it is sufficient as a financing statement.

Reporters' Comments

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

2. **Changes to Financing Statements.** This section addresses changes to financing statements, including addition and release of collateral. Although termination statements, assignments, and continuation statements are types of amendment, this Article follows former Article 9 and treats these types of amendments separately. See Section 9-511 (termination statements); 9-512 (assignments); 9-517 (continuation statements).

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

This section revises former Section 9-402(4) to permit secured parties 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 Section 9-508(a).

SECTION 9-510. 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 had the original debtor acquired rights in the collateral.

(b) If the difference between the name of the original debtor and that of the new debtor causes a filed financing statement that is effective under subsection (a) to be seriously misleading:

(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 under Section 9-203(c); 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 under Section 9-203(c) unless an amendment 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 9-507(b).

Reporters' Comments

1. **Source.** New.

2. **The Problem.** Sections 9-203(b) and 9-510 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 9-313(c); 9-507(b). Former Article 9 is less clear with respect to whether an after-acquired property clause in a security agreement authenticated by the original debtor would be effective to create a security interest in property acquired by the new corporation or

the merger survivor and, if so, whether a financing statement filed against the original debtor would be effective to perfect the security interest. This section and Section 9-203(b) are an attempt at clarification.

3. How a New Debtor Becomes Bound. Normally, a security interest is unenforceable unless the debtor has authenticated a security agreement describing the collateral. See Section 9-203(a). New Section 9-203(b) creates an exception, under which a security agreement entered into by one person is effective with respect to the property of another. This exception comes into play if a “new debtor “becomes bound” as debtor by a security agreement entered into by another person (the “original debtor”). (The first and last quoted terms are defined in new subsections of Section 9-102; “becomes bound” is defined in Section 9-203(c).) If a new debtor does become bound, then the security agreement entered into by the original debtor satisfies the security-agreement requirement of Section 9-203(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 9-203(c) provides the way in which a new debtor “becomes bound” by an original debtor’s security agreement. Under Section 9-203(c)(1), 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.

Under certain circumstances, a new debtor “becomes bound” for purposes of Article 9 even though it would not be bound under other law. Under Section 9-203(c)(2), a new debtor becomes 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 Section 9-203(c)(2), B Corp would “become bound” for purposes of Section 9-203(b) and this section. Section 9-203(c)(2) excludes sureties and other secondary obligors as well as persons who become obligated through veil piercing and other non-successorship doctrines. In many cases, it will exclude successors to the assets and liabilities of a division of a debtor.

4. When a Financing Statement Is Effective Against a New Debtor. Subsection (a) provides that a filing against the original debtor is effective to perfect a security interest in collateral that a new debtor 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 9-507(a) 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 debtor continues to be effective until it lapses. See subsection (c); Section 9-507(b).

5. **Priority.** Section 9-323A 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 9-511. TERMINATION STATEMENT.

(a) A termination statement for a financing statement is an amendment of a financing statement that, in addition to complying with the requirements of Section 9-509(a), indicates either that it is a termination statement or that an identified financing statement is no longer effective.

(b) Only 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] [as soon as reasonably practicable but not more than 3 days] after the secured party receives a [signed] [authenticated] demand by the debtor, and if there is no outstanding secured obligation and no commitment to make an advance, incur an obligation, 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 an advance, incur an obligation, 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 other person obligated has discharged its obligation, the secured party of record for a financing statement, [within 10 days] [as soon as

reasonably practicable but not more than 3 days] after the secured party receives [a] [an authenticated] demand by the debtor, shall send to the debtor a termination statement for the financing statement or file the termination statement with filing office.

(d) Except as otherwise provided in Section 9-513, 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. **Source.** Former Section 9-404.

2. **Requirements for Termination Statement.** 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, like a financing statement, a termination statement need not be signed or otherwise authenticated.

3. **Who May File.** Subsection (b) provides that a secured party of record may file a termination statement. If there is more than one secured party of record, a termination statement filed by one does not affect the rights of the others. See Section 9-513.

4. **Duty to File or Send.** Subsection (c) 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 for the filing of an unauthorized financing statement or amendment. See Section 9-624(d).

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

6. **Effect of Filing.** Subsection (d) is new. It states the effect of filing a termination statement. If one of several secured parties of record files a termination statement, subsection (d) applies only with respect to the rights of the person filing the termination statement. See Section 9-513.

7. **“Bogus” Filings and Disappearing Secured Parties.** 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 9-519 addresses this problem, along with the problem faced by a debtor whose secured party has disappeared or gone out of business.

SECTION 9-512. ASSIGNMENT OF RIGHTS UNDER FINANCING STATEMENT.

(a) Except as otherwise provided in subsection (c), an initial financing statement may reflect an assignment of all of the secured party's rights with respect to some or all of the collateral indicated in the financing statement by providing the name and mailing address of the assignee as the name and address of the secured party. Upon filing, the assignee named in an initial financing statement filed under this subsection is the secured party of record for the financing statement. [An initial financing statement may provide that the rights under the financing statement are being assigned only with respect to the portion of the collateral covered by the financing statement which 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 of the financing statement that complies with the requirements of Section 9-509(a) and indicates the name of the secured party of record 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 property mortgage that is effective as a fixture filing under Section 9-502(b) may be made only by an assignment of record of the mortgage in the manner provided by other law of this State.

Reporters' Comments

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

2. **Comparison to Prior Law.** Most of the changes to this section are for clarification or to embrace medium-neutral drafting. As a general matter, this Article preserves the opportunity given by former Section 9-405 to assign a security interest of record in one of two different ways. Under subsection (a), a secured party may assign all of its 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.

3. **Partial Assignments in Initial Financing Statement.** The bracketed portion of subsection (a) may be unnecessary. The first sentence provides explicitly that an assignment may relate to "some or all of the collateral."

SECTION 9-513. 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 under Section 9-509(a).

(b) A record filed by one secured party of record affects only the rights of the filer and does not affect the rights under the financing statement of another secured party of record.

Reporters' Comments

1. **Source.** Former 9-406.

2. **Multiple Secured Parties.** 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 while protecting the secured party's rights from the effects of filings made by another secured party of record.

Example 1: 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, A's would remain perfected in all the collateral.

Example 2: A financing statement names A and B as the secured parties. If B files a termination statement, A's rights as a secured party of record would be unaffected. That is, the financing statement would continue to be effective to perfect A's security interest..

3. **Release of Collateral.** Former Section 9-406 deals with releases of collateral. Under new Section 9-509, releases of collateral are dealt with as a form of amendment that modifies the indication of collateral covered by a financing statement.

[SECTION 9-514. SUCCESSOR OF SECURED PARTY. A person that succeeds to substantially all of the rights of a secured party by operation of law and itself becomes 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. **Source.** New.

2. **Successors.** This section resolves a practical problem faced by successors to a secured party—how to identify itself with respect to 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. This section does not determine whether a successor enjoys the right to perform any particular act. Rather, it indicates the manner in which a successor may perform an authorized act.

The definition of “successor” derives in part from the definition of “successor of a beneficiary” in revised Section 5-102(a)(15).

3. **Relation to “Open Drawer” Policy and Absence of Signature Requirement.** This section appears in brackets, inasmuch as it may not be necessary. Under the “open drawer” approach adopted by this Article, the filing office has no duty to determine whether the putative successor in fact is a successor, and it may not refuse to accept a record because of doubts about whether the putative successor in fact is a successor. Also, records communicated to the filing office need not be authenticated. Arguably, non-UCC principles of agency law are sufficient to determine the effectiveness of a filing by a putative successor.

**SECTION 9-515. WHAT CONSTITUTES FILING RECORD;
EFFECTIVENESS OF FILING.**

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

(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:

(A) in the case of an initial financing statement, the record does not provides a name for the debtor or the filing office is unable to read or decipher a name that is provided; or

(B) in other cases, the record does not 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 does not provide a name for the secured party of record or the filing office is unable to read or decipher the name provided;

(5) in the case of an initial financing statement, the statement does not:

(A) provide a mailing address for the debtor;

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

or

(C) if the financing statement indicates that the debtor is an organization, provide the type of organization, provide a State of organization for the debtor, or provide an organizational identification number for the debtor or indicate that the debtor has none; or

(6) in the case of an assignment reflected in an initial financing statement under Section 9-512(a) or an amendment filed under Section 9-512(b), the record does not provide a name for the assignee.

(c) Except as otherwise provided in Section 9-335, a filed financing statement complying with Section 9-502(a) is effective even if some or all of the information described in subsection (b)(5) is not stated or is incorrect.

(d) A record that is presented to the filing office with tender of the filing fee 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 reasonable reliance upon the absence of the record in the files.

Reporters' Comments

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

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

3. **Effectiveness of Rejected Records.** A financing statement or other record that is presented to the filing office but which the filing office refuses to accept provides no public notice, regardless of the reason for the rejection. However, this section distinguishes between records that the filing office rightfully rejects and those that it wrongfully rejects. A filer is able to prevent a rightful rejection by complying with the requirements of subsection (b). (Failure to comply with subsection (b) affords the only grounds for rejection. See Section 9-521(a).) No purpose is served by giving effect to records that justifiably never find their way into the system, and subsection (b) so provides.

Subsection (d) deals with the filing office's unjustified refusal to accept a record. Here, the filer is in no position to prevent the rejection and, many believe, as a general matter should not be prejudiced by it. Although wrongfully rejected records generally are effective, subsection (d) contains a special rule to protect a third party purchaser of the collateral (e.g., a buyer or competing secured party) who gives value in reliance upon the apparent absence of the record in the files. As against an innocent reliance party, subsection (d) imposes upon the filer the risk that a record failed to make its way into the filing system. This risk is likely to be small, particularly when a record is presented electronically, and the filer can guard against this risk by conducting a post-filing search of the records. Moreover, Section 9-521(b) requires the filing office to give prompt notice of its refusal to accept a record for filing.

4. **Effectiveness of Rejectable But Unrejected Records.** Section 9-521(a) requires the filing office to refuse to accept an initial financing statement lacking the information described in subsection (b)(5). However, if the filing office accepts such a financing statement nevertheless, the absence of the information normally does not affect the effectiveness of the financing statement. See subsection (c). Similarly, an otherwise effective financing statement remains so even though the information described in subsection (b)(5) is incorrect, except as against certain persons who relied upon the incorrect information. See Section 9-335.

SECTION 9-516. DURATION AND EFFECTIVENESS OF FINANCING STATEMENT; EFFECT OF LAPSED FINANCING STATEMENT.

(a) Except as otherwise provided in subsections (b), (e), (f), and (g), and Section 9-519(i), a filed financing statement is effective for a period of five years after the date of filing.

(b) Except as otherwise provided in subsections (e), (f), and (g), and Section 9-519(i), if an initial financing statement is filed in connection with a [public finance transaction] [or] [manufactured home transaction] and indicates that it is effective for an extended period under Section 9-502(b), the filed financing statement is effective for the extended period indicated.

(c) The effectiveness of a filed financing statement lapses on the expiration of the period of its effectiveness unless before the lapse a continuation statement is filed pursuant to subsection (d) [, notwithstanding the commencement of insolvency proceedings by or against the debtor]. Upon lapse, a financing statement becomes ineffective and any security interest or statutory lien that was perfected by the financing statement becomes unperfected, unless the security interest [or statutory lien] is perfected without filing. If the security interest or a statutory lien becomes unperfected upon lapse, it is deemed never to have been perfected as against a prior or subsequent purchaser of the collateral for value.

(d) 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 (a) or the extended period under subsection (b).

(e) Subject to Section 9-513, upon timely filing of a continuation statement, the effectiveness of the initial financing statement continues for a period of five years commencing on the day on which the financing statement would have become effective in the absence of the filing. Upon the expiration of the five-year period,

the financing statement lapses in the same manner as provided in subsection (c), unless, before the lapse, another continuation statement is filed pursuant to subsection (d). Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the initial financing statement.

(f) If a debtor is a transmitting utility and a filed financing statement so indicates, the financing statement is effective until a termination statement is filed.

(g) A real property mortgage that is effective as a fixture filing under Section 9-502(c) remains effective as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real property.

Reporters' Comments

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

2. **Period of Financing Statement's Effectiveness.** Subsection (a) states the general rule: a financing statement is effective for a five-year period unless its effectiveness is continued under this section or terminated under Section 9-519. Subsection (b) provides for a longer period in the case of a public finance transaction or a manufactured home transaction, inasmuch as these financings typically extend beyond the standard, five-year period. Under subsection (f), a financing statement filed against a transmitting utility remains effective indefinitely, until a termination statement is filed. Likewise, under subsection (g), a real property mortgage effective as a fixture filing remains effective until its effectiveness terminates under real property law.

3. **Lapse.** When the period of effectiveness under subsection (a) or (b) expires, the effectiveness of the financing statement lapses. Under former Section 9-403(2), lapse was tolled if the debtor entered bankruptcy or another insolvency proceeding. A few years ago, Bankruptcy Code § 362(b)(3) was amended to permit a secured party to continue or maintain the perfected status of its security interest without first obtaining relief from the automatic stay. Accordingly, subsection (c) deletes the former tolling provision. 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.

4. **Continuation Statements.** Subsection (d) explains who may file a continuation statement and when it may be filed. A continuation statement filed by

a person other than a secured party of record, or at a time other than that prescribed by subsection (d), is ineffective. However, the filing office nevertheless must accept it. See Sections 9-521(a); 9-515(b). Subsection (e) specifies the effect of a continuation statement and provides for successive continuation statements.

SECTION 9-517. CONTENTS OF CONTINUATION STATEMENT. A continuation statement is an amendment of a financing statement that, in addition to complying with the requirements of Section 9-509(a), indicates that it is a continuation statement for, or that it is filed to continue the effectiveness of, the financing statement.

Reporters' Comments

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

2. **Contents of Continuation Statement.** A continuation statement must comply with the requirements for an amendment, see Section 9-509(a) and, in addition, indicate that it is a continuation statement or that it has been filed to continue the effectiveness of the financing statement to which it relates. Consistent with the medium-neutral approach of Part 5, no signature is required for a continuation statement.

SECTION 9-518. EFFECT OF INDEXING ERRORS.

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

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

Reporters' Comments

1. **Source.** New.

2. **Protection for Reliance Parties.** Like a record that the filing office refuses to accept, a record that the filing office accepts but mis-indexes affords no public notice. This section treats a mis-indexed record much like Section 9-515(d) treats a record that the filing office wrongfully refuses to accept. Generally, under subsection (a), the filing office's error does not affect the effectiveness of the filing. Cf. Section 9-515(a). However, under subsection (b), 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. Cf. Section 9-515(d).

This section and Section 9-515(d) 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.

**SECTION 9-519. CLAIM CONCERNING INACCURATE OR
WRONGFULLY FILED RECORD; CORRECTION STATEMENTS;
TERMINATION REQUESTS; EFFECT OF FAILURE TO OBJECT TO
TERMINATION REQUEST.**

(a) If a person believes 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.

(b) If a person believes 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 9-511, 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 file number assigned under Section 9-520(a) or, if the initial financing statement was filed before the effective date of this [Act], by the date of filing and file number. A correction statement must indicate that it is a correction statement and provide 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 to cure any inaccuracy. A termination request must indicate that it is a termination request and provide 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.

(d) The filing of a correction statement or a termination request does not affect the effectiveness of the initial financing statement or other record to which it relates.

[(e) Promptly upon communicating, pursuant to Section 9-620(a)(6), [the information contained in a termination request] [the fact that a termination request has been filed with the filing office] to the secured party of record named in the financing statement to which a termination statement relates, the filing office shall create and file a record indicating the date on which it made the communication and identifying the initial financing statement and the termination request by the file numbers assigned under Section 9-520(a).

(f) If a secured party of record believes that it has not failed to comply with its duty to file or send to the debtor a termination statement as indicated in a termination request, the secured party of record may file an objection statement.

(g) An objection statement must identify the initial financing statement to which it relates by the file number assigned under Section 9-520(a) or, if the initial financing statement was filed before the effective date of this [Act], by the date of filing and file number, and must indicate that the secured party of record does not believe that it has failed to comply with its duty to file or send to the debtor a termination statement as indicated in the termination request.

(h) The filing of an objection statement does not affect the effectiveness of the initial financing statement or other record to which it relates and does not preclude any judicial relief to which the person filing a termination request may be entitled.

(i) If, within [] days after the date indicated in the record filed pursuant to subsection (e), the secured party of record does not file an objection statement relating to the termination request, the effectiveness of the initial financing statement to which the termination request relates terminates.]

Reporters' Comments

1. **Source.** New.

2. **The Problem.** This 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.

3. **A Partial Solution.** 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. The statement or request becomes part of the "financing statement," as defined in Section 9-102; however, subsection (d) provides that the filing does not affect the effectiveness of the initial financing statement or other record to which it relates. These provisions resemble the analogous remedy in the Fair Credit Reporting Act.

This section does not displace other provisions of this Article that impose liability for making unauthorized filings or failing to file or send a termination statement. See Section 9-624(d). Nor does it displace any available judicial remedies.

4. **A More Aggressive Approach.** Subsections (e) through (i) present a more aggressive approach to the problem of wrongfully filed financing statements and disappearing secured parties by providing for the automatic termination of financing statements if the secured party fails to object to a termination request.

Section 9-520(a)(6) requires the filing office to inform each secured party of record of every record affecting the financing statement. Thus, the allegedly offending secured party of record will be informed that a termination request has been filed. Subsections (f) and (g) afford the secured party of record the opportunity to file an objection statement, in which it states its belief that it has not failed to file or send a required termination statement. If no objection statement is forthcoming within the prescribed time period, the effectiveness of the initial financing statement terminates automatically. To enable a searcher to determine from the public record whether the time for filing an objection statement has expired, subsection (e) requires the filing office to indicate the date on which the time began to run, i.e., the date on which the filing office complied with its duty under Section 9-520(a)(6) to inform the secured party of record.

Subsections (e) through (i) are in brackets, to reflect that the Drafting Committee is divided over its wisdom. All members recognize that “bogus” filings and disappearing secured parties have caused real problems. However, the members disagree over whether the likely benefits of subsections (e) through (i) justify imposing upon the filing offices the costs of the procedures these subsections contemplate. The Drafting Committee also disagrees about the seriousness of the risk that the bracketed provisions would impose on legitimate secured parties.

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

[SUBPART 2. DUTIES AND OPERATION OF FILING OFFICE]

SECTION 9-520. NUMBERING, MAINTAINING, AND INDEXING RECORDS; COMMUNICATING INFORMATION CONTAINED IN RECORDS.

- (a) For each record filed with a filing office, the filing office shall:
 - (1) assign a file number to the record pursuant to Section 9-520A;
 - (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 record [in accordance with] [under] [pursuant to] subsections (b), (c), and (d);
 - (5) note in the index the file number and the date and time of filing; and
 - (6) communicate the [information contained in the record] [the fact that the record has been filed with the filing office] to each debtor and secured party of record named in the financing statement to which the record relates and to the person that filed the record with the filing office.

(b) Except as otherwise provided in subsections (c) and (d), the filing office shall index an initial financing statement according to the name of the debtor and shall index all filed records relating to the initial financing statement in a manner that associates with one another an initial financing statement and all filed records relating to the initial financing statement.

(c) If a financing statement covers timber to be cut, minerals or the like including oil and gas, or accounts subject to Section 9-306, 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 of each owner of record shown on the financing statement as if they were the mortgagors under a mortgage of the real property 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 property described.

(d) In the case of a fixture filing, or a financing statement covering timber to be cut, minerals or the like including oil and gas, or accounts subject to Section 9-306, the filing office shall index an assignment filed under Section 9-512(a) or an amendment filed under Section 9-512(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 property mortgage under the name of the assignee, the filing office shall index the assignment or the amendment under the name of the assignee.

(e) The filing office shall maintain a storage and retrieval capability that:

(1) provides for retrieval of a record by the name of the debtor and the file number assigned to the record; and

(2) associates with one another an initial financing statement and each filed record relating to the initial financing statement.

(f) The filing office shall perform the acts required subsections (a) through (d) at the time and in the manner prescribed by rule, but not later than two business days after the filing office receives the record in question.

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

Reporters' Comments

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

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

3. **Information from Filing Office.** In an effort to reveal the fact of unauthorized filings as soon as practicable, subsection (a)(6) adds a requirement that the filing office inform affected persons of each record filed. Rather than specify the persons that would be "affected" by a particular record, subsection (a) in effect deems all debtors and secured parties of record to be affected by every record relating to a financing statement. This approach is easier to understand and administer.

The draft contains two alternatives for the information that the filing office is to communicate. The first requires the filing office to communicate all of the information contained in the record. For example, a photocopy of a written record would satisfy that requirement. The second alternative is less burdensome, but nevertheless might be adequate to accomplish the purpose of policing unauthorized filings. It would require the filing office to communicate only the fact that the record had been filed. For example, the second alternative would be satisfied by the following statement, communicated in writing or otherwise:

Please take note that a record was filed with this office as indicated below:

Date and time of filing:	January 2, 1999
File No. of initial financing statement	123456
Type of record:	Amendment
Debtor's name:	ABC Corp.
Debtor's address	XXX XXXX YYY, YYYY
Secured party's name:	XYZ Finance Co.
Secured party's address	XXX XXXX

YYY, YYYY

The details of the information to be specified might be left to the Rules.

4. **Standard of Performance.** Subsection (f) 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.

SECTION 9-520A. ASSIGNMENT OF FILE NUMBER. A file number assigned to a record [pursuant to Section 9-520(a)(1)] must be unique and contain at least three separate segments in the following order:

- (1) The first segment must indicate, in numbers, the date of filing;
- (2) The second segment must consist of a number that is assigned sequentially based on the order in which records are filed on each business day.
- (3) The third segment must consist of [an algorithmically derived] [a] verification number based on the numbers assigned pursuant to paragraphs (1) and (2).

Reporters' Comments

1. **Source.** New.

2. **File Numbers.** This section prescribes a uniform method of assigning file numbers to records. The Drafting Committee has yet to review it.

SECTION 9-521. ACCEPTANCE AND REFUSAL TO ACCEPT RECORD.

(a) A filing office shall refuse to accept a record for filing for a reason set forth in Section 9-515(b) and may refuse to accept a record for filing only for a reason set forth in Section 9-515(b).

(b) 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.

(c) The filing office may not refuse to accept a written initial financing statement in the following form except for a reason set forth in Section 9-515(b):

[INSERT FINANCING STATEMENT FORM]

[INSERT ADDENDUM FORM]

(d) The filing office may not refuse to accept a written record in the following form except for a reason set forth in Section 9-515(b):

[INSERT [CHANGE] FORM]

Reporters' Comments

1. **Source.** New.

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

Subsection (a) both prescribes and limits the bases upon which the filing office must and may reject records by reference to the reasons set forth in Section 9-515(b). For the most part, the bases for rejection are limited to those that prevent the filing office from dealing with a record that it receives—because some the requisite information (e.g., the debtor's name) is missing or cannot be deciphered, because the record is not communicated by 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.

3. **Consequences of Accepting a Rejectable Record.** Section 9-515(b) includes 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 contain a mailing address for the debtor, does not disclose whether the debtor is an individual or an organization (e.g., a partnership or corporation) or, if the debtor is an organization, does not give specific information concerning the organization. The 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. Section 9-515(c). The financing statement generally is effective if the information is incorrect; however, the security interest is subordinate to the rights of a purchaser who gives value in reasonable reliance upon the incorrect information. Section 9-335.

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

5. **“Safe Harbor” Written Forms.** Although subsection (a) limits the bases upon which the filing office can refuse to accept records, subsections (c) and (d) 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 forms in subsection (c) are based upon national financing statement forms that already are in use. Those forms were developed over an extended period and reflect the comments and suggestions of filing officers, secured parties and their counsel (both directly and through organizations such as the American Bar Association), service companies, and the Drafting Committee. They are widely available from printers and search companies, and filing offices in a majority of States have undertaken to accept them, in most cases without any extra or non-standard filing fee.

The multi-purpose form in subsection (d) covers changes with respect to the debtor, the secured party, the collateral, and the status of the financing statement (termination and continuation).

SECTION 9-522. LAPSED FINANCING STATEMENTS. Except to the extent that a statute governing disposition of public records provides for destruction at a later time, if a financing statement lapses under Section 9-516(a) with respect to all secured parties of record, the filing office immediately 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 retrievable by using the file number of the destroyed record.

Reporters' Comments

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

2. **“Open Drawer” Policy.** This section has been revised to clarify that the filing office may destroy written records evidencing a financing statement only if it has lapsed under Section 9-516(a). Until a financing statement lapses under Section 9-516(a), the filing office remains responsible to maintain the written records and to provide information under Section 9-523, even though the financing statement has been terminated under Section 9-511.

SECTION 9-523. INFORMATION FROM FILING OFFICE; SALE OR LICENSE OF RECORDS.

(a) If a person filing a written record furnishes a copy to the filing office, the filing office upon request shall:

(1) note upon the copy the file number and date and time of the filing of the original and deliver or send the copy to the person; or

(2) send to the person an image of the record showing the file number and date and time of the filing of the original.

(b) The filing office shall communicate the following information to any person that requests it:

(1) whether there is on file on a date and time specified by the filing office, but not a date earlier than three business days before the filing office receives the request, any financing statement that designates a particular debtor [or, if the request so states, designates a particular debtor at the address specified in the request,] and that has not lapsed under Section 9-516(a) with respect to all secured parties of record;

(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 not 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.

Legislative Note: States whose filing office responds to search requests limited to a particular address should adopt the bracketed language in subsection (b)(1).

Reporters' Comments

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

2. **Information from Filing Office.** Former Section 9-407, dealing with obtaining information from the filing office, was bracketed to suggest to legislatures that its enactment was optional. Experience has shown that the method by which interested persons can obtain information concerning the public records should be uniform. Accordingly, the analogous provisions of this Article are not in brackets. This section reflects the “open drawer” policy, under which only lapsed financing statements will be removed from the records; terminated financing statements will remain part of the filing office’s data base. See the Comment to Section 9-522, above.

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

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

4. **Performance Standard.** In some States, filing offices take weeks to respond to requests for information. In some States, requests are filled using information that is weeks old. The utility of the filing system depends on the ability of searchers to get current information quickly. Accordingly, subsection (d) 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)(1).

5. **Certificates.** The former statute provides that the filing office respond to a request for information by providing a certificate. The principle of medium-neutrality would suggest that the statute not require a written certificate. However, official written certificates might be introduced into evidence more easily than official communications in another medium. Under 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.

6. **Sales of Records in Bulk.** 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.

SECTION 9-524. DELAY BY FILING OFFICE. Delay by the filing office beyond the time limits prescribed in this part is excused if:

- (1) 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
- (2) the filing office exercises reasonable diligence under the circumstances.

Reporters' Comment

Source. New; derived from Section 4-109.

[SECTION 9-525. REGISTERED AGENT.

[Intentionally omitted]

Reporters' Comments

1. **Source.** New.

2. **Registered Agent.** 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 9-526. ASSIGNMENT OF FUNCTIONS TO PRIVATE CONTRACTOR. The [insert appropriate official or governmental agency] [filing office] may contract with a private person to perform some or all of its functions under this part, other than the adoption of rules under Section 9-528. A contract under this section is subject to [insert reference to any applicable statute that regulates government contracting and procurement].]

Reporters' Comments

1. **Source.** New.

2. **Private contractors.** This section 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. Of

course, the filing office may not delegate its power to adopt administrative rules. The section is bracketed to reflect doubt about its need.

[SECTION 9-527. 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 second sentence of Section 9-502(a), \$ _____]. The fee for each name more than one required to be indexed is \$ _____. The fee for filing a financing statement stating an extended period of effectiveness under Section 9-502(b) is [\$____, if the period of effectiveness is 10 years, \$____, if the period of effectiveness is 20 years, and \$____, if the period of effectiveness is 30 years]. [The fee for filing a written record in a form other than as set forth in Sections 9-521(c) and (d) 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.]

Legislative Note: A State may wish to consolidate the provisions of this section with statutes setting fees for other services.

Reporters' Comments

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

2. **Fees.** This section contains all fee requirements for filing and for responding to requests for information. The penultimate sentence of subsection (a) is intended to discourage filing offices from favoring a local “standard form” over the national forms set forth in subsections (c) and (d) of Section 9-521. The section is bracketed to indicate that a States may wish to consolidate the provisions of this section with statutes setting fees for other services.

SECTION 9-528. 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 consistent with this article [and must be adopted in accordance with the [insert any applicable state administrative procedure act]].

(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, 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, the filing office, so far as is consistent with the purposes, policies, and provisions of this article, shall:

(1) before adopting, amending, and repealing rules, consult with filing offices in other jurisdictions that enact substantially this part and consult the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators or any successor organization; 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.

Reporters’ Comments

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

2. **Rules Required.** Operating a filing office is a complicated business, requiring many more rules and procedures than this Article usefully can provide. Subsection (a) requires the adoption of 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.

3. **Importance of Uniformity.** In today's national economy, uniformity of the policies, practices, and technology of the filing offices will reduce the costs of secured transactions substantially. The International Association of Corporate Administrators (IACA), referred to in subsection (b), is an organization whose membership includes filing officers from every State. These individuals are responsible for the proper functioning of the Article 9 filing system. IACA has been working with liaisons from the Drafting Committee to develop workable statutory provisions as well as model administrative rules, all with a view toward efficiency and uniformity.

SECTION 9-529. 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 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 or any successor organization and the reasons for these variations.

Reporters' Comments

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

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

PART 6
DEFAULT

[SUBPART 1. DEFAULT AND
ENFORCEMENT OF SECURITY INTEREST]

**SECTION 9-601. RIGHTS AND REMEDIES AFTER DEFAULT;
JUDICIAL ENFORCEMENT; CONSIGNOR OR BUYER OF ACCOUNTS,
CHATTEL PAPER, OR PAYMENT INTANGIBLES; CERTAIN
STATUTORY LIENS.**

(a) After default, a secured party has the rights and remedies provided in this part and, except as otherwise provided in Section 9-602(a), those provided by agreement of the parties. A secured party may reduce the claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure. If the collateral is documents, a secured party may proceed either as to the documents or as to the goods they cover. [A secured party in possession has the rights, remedies, and duties provided in Section 9-207.] The rights and remedies referred to in this subsection are cumulative and may be exercised simultaneously.

(b) Except as otherwise provided in subsection (d) and Section 9-605, after default, a debtor and an obligor have the rights and remedies provided in this part [and] [,] by agreement of the parties[, and in Section 9-207].

(c) If a secured party has reduced its claim to judgment, the lien of any levy that 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, or 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.

(d) Except as otherwise provided in Sections 9-607(d), 9-608(b), and 9-614(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.

(e) This part applies to an agricultural lien but not to any other statutory lien.

Reporters' Comments

1. **Source.** Former Section 9-501(1), (2), (5); subsections (d) and (e) are new.

2. **When Remedies Arise.** Under subsection (a) the secured party's remedies arise "[a]fter default. Like former Section 9-501, this Article leaves the agreement of the parties to define the circumstances giving rise to a default. This Article does not determine whether a secured party's post-default conduct can constitute a waiver of default in the face of 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.

3. **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 Subpart 2 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.

4. **Judicial Enforcement.** Subsection (c) generally follows former Section 9-501(5). The principal change provides that a levy relates back to the earlier of the date of filing or the date of perfection. This provides a secured party that enforces its security interest by levy with the benefit of the "first-to-file-or-perfect" priority rule of Section 9-319(a)(1).

5. **Sales of Receivables.** New subsection (d) 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").

6. **Consignments.** This Article is inapplicable to the true consignor's enforcement of its ownership interest. See subsection (d). However, this Article does govern cases in which the ownership interest of the true consignor is subordinate to the rights of the consignee's secured party. We have yet to draft a rule governing this situation. An appropriate rule might be that an enforcing senior secured party must pay all of the excess proceeds to the junior consignor-owner.

7. **Statutory Liens.** Part 6 does not apply to statutory liens other than agricultural liens. For the most part, this Part provides parallel treatment for the enforcement of agricultural liens and security interests. Several minor changes to former Part 6 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 (c), the statute creating an agricultural lien would govern whether and the date to which an execution lien relates back. Section 9-606 explains when a "default" occurs in the agricultural lien context.

SECTION 9-602. WAIVER AND VARIANCE OF RIGHTS AND DUTIES.

(a) 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 following sections may not be waived or varied by a debtor or by a consumer obligor in a consumer goods secured transaction, except as expressly provided in Section 9-623:

(1) Section 9-607(c)[, which deals with collection and enforcement of collateral];

(2) Sections 9-610(b), 9-611, and 9-613[, which deal with disposition of collateral];

(3) Section 9-609 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 9-607(d) and 9-614(c) insofar as they deal with application or payment of noncash proceeds of collection, enforcement, or disposition;

(5) Sections 9-607(d), 9-608(a), and 9-614(d) insofar as they require accounting for or payment of surplus proceeds of collateral;

(6) Section 9-614(e)[, which deals with calculation of a deficiency or surplus when the proceeds of a disposition are unreasonably low];

(7) Section 9-618, 9-619, or 9-620[, which deal with acceptance of collateral in satisfaction of obligation];

(8) Section 9-621[, which deals with redemption of collateral];

(9) Section 9-622[, which deals with reinstatement of obligations];

(10) Section 9-623, which deals with permissible waivers;

(11) Sections 9-624, 9-625, and 9-628[, which deal with the secured party's liability for failure to comply with this article]; and

(12) Section 9-209[, which deals with requests for an accounting and requests concerning a list of collateral and statement of account].

(b) [Notwithstanding Section 1-102(3), an] [An] obligor other than a consumer obligor in a consumer goods secured transaction may waive or vary the rules referred to in subsection (a) to the extent and in the manner provided by other law.

Reporters' Comments

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

2. **Waiver by Debtors.** Subsection (a) contains restrictions on waivers by debtors. In an effort at clarification, this Article uses the term “waive or vary” instead of “renounc[e] or modify[]” which appears in former Section 9-504(3). Subsection (a) 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 9-607), (ii) the implicit duty to refrain from a breach of the peace in taking possession of collateral under Section 9-609, (iii) the duty to apply noncash proceeds of collection or disposition in a commercially reasonable manner (Sections 9-602 and 9-614), (iv) the right to reinstate a secured obligation in a consumer goods secured transaction (Section 9-622), (v) the right to limitations on the effectiveness of certain waivers (Section 9-623), and (vi) the right to a response to a request for an accounting, concerning a list of collateral, or concerning a statement of account (Section 9-209). The

descriptions of the nonwaivable rights appear in brackets pending resolution of a disagreement over style.

Subsection (a) 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.

3. Waiver by Others. The restrictions on waiver imposed in subsection (a) relate to waivers by a debtor (defined in Section 9-102 as a person with a property interest, other than a security interest or other lien, in the collateral) and an obligor (whether or not a debtor) in a consumer goods secured transaction. Subsection (b) provides explicitly that a waiver by an obligor other than a consumer obligor in a consumer goods transaction 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. In this way, an obligor’s ability to waive is the same, regardless of whether the obligation is incurred in connection with a secured transaction under this Article.

Secondary obligors enjoy many of the same rights as debtors. However, under subsection (b) a non-debtor obligor may waive all of its rights and all of the secured party’s duties under Part 6 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 6 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).

To see the operation of subsection (b), 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 subsection (b), 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 subsection (b) permits Corporation to waive its 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 9-623(a).

Example 3: Child owes creditor a debt for a purchase money loan secured by Child’s automobile. The automobile is used primarily for transportation between home and the university Child attends. Parent has co-signed the

promissory note. Parent is a secondary obligor. Nevertheless, because Parent is an obligor in a consumer goods secured transaction, subsection (b) does not negate the restrictions on waiver imposed by subsection (a).

SECTION 9-603. AGREEMENT ON STANDARDS CONCERNING RIGHTS AND DUTIES. The parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party, other than duties concerning taking possession of collateral without breach of the peace under Section 9-609, if the standards are not manifestly unreasonable.

Reporters' Comments

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

2. **Limitation on Ability to Set Standards.** This section does not permit the parties to set standards measuring fulfillment of the secured party's duty to take collateral without breaching the peace.

SECTION 9-604. PROCEDURE IF SECURITY AGREEMENT COVERS REAL PROPERTY OR FIXTURES.

(a) If a security agreement covers both personal and real 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 personal and real 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.

(b) If a security agreement covers goods that are or become fixtures, a secured party, subject to subsection (c), 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.

(c) If a secured party with a security interest in fixtures has priority over all owners and encumbrancers of the real property, the secured party may, on default, subject to the other provisions of this part, remove the collateral from the real property. The secured party shall reimburse any encumbrancer or owner of the real property which 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 property 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 assurance for the performance of the obligation to reimburse.

Reporters' Comments

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

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

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

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

Former Section 9-313(8) affords to the secured party the right to remove fixtures under certain circumstances. This remedy, with minor modifications, now appears in subsection (c).

SECTION 9-605. UNKNOWN DEBTOR OR SECONDARY OBLIGOR.

A secured party owes no duty under this article to a person, or to a secured party or lienholder that has filed a financing statement against the person, unless the 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.

Reporters' Comments

1. **Source.** New.

2. **Duties to Unknown Persons.** This section relieves a secured party from duties to a debtor or secondary obligor and to a secured party or lienholder who has filed a financing statement against the debtor, if the secured party does not know about the debtor or secondary obligor. For example, a secured party may be unaware that the original debtor has sold the collateral subject to the security interest and that the new owner now is the debtor. This subsection should be read in conjunction with the exculpatory provisions in Section 9-627.

SECTION 9-606. TIME OF DEFAULT FOR AGRICULTURAL LIEN.

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. **Source.** New.

2. **Time of Default.** Remedies under this part become available upon the debtor's "default." See Section 9-601. This section explains when "default" occurs in the agricultural lien context. It requires one to consult the enabling statute to determine when the lienholder is entitled to enforce the lien.

SECTION 9-607. 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 9-313; 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 the obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor, and with respect to any property that secures the obligations of the account debtor or other person obligated on the collateral].

[(b) In order to exercise under subsection (a)(3) the rights of a debtor to enforce nonjudicially any [mortgage/deed of trust] covering real property, a secured party may [file/record] in the office in which the [mortgage/deed of trust] is [filed/recorded] a copy of the security agreement that entitles the secured party to exercise those rights and an affidavit authenticated 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 9-109(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 9-109(a)(2) or (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.

Reporters' Comments

1. **Source.** Former Section 9-502; subsections (b) and (c) are new.

2. **Scope.** As a general matter Part 6 deals with the rights and duties of debtors and secured parties following default. However, this section applies to the collection and enforcement rights of secured parties whether or not a default has occurred. Although seemingly anomalous, in practice it is not unusual for debtors to agree that secured parties are entitled to collect and enforce rights against account debtors prior to default.

This section permits a secured party to collect and enforce obligations included in collateral in its capacity as a secured party. It is not necessary for a secured party first to become the owner of the collateral pursuant to a disposition or acceptance. However, the secured party's rights to collect from and enforce collateral against account debtors and others obligated on collateral under subsection (a) are subject to Sections 9-404, 9-405, 9-406, 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, this section establishes only the baseline rights of the secured party vis-a-vis the debtor—the secured party is entitled to enforce and collect upon default or earlier if so agreed.

3. **Primary Changes.** The primary substantive changes to this section are: (i) expansion of its application to collection and enforcement against all persons obligated on collateral, not just account debtors; (ii) explicit provision for the secured party's enforcement of the debtor's rights in respect of the account debtor's (and other third parties') obligations; and (iii) provision for the secured party's enforcement of support obligations with respect to those obligations (support obligations are components of the collateral, see Section 9-203(d)).

4. **Rights Against Third Parties.** The rights of a secured party against an account debtor or other third party under subsection (a) include the right to enforce claims that the debtor may enjoy against others. The claims might include a breach of warranty claim arising out of a defect in equipment that is collateral or a secured party's action for an injunction against infringement of a patent that is collateral. Those claims typically would be proceeds of original collateral under Section 9-313(a).

5. **Rights Against Real Property Mortgagor.** Subsection (b) addresses the situation in which the collateral consists of a mortgage note. After the debtor's (mortgagee's) default, the secured party (assignee) may wish to proceed with a nonjudicial foreclosure of the real property mortgage securing the note but may be unable to do so because it has not become the assignee of record. The assignee/secured party may not have taken a recordable assignment at the commencement of the transaction; perhaps the mortgage note in question was one of hundreds assigned to the secured party as collateral. Having defaulted, the mortgagee may be unwilling to sign a recordable assignment. This section enables the secured party (assignee) to become the assignee of record by recording the security agreement and an affidavit certifying default in the applicable real property records. Of course, the secured party's rights derive from those of its debtor. Subsection (b) would not entitle the secured party to proceed with a foreclosure unless the mortgagor also is in default or the debtor (mortgagee) otherwise enjoyed the right to foreclose. Brackets around the subsection indicate some doubt about the desirability of the provision.

6. **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 9-109(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 a security interest of a third party is perfected by control (Section 9-109(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 9-109(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 9-109(a)(2), the control agreement determines the depository institution's obligation to obey.

If a security interest in a deposit account is unperfected, or is perfected by filing under Section 9-313, the depository institution ordinarily owes no obligation to obey the secured party's instructions. See Section 9-338. To reach the funds, the secured party must use an available judicial procedure.

7. **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 payment intangibles and the secured party (buyer) has no right of recourse against the debtor or a secondary 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 9-624, and the secured party's recovery of a deficiency would be subject to Section 9-625.

8. Attorney's Fees and Legal Expenses. The phrase "reasonable attorney's fees and legal expenses," which appears in subsection (d), includes only those fees and expenses incurred in proceeding against account debtors or other third parties. The secured party's right to recover these expenses arises automatically under this section. The secured party also may incur other attorney's fees and legal expenses in proceeding against the debtor or obligor. Whether the secured party has a right to recover those fees and expenses depends on whether the debtor or obligor has agreed to pay them, as is the case with respect to attorney's fees and legal expenses under Sections 9-608(a)(1)(a) and 9-614(a)(1). The parties also may agree to allocate a portion of the secured party's overhead to collection and enforcement under subsection (d) or Section 9-608(a).

SECTION 9-608. APPLICATION OF PROCEEDS OF COLLECTION OR ENFORCEMENT; LIABILITY FOR DEFICIENCY AND RIGHT TO SURPLUS.

(a) 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 of collection or enforcement under this section in the following order to:

(A) 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;

(B) the satisfaction of obligations secured by the security interest or agricultural lien under which the collection or enforcement is made; and

(C) 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 an authenticated demand for proceeds before distribution of the proceeds is completed.

(2) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder complies, the secured party need not comply with the holder's demand under paragraph (1)(C).

(3) A secured party need not apply or pay over for application the noncash proceeds (Section 9-313) 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.

(4) 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 9-625.

(b) If the underlying transaction is 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 9-625.

Reporters' Comments

1. **Source.** Subsection (a) is new. Subsection (b) derives from former Section 9-502(2).

2. **Modifications of Prior Law.** Subsection (a) modifies former Section 9-502(2) by (i) explicitly providing for the application of proceeds recovered by the secured party in substantially the same manner as provided in Section 9-614(a) and (c) for dispositions of collateral; and (ii) referring to the applicability of Section 9-625 in the event of the secured party's failure to comply with the commercial reasonableness requirement.

3. **Noncash Proceeds.** Subsection (a)(3) addresses the situation in which an enforcing secured party receives noncash proceeds.

Example: An enforcing secured party receives a promissory note from the account debtor. The secured party may wish to credit the debtor with the principal amount of the note upon receipt of the note or may wish to credit the debtor only as and when the note is paid. Under subsection (a)(3), the secured party is under no duty to apply the note or its value to the

outstanding obligation. If the secured party elects to apply the note to the outstanding obligation, however, it must do so in a commercially reasonable manner. The parties may provide for the method of application of noncash proceeds in the security agreement, if the method is not manifestly unreasonable. See Section 9-603.

SECTION 9-609. 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 the taking 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 9-610.

Reporters' Comments

1. **Source.** Former Section 9-503.

2. **Multiple Secured Parties.** More than one secured party may be entitled to take possession under this section. Conflicting rights to possession among parties are resolved by the priority rules of this Article or, as applicable, other law. Thus, a senior secured party is entitled to possession as against a junior claimant. Non-UCC law governs whether a junior secured party in possession of collateral is liable to the senior in conversion. Normally, a junior who refuses to relinquish possession of collateral upon the demand of a secured party having a superior possessory right thereto is liable in conversion. Section 9-614 governs a junior secured party's rights to recover its expenses from the collateral.

SECTION 9-610. 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 disclaimed

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. A secured party may disclaim or modify warranties under this section in the contract for disposition by giving a purchaser an authenticated statement that contains specific language disclaiming or modifying the warranties. Language in an authenticated statement is sufficient to disclaim 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 import.

(b) Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and 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.

Reporters’ Comments

1. **Source.** Former Section 9-504(1), (3)

2. **Warranties.** Subsection (a) affords the transferee at a disposition under this section the benefit of any title, possession, quiet enjoyment, and similar warranties that would have accompanied the disposition by operation of non-Article 9 law had the disposition been conducted under 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 (Revised Section 2-405) unless effectively disclaimed (Revised Section 2-407).

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. Any conflict between this Article and Revised Article 2 will be worked out between the Drafting Committees.

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. Disposition by Junior Secured Party. Subsection (a) is not limited to first-priority security interests. Rather, any secured party as to which there has been a default enjoys the right to dispose of collateral under this subsection. The exercise of this right by a secured party whose security interest is subordinate to that of another secured party does not of itself constitute a conversion or otherwise give rise to liability in favor of the holder of the senior security interest. Section 9-614 addresses application of the proceeds of a disposition by a junior secured party. Under Section 9-614(b), a junior secured party owes no obligation to apply the proceeds of disposition to the satisfaction of obligations secured by a senior security interest. Section 9-614(g) builds on this general rule by protecting certain juniors from claims of a senior concerning cash proceeds of the disposition. Even if a senior were to have a non-Article 9 claim to proceeds of a junior’s disposition, Section 9-614(g) would protect a junior that acts in good faith and without knowledge that its actions violate the rights of a senior party. Because the disposition by a junior would not cut off a senior’s security interest or lien (see Section 9-615), in many (probably most) cases the junior’s receipt of the cash proceeds would not violate the rights of the senior.

The holder of a senior security interest is entitled, by virtue of its priority, to take possession of collateral from the junior secured party and conduct its own disposition, provided that the senior enjoys the right to take possession of the collateral from the debtor. See Section 9-609. The holder of a junior security interest normally must notify the senior secured party of an impending disposition. See Section 9-611. Regardless of whether the senior receives a notification from the junior, the junior's disposition does not of itself discharge the senior's security interest. See Section 9-615. Unless the senior secured party has authorized the disposition free and clear of its security interest, the senior's security interest ordinarily will survive the disposition by the junior and continue under Section 9-313(c). 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.

5. Security Interests of Equal Rank. Sometimes two security interests enjoy the same priority. This situation may arise by contract, e.g., pursuant to "equal and ratable" provisions in indentures, or by operation of law. See Section 9-324(3); 9-325(2); 9-326(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, see Section 9-615, and (2) neither SP-W nor SP-Y is entitled to receive a distribution of proceeds but SP-Z is. See Section 9-614(b)(3).

When one considers the ability to obtain possession of the collateral, a secured party with equal priority is unlike a senior secured party. As the senior secured party, SP-W should enjoy the right to possession as against SP-X. See Section 9-609, Comments. If SP-W takes possession and disposes of the collateral under this section, it is entitled to apply the proceeds to satisfy its secured claim. SP-Y, however, should not have such a right to take possession from SP-X; otherwise, once SP-Y took possession from SP-X, SP-X would have the right to get possession from SP-Y, which would be obligated to redeliver possession to SP-X, and so on. Resolution of this problem is left to the parties and, if necessary, the courts.

6. Public vs. Private Dispositions. This Article maintain three distinctions between "public" and other dispositions: (i) the secured party may buy at the

former, but not at the latter (Section 9-610(b)); (ii) the debtor is entitled to notification of “the time and place of a public sale” and notification of “the time after which a private sale or other intended disposition is to be made (Section 9-613(a)(1)(E)); (iii) the section is less protective of transferees in a noncomplying public sale than in other noncomplying dispositions (Section 9-615(a)). As used in this Article, a “public sale” is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. “Meaningful opportunity” is meant to imply that some form of advertisement or public notice must precede the sale and that the public (or the commercially relevant segment of the public) must have access to the sale.

7. Investment Property. Dispositions of investment property may be regulated by the federal securities laws. Although the “public sale” of securities under this Article may implicate the registration requirements of the Securities Act of 1933, it need not do so. A disposition that qualifies for deviations from the rules for “private placement” exemptions under the Securities Act of 1933 in connection with public advertising nevertheless may constitute a “public sale” within the meaning of this section. Moreover, the “commercially reasonable” requirements of subsection (b) need not prevent a secured party from conducting a foreclosure sale without first complying with federal registration requirements. To eliminate any doubt, a secured party whose collateral consists of unregistered securities may wish to 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 9-603.

8. “Recognized Market.” A “recognized market,” as used in subsection (b) and Section 9-611(b), 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.

9. 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.

10. Relevance of Price. The amount of proceeds received in a disposition (e.g., the cash price if the disposition is by way of sale) is not a term that must be commercially reasonable. See the Comments to Section 9-614.

SECTION 9-611. PERSONS ENTITLED TO NOTIFICATION BEFORE DISPOSITION OF COLLATERAL.

(a) In this section, “notification date” means the earlier of the date on which a secured party sends to the debtor and any secondary obligor an authenticated notification of disposition and the date on which the debtor and any secondary obligor waive the right to notification.

(b) A secured party shall send to a debtor and any secondary obligor a reasonable authenticated notification of disposition under Section 9-613 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 an authenticated notification of disposition to:

(1) any other person from which the secured party has received, before the notification date, an authenticated notification of a claim of an interest in the collateral;

(2) any other secured party that, [] days before the notification date, held a security interest or agricultural lien in the collateral perfected by the filing of a financing statement that identified the collateral, was indexed under the debtor's name as of that date, and was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date; and

(3) any other secured party that, [] days before the notification date, held a security interest in the collateral perfected by compliance with a statute or treaty described in Section 9-309A(a).

(c) A secured party complies with the notification requirement specified in subsection (b)(2) if:

(1) not later than [] 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 (b)(2); and

(2) before the notification date the secured party:

(A) did not receive a response to the request for information; or

(B) received a response to the request for information and sent an authenticated notification of disposition to each secured party named in that response and whose financing statement covered the collateral.

Reporters' Comments

1. **Source.** Former Section 9-504(3).

2. **Notification to Debtors and Secondary Obligors.** This section imposes a duty to send notification of a disposition not only to the debtor but also to a secondary obligor. It 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 Article also resolves the question of the secondary party's ability to waive the right to notification. See Section 9-602.) Section 9-605 relieves a secured party from any duty to send notification to a debtor or secondary obligor unknown to the secured party.

Under subsection (b), the principal obligor (borrower) is not always entitled to notification of disposition.

Example: Mooney borrows on an unsecured basis, and Harris grants a security interest in his car to secure the debt. Mooney is a primary obligor, not a secondary obligor. As such, he is not entitled to notification of disposition under this section.

3. **Notification to Other Secured Parties.** Prior to the 1972 amendments, 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 (b)(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 the proper office for filing a financing statement as of a particular date, measured by reference to the “notification date” as defined in subsection (a). This determination requires reference to the choice-of-law provisions of Part 3. The secured party must ascertain whether any financing statements covering the collateral and indexed under the debtor’s name, as the name existed as of that date, in fact were filed in that office. The foreclosing secured party generally need not notify secured parties whose effective financing statements have become more difficult to locate because of changes in the location of the debtor, proceeds rules, or changes in the debtor’s name.

Under subsection (b)(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 9-309A(a), such as a certificate-of-title act.

Subsection (c) provides a “safe harbor” that takes into account the inevitable delays attendant to receiving information from the public filing offices. It provides, generally, that the secured party will be deemed to have satisfied its notification duties under subsection (b)(2) if it requests search(es) from the proper office(s) at least [] 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 subsection (b)(2) 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 9-624. Also relevant are Section 9-614(g), under which senior secured parties ordinarily are not entitled to share in proceeds of a junior’s disposition, Section 9-615(a), under which a disposition cuts off junior security interests, and Section 9-614(b), under which junior secured parties are not entitled to receive excess proceeds from the disposing secured party unless they demand them.

4. Authentication Requirement. Subsection (b) explicitly provides that notification of disposition must be “authenticated.” Some cases read former Section 9-504(3) as validating oral notification.

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

6. Failure to Conduct Notified Disposition. Nothing in this Article 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.

SECTION 9-612. TIMELINESS OF NOTIFICATION BEFORE DISPOSITION OF COLLATERAL. Unless otherwise agreed, in a transaction other than a consumer goods secured transaction a notification of disposition sent after default and 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 10 days before the earliest time of disposition set forth in the notification nevertheless is sent within a reasonable time is a question of fact.

Reporters' Comments

1. **Source.** New.

2. **Timeliness of Notification.** The 10-day notice period in this section is intended to be a “safe harbor” and not a minimum requirement. To qualify for the “safe harbor” the notification must be sent after default. A notification also must be sent in a commercially reasonable manner. See Section 9-611(b) (“reasonable authenticated notification”). Those requirements prevent a secured party from taking advantage of the “safe harbor” by, for example, giving the debtor a notification at the time of the original extension of credit or sending the notice by surface mail to a debtor overseas. the “safe harbor” is not applicable in a consumer goods secured transaction.

SECTION 9-613. CONTENTS AND FORM OF NOTIFICATION BEFORE DISPOSITION OF COLLATERAL.

(a) Except in a consumer goods secured transaction, the following rules apply:

(1) Unless otherwise agreed, the contents of a notification of disposition are sufficient if the notification:

(A) describes the debtor and the secured party;

(B) describes the collateral that is the subject of the intended disposition;

(C) states the method of intended disposition;

(D) states that the debtor [or secondary obligor] is entitled to an accounting of the unpaid indebtedness and states the charge, if any for an accounting; and

(E) 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.

(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, obligor, or other person to which
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].

You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell [or lease or license, *as applicable*] [for a charge of \$ _____]. You may request an accounting by calling us at [telephone number]

* * *

[End of Form]

(b) In a consumer goods secured transaction, the following rules apply:

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

(A) the information specified in Section 9-613(a)(1);

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

(C) the amount that must be paid to the secured party to redeem the obligation secured under Section 9-621;

(D) the amount that must be paid to the secured party to reinstate the obligation secured under Section 9-622; and

(E) 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:

NOTIFICATION 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, and all late charges. 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.

[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, and all late charges. 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.

If you want us to explain to you in writing how we have figured the amount that
you owe us, you may call us at [telephone number] . [We will charge you
\$] for the explanation.]

[End of Form]

Reporters' Comments

1. **Source.** New.

2. **Contents of Notification.** To comply with the “reasonable authenticated notification” requirement of Section 9-611(b), the contents of a notification must be reasonable. Except in a consumer goods secured transaction, the contents of a notification that includes the information set forth in subsection (a) are sufficient as a matter of law, unless the parties agree otherwise. (The reference to “time of disposition” means here, as it does in former Section 9-504(3), not only the hour of the day but also the date.) Although a secured party may choose to include additional information concerning the transaction or the debtor’s rights and obligations, no additional information is required unless the parties agree otherwise. A notification that lacks some of the information set forth in subsection (a)(1) nevertheless may be sufficient if found to be so by the trier of fact. See subsection (a)(2). A properly completed sample form of notification in subsection (a)(4) is one example of a notification that would contain the information set forth in subsection (a)(1). No particular phrasing of the notification is required, however.

3. **Consumer Goods Secured Transactions.** Subsection (b)(1) sets forth the information required for an effective notification in a consumer goods secured transaction. A notification that lacks any of the information set forth in subsection (b)(1) is insufficient as a matter of law. Compare subsection (a)(2), under which the trier of fact may find a notification to be sufficient even if it lacks some information listed in subsection (a)(1). However, under subsection (b)(3), a notification that is substantially complying is sufficient, even if it contains minor errors that are not seriously misleading.

**SECTION 9-614. APPLICATION OF PROCEEDS OF DISPOSITION;
LIABILITY FOR DEFICIENCY AND RIGHT TO SURPLUS.**

(a) In this section, “affiliate” means [a person controlling, controlled by, or under common control with another person].

(b) A secured party shall apply or pay over for application the cash proceeds 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 an authenticated demand for proceeds before distribution of the proceeds is completed.

(c) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder does so, the secured party need not comply with the holder's demand under subsection (b)(1).

(d) A secured party need not apply or pay over for application noncash proceeds 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.

(e) If the security interest under which a disposition is made secures payment or performance of an obligation, after making the payments and applications required by subsection (b) the secured party shall account to and pay a debtor for any surplus, and, unless otherwise agreed, the obligor is liable for any deficiency. If the underlying transaction is 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 9-625.

(f) This subsection applies to a disposition at which the transferee is the secured party, an affiliate of the secured party, or a secondary obligor. If the

amount of proceeds of the disposition is unreasonably low, the surplus or deficiency under subsection (e) is calculated based on the amount of proceeds that would have been realized in a commercially reasonable disposition to a transferee other than the secured party, an affiliate of the secured party, or a secondary obligor.

(g) 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 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.

Reporters' Comments

1. **Source.** former Section 9-504(1), (2).

2. **Application of Proceeds.** This section contains the rules governing application of proceeds and the debtor's liability for a deficiency. 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 9-624.

3. **Noncash Proceeds.** Subsection (d) addresses the application of noncash proceeds of a disposition, such as a note or lease. The explanation in the Comments to Section 9-608 generally applies to this subsection. Under subsection (d), 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 9-603.

4. **Surplus and Deficiency.** Subsection (e) deals with surplus and deficiency. It revises former Section 9-504(2) by imposing an explicit requirement that the secured party "pay" the debtor for any surplus, while retaining the secured

party's duty to "account. Inasmuch as the debtor may not be an obligor, subsection (e) 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.

5. Collateral Under New Ownership. When the debtor sells collateral subject to a security interest, the original debtor (creator of the security interest) is no longer a debtor inasmuch as it no longer has a property interest in the collateral; the buyer is the debtor. See Section 9-102. As between the debtor (buyer of the collateral) and the original debtor (seller of the collateral), the debtor (buyer) normally would be entitled to the surplus. Subsection (d) therefore requires the secured party to pay the surplus to the debtor (buyer), not to the original debtor (seller) with which it has dealt. But, because this situation arises as a result of the debtor's wrongful act, this Article does not expose the secured party to the risk of determining ownership of the collateral. If the secured party does not know about the new debtor and accordingly pays the surplus to the original debtor, the exculpatory provisions of this Article exonerate the secured party from liability to the new debtor. See Section 9-627(a), (b). If a debtor sells collateral *free* of a security interest, such as a sale to a buyer in ordinary course of business (see Section 9-316(a)), the property is no longer collateral and the buyer is not a debtor.

6. "Low Price" Dispositions. Subsection (f) provides a special method for calculating a deficiency or surplus when the secured party, an affiliate of the secured party (as defined in subsection (a)), or a secondary obligor acquires the collateral at a foreclosure disposition. It recognizes that when the foreclosing secured party or a related party is the transferee of the collateral, the secured party sometimes lacks the incentive to maximize the proceeds of disposition. As a consequence, the disposition may comply with the procedural requirements of this Article (e.g., it is conducted in a commercially reasonable manner following reasonable notice) but nevertheless fetch a price that is unreasonably low.

Subsection (f) adjusts for this lack of incentive. If the proceeds of a disposition of collateral to a secured party, an affiliate, or a secondary obligor are "unreasonably low," then instead of calculating a deficiency (or surplus) based on the actual net proceeds, the calculation is based upon the amount that would have been received in a commercially reasonable disposition to an unrelated person. Subsection (f) thus rejects the view that the secured party's receipt of an unreasonably low amount constitutes noncompliance with Part 6.

The term "unreasonably low" is not susceptible to precise definition. An amount of proceeds is "unreasonably low" if it is less than the "reasonably equivalent value" of the collateral as that term was construed in the context of fraudulent transfer law prior to the opinion in *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994).

7. "Affiliate." The Drafting Committee has yet to consider the definition of "affiliate," for purposes of the special rule in subsection (f). The bracketed definition in subsection (a) is from the Uniform Franchise and Business Opportunities Act.

SECTION 9-614A. NOTIFICATION OF CALCULATION OF SURPLUS OR DEFICIENCY.

(a) This section applies to a consumer goods secured transaction in which the debtor is entitled to a surplus or a consumer obligor is liable for a deficiency under Section 9-614(e).

(b) Before or when the secured party accounts to the debtor and pays any surplus or first makes demand on the obligor for payment of the deficiency, the secured party shall send to the debtor or obligor a written notification:

(1) stating the amount of the surplus or deficiency; and

(2) providing a reasonable explanation of how the secured party calculated the surplus or deficiency, including an indication of:

(A) the amount of the obligation secured, calculated as of a date not more than [] days before disposition of the collateral;

(B) the components of the obligation secured, including, as applicable, the unpaid balance of principal or purchase price, interest or other finance charges, delinquency, default, deferral, or other additional charges, and reasonable expenses and attorney's fees described in Section 9-614(a)(1); and

(C) the amount of credit applied to the obligation secured, made after the date of calculation, and its components, including, as applicable, payments, rebates, and proceeds of a disposition of collateral.

(c) 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.

Reporters' Comments

1. **Source.** New.

2. **Information Concerning Deficiency.** This section reflects the view that, in every consumer goods secured transaction, the obligor should be entitled to

know the amount of the deficiency claimed by the secured party and the basis upon which the deficiency was calculated. A secured party is obligated to provide this information no later than the time it first attempts to collect the deficiency. The obligor need not make a request for an accounting in order to receive it. A secured party that fails to comply with the requirement of this section is liable for loss caused. See Section 9-624(b). A secured party that does not attempt to collect a deficiency has no obligation to send notification under this section and, consequently, cannot be liable for noncompliance.

3. **Information Concerning Surplus.** This section also requires the secured party to explain to the debtor in a consumer goods secured transaction how a surplus was calculated.

SECTION 9-615. RIGHTS OF TRANSFeree OF COLLATERAL.

(a) 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] [cite 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 article or any judicial proceedings:

(1) in a public sale, if the transferee has no knowledge of any defects in the sale, does not buy in collusion with the secured party, other bidders, or the person conducting the sale, and acts in good faith; or

(2) in any other case, if the transferee acts in good faith.

(b) If a transferee does not take free of the rights and interests described in subsection (a), 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.

(c) Except as otherwise provided in this subsection or elsewhere in this article, a secured party's disposition of collateral does not discharge any security interest or other lien.

Reporters' Comments

1. **Source.** Former Section 9-504(4).

2. **Title Taken by Transferee.** Subsection (a) sets forth the rights acquired by persons that qualify under paragraphs (1) or (2). Such a person is a “transferee, inasmuch as a buyer at a foreclosure sale does not meet the definition of “purchaser” in Section 1-201. By virtue of the expanded definition of the term “debtor” in Section 9-102, subsection (a) makes clear that the ownership interest of a person that bought the collateral subject to the security interest is terminated. Such a person is a debtor under this Article. Under the former Article, the result arguably is the same, but the statute is not clear. Under subsection (a), a disposition normally discharges the security interest being foreclosed and any subordinate security interests. Subsection (c) makes 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.

Subsection (b) specifies the consequences for a transferee that does not qualify for protection (e.g., a transferee with knowledge of defects in a public sale).

3. **Disposition by Third Party.** Secured parties may utilize the services of third persons to dispose of repossessed collateral.

Example: Secured Party (SP) takes possession of goods collateral after default and entrusts the goods to Merchant. Merchant then wrongfully sells the collateral to a buyer in ordinary course of business (Buyer). That disposition would transfer to Buyer all of SP’s rights and the rights that SP had the power to transfer (including those of the debtor). Sections 2-403(1); 9-615(a). The sale would constitute a disposition under this Article and, as such, would give rise to the consequences specified in this Part. SP would have a conversion claim against Merchant, and the debtor could assert its rights under Part 6 arising out of SP’s (probably) noncomplying disposition.

SECTION 9-616. RIGHTS AND DUTIES OF CERTAIN PERSONS

LIABLE TO SECURED PARTY.

(a) A person that is liable to a secured party under a guaranty, indorsement, repurchase agreement, or the like acquires the rights and [assumes] [becomes obligated to perform] the duties of the secured party if the person:

(1) receives an assignment of a secured obligation from the secured party;

(2) receives a transfer of collateral from the secured party [and agrees to accept the rights and assume the duties of the secured party]; or

(3) is subrogated to the rights of a secured party.

(b) An assignment, transfer, or subrogation described subsection (a) is not a disposition of collateral under this article and does not relieve the secured party of its duties under this article.

Reporters' Comments

1. **Source.** Former Section 9-504(5).

2. **Assignments and Repurchase Agreements.** Under this section, assignments of secured obligations and other transactions (regardless of form) that function like assignments of secured obligations are not dispositions to which Part 6 applies. Rather, they constitute assignments of rights and (occasionally) delegations of duties. Application of this section may require an investigation into the agreement of the parties, which may not be reflected in the words of the repurchase agreement (e.g., when the agreement requires a recourse party to "purchase the collateral" but contemplates that the purchaser will then conduct an Article 9 foreclosure sale).

This section, like former Section 9-504(5), does not constitute a general and comprehensive rule for allocating rights and duties upon assignment of a secured obligation. Rather, it applies only in 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.

SECTION 9-617. TRANSFER OF RECORD OR LEGAL TITLE.

(a) In this section, "transfer statement" means a record authenticated by a secured party stating:

(1) that the debtor has defaulted in connection with an obligation secured by specified collateral;

(2) that the secured party has exercised its post-default remedies with respect to the collateral;

(3) that, by reason of the exercise, a transferee has acquired the rights of the debtor in the collateral; and

(4) the name and mailing address of the secured party, the debtor, and the transferee.

(b) A transfer statement entitles the transferee to the transfer of record of all rights of the debtor in the collateral specified in the statement in any official filing, recording, registration, or certificate-of-title system covering the collateral. If a transfer statement is presented with the applicable fee and request form to the official or office responsible for maintaining the system, the official or office must accept the transfer statement, promptly amend its records to reflect the transfer, and, if applicable, issue a new appropriate certificate of title in the name of transferee.

(c) 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. **Source.** New.

2. **Transfer of Record or Legal Title.** Potential buyers of collateral that is covered by a certificate of title (e.g., an automobile) or is subject to a registration system (e.g., a copyright) typically require as a condition of their purchase that the certificate or registry reflect their ownership. In many cases, this condition can be met only with the consent of the record owner. If the record owner is the debtor and, as often is the case after the default, the debtor refuses to cooperate, the secured party may have great difficulty disposing of the collateral. Applicable non-UCC law (e.g., a certificate-of-title act, federal registry, 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 this Article.

Subsection (b) provides a simple title-clearing mechanism, for use primarily when other law does not provide one. Of course, use of this mechanism will not be effective to clear title to the extent that subsection (b) is preempted by federal law. The Drafting Committee has not yet considered whether this mechanism should be available if other law provides a separate title-clearing mechanism. Subsection (c) acknowledges that clearing title under subsection (b) or under other law merely puts the secured party in a position to pass legal or record title to a transferee at foreclosure. After title has been cleared, the secured party retains its duties with respect to enforcement of its security interest, and the debtor retains its rights as well.

SECTION 9-618. ACCEPTANCE OF COLLATERAL IN FULL OR PARTIAL SATISFACTION OF OBLIGATION; COMPULSORY DISPOSITION OF COLLATERAL.

(a) In this section and in Section 9-619, “proposal” means a [written] statement authenticated 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 notification of objection to the proposal authenticated by a person to which the secured party was required to send a proposal under Section 9-619 or any other person holding an interest in the collateral subordinate to the security interest that is the subject of the proposal; and

(3) if the collateral is consumer goods, the collateral is not in the possession of the debtor when the debtor consents to the acceptance.

(c) A purported or apparent acceptance of collateral under this section is ineffective unless the secured party:

(1) consents to the acceptance in an authenticated record or sends to the debtor a proposal; and

(2) the conditions of subsection (b) are met.

(d) For purposes of this section:

(1) a debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default; and

(2) a debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default or the secured party:

(A) 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;

(B) in the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and

(C) does not receive a notification of objection authenticated by 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 which the proposal was sent pursuant to Section 9-619, within 20 days after notification was sent to that person; and

(2) in other cases, within 20 days after the last notification was sent pursuant to Section 9-619 or, if a notification was not sent, before the debtor consents to the acceptance under subsection (d).

(f) 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 pursuant to Section 9-610 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.

Reporters' Comments

1. **Source.** Former Section 9-505, completely rewritten.

2. **Overview and Organization.** This section and the two sections following deal with strict foreclosure, a procedure by which the secured party acquires the debtor's interest in the collateral without the need for a sale or other disposition under Section 9-610. The provisions have been entirely reorganized

and substantially rewritten. The more straightforward approach taken in this Article eliminates the fiction that the secured party always will present a “proposal for the retention of collateral and the debtor will have a fixed period to respond. By eliminating the need (but preserving the possibility) for proceeding in this fashion, this section eliminates much of the awkwardness of former Section 9-505. It reflects the belief that strict foreclosures should be encouraged and often will produce better results than a disposition for all concerned. This Comment explains how the three sections are organized. The following Comments contain a subsection-by-subsection analysis of the text.

Subsection (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, authenticated agreement to the acceptance or, in the case of an acceptance in full satisfaction, by the debtor’s 20-day silence after receipt of an authenticated “proposal (as defined in subsection (a)). Subsection (c) conditions the effectiveness of an apparent acceptance on the secured party’s authenticated acceptance or its sending a proposal; “constructive or “deemed acceptances are not effective.

The second condition necessary to an effective acceptance of collateral is the absence of a timely objection from a person that holds an interest subordinate to the security interest in question. Subsection (e) indicates when an objection is timely. If either of these conditions is not met, any purported or apparent acceptance in satisfaction is ineffective.

The third condition applies only in a consumer goods secured transaction: the collateral may not be in the possession of the debtor when the debtor consents to the acceptance.

In addition to the conditions described above, Section 9-619 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 Section 9-620(b) the failure to comply with the notification requirement of Section 9-619 does not render the acceptance of collateral ineffective. Rather, the acceptance can take effect notwithstanding the secured party’s noncompliance. Section 9-620(b) indicates that a person to which the required notice was not sent has the right to recover damages under Section 9-624(b). Section 9-620(a) sets forth the effect of an acceptance of collateral.

3. Proposals. Subsection (a) defines the term “proposal. A “proposal is necessary only if the debtor does not agree to an acceptance in an authenticated record as described in subsection (d)(1) or (d)(2). 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. Note, however, that a conditional proposal

generally requires the debtors agreement in order to take effect. See subsection (d), discussed in the following Comment.

4. 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), 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 20 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 agreement in an record authenticated after default. In all other respects, the conditions necessary to an effective partial strict foreclosure are the same as those governing acceptance of collateral in full satisfaction.

The time when a debtor consents to a strict foreclosure is significant in several circumstances under this section and the following one. See Sections 9-618(b)(1), (b)(3), (e)(2); 9-619(a)(1), (a)(2), (a)(3). For purposes of determining the time of consent, 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 a secondary obligor. Any junior party—secured party or lienholder—is entitled to lodge an objection to a proposal, even if that person was not entitled to notification under Section 9-619. Subsection (e), discussed below, indicates when an objection is timely.

In a consumer goods secured transaction, an acceptance is not effective unless the collateral is not in the possession of the debtor when the debtor consents to the acceptance. Subsection (b)(3).

5. Secured Party's Agreement. The conditions of subsection (b) relate to actual or implied consent by the debtor and any secondary obligor or holder of a junior security interest or lien. To insure that the debtor cannot unilaterally cause an acceptance of collateral, subsection (c) provides that compliance with these conditions is necessary but not sufficient to cause an acceptance of collateral. Rather, under subsection (c), acceptance does not occur unless, in addition, the secured party consents to the acceptance in an authenticated record or sends to the debtor a proposal.

6. When Acceptance Occurs. This section does not impose any formalities or identify any steps that a secured party must take in order to accept collateral once the conditions of subsections (b) and (c) have been met. Absent facts or circumstances indicating a contrary intention, the fact that the conditions have been met provides a sufficient indication that the secured party has accepted the collateral on the terms to which the debtor has agreed or failed to object. Acceptance of the collateral normally is automatic upon the secured party's becoming bound and the time for objection passing. As a matter of good business

practice, an enforcing secured party may wish to memorialize its acceptance, such as by notifying the debtor that the strict foreclosure is effective or by placing a written record to that effect in its files. The secured party's agreement to accept collateral is self-executing and cannot be breached. The secured party is bound by its agreement to accept collateral and by any proposal to which the debtor consents.

7. No Possession Requirement. This section eliminates the former requirement that the secured party be "in possession of collateral. Intangible collateral, which cannot be possessed, may be subject to a strict foreclosure under this section. However, under subsection (b)(3), if the collateral is consumer goods, acceptance does not occur unless the debtor is not in possession.

8. 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 9-607 or 9-610. A debtor's voluntary surrender of collateral to a secured party and the secured party's acceptance of possession of the collateral raises no implication whatsoever that the secured party intends or is proposing to accept the collateral in satisfaction of the secured obligation under this section.

9. 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 Section 9-619 is effective if it is received by the secured party within 20 days from the date the notification was sent to that person. Other objecting parties (i.e., third parties that are not entitled to notification) may object at any time within 20 days after the last notification is sent under Section 9-619. 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.

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 9-610, and courts should construe those laws and this section harmoniously. A secured party's acceptance of collateral in the possession of the debtor also may implicate statutes dealing with a seller's retention of possession of goods sold. See, e.g., Cal. Civ. Code § 3440.1-9.

11. Accounts, Chattel Paper, and Payment Intangibles. If the collateral is accounts, chattel paper, or payment 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 9-112. 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 a new security agreement authenticated by the debtor would not be necessary.

12. **Obligation to Dispose of Consumer Goods.** Subsection (f) imposes an obligation on the secured party to dispose of consumer goods under certain circumstances. Regarding the 60% test, see the Comments to Section 9-622.

SECTION 9-619. NOTIFICATION OF PROPOSAL TO ACCEPT

COLLATERAL. A secured party that desires to accept collateral in partial satisfaction of the obligation it secures shall send its proposal to any secondary obligor, and a secured party that desires to accept collateral in full or partial satisfaction of the obligation it secures shall send its proposal also to:

(1) any person from which the secured party has received, before the debtor consented to the acceptance, an authenticated notification of a claim of an interest in the collateral;

(2) any other secured party or lienholder that, [] days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that identified the collateral, was indexed under the debtor's name as of that date, and was filed in the office or offices in which to file a financing statement against the debtor covering the collateral as of that date; and

(3) any other secured party that, [] days before the debtor consented to the acceptance, held a security interest in the collateral perfected by compliance with a statute or treaty described in Section 9-309A(a).

Reporters' Comments

1. **Source.** Former Section 9-505, substantially expanded.

2. **Notification.** This section 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. With regard to (ii), see the Comment to Section

9-611. This section also requires notification to any secondary obligor if the proposal is for acceptance in partial satisfaction.

SECTION 9-620. EFFECT OF ACCEPTANCE OF COLLATERAL.

(a) 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, but recovery of a deficiency is subject to Section 9-625;
- (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.

(b) A subordinate interest is discharged or terminated under subsection (a) whether or not the secured party is required to send or does send notification to the holder thereof. However, any person to which the secured party was required to send, but did not send, notification has the remedy provided by Section 9-624(b).

Reporters' Comments

1. **Source.** New.

2. **Effect of Acceptance.** Subsection (a) specifies the effect of an acceptance of collateral in full or partial satisfaction of the secured obligation. Paragraph (1) expresses the fundamental consequence of accepting collateral in full or partial satisfaction of the secured obligation—the obligation is discharged to the extent consented to by the debtor. Paragraphs (2) through (4) indicate the effects of an acceptance on various property rights and interests. Paragraph (2) follows Section 9-615(a) in providing that the secured party acquires “all of a debtor's rights in the collateral. Under paragraph (3), the effect of strict foreclosure on holders of junior security interests and liens is the same regardless of whether the collateral is accepted in full or partial satisfaction of the secured obligation: all junior encumbrances are discharged. Subsection (b) makes clear that this is the effect regardless of whether a 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.

SECTION 9-621. RIGHT TO REDEEM COLLATERAL. At any time before a secured party has collected collateral under Section 9-607, disposed of collateral or entered into a contract for its disposition under Section 9-610, or accepted collateral in full or partial satisfaction of the obligation it secures under Section 9-618, the debtor, any secondary obligor, or any other secured party or lienholder may redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the reasonable expenses and attorney's fees described in Section 9-614(a)(1).

Reporters' Comments

1. **Source.** Former Section 9-506.

2. **Redemption.** Subsection (a) follows former Section 9-506 but extends the right of redemption to holders of nonconsensual liens. Most of the other changes are not substantive.

3. **Effect of "Repledging."** Section 9-207 generally permits a secured party 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.

SECTION 9-622. REINSTATEMENT OF OBLIGATION SECURED WITHOUT ACCELERATION.

(a) 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 consumer goods secured transaction, a debtor or a secondary obligor who 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 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 described in Section 9-614(a)(1).

(b) A tender of payment under subsection (a) 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 9-611(b) 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 9-610 or accepts collateral in full or partial satisfaction of the obligation it secures under Section 9-618.

(c) A tender of payment under subsection (a) 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.

(d) A secured obligation may be reinstated under subsection (a) only once.

Reporters' Comments

1. **Source.** New.

2. **Reinstatement.** This section provides a one-time right to reinstatement of a debt following a default. It applies only in a consumer goods secured transaction in which 60 percent or more of the cash price or secured obligation has been paid. Application of the 60 percent test is straightforward when an item of collateral secures only its purchase price or a single obligation. In the less typical case in which an item of collateral secures several obligations, its application is more difficult. In the interest of avoiding unnecessary statutory complexity, however, the statute leaves it to the [agreement of the parties and the] courts to work out sensible approaches. For example, if an item secures its own purchase money debt as well as other obligations, the 60 percent test should take into account only the purchase money debt. The debtor could elect to cure a default on that debt which, in turn, also would cure defaults on other debt arising out of "cross-defaults based on the purchase money debt. On the other hand, if an item secures several non-purchase money obligations, the 60 percent test should be applied to the aggregate amount of the obligations at the time of the debtor's or secondary obligor's tender.

3. **Waiver or Variance.** The debtor's rights under this section may not be waived or varied by agreement, see Section 9-602(a)(9), except as otherwise provided in Section 9-623(a)(1). Likewise, this section overrides any contrary agreement adversely affecting the debtor's rights, such as a provision for a higher finance charge following a reinstatement. However, this section does not prevent a secured party from making an enforceable agreement granting the debtor additional reinstatement rights, which may be more generous than those that this section provides.

SECTION 9-623. WAIVER.

(a) Subject to subsection (c), a debtor or a consumer obligor in a consumer goods secured transaction may waive the right to notification of disposition of collateral under Section 9-611, the right to redeem the collateral under Section 9-621, or the right to reinstate a secured obligation under Section 9-622 only by signing a record containing a statement to that effect after default.

(b) Subject to subsection (c), a consumer obligor in a consumer goods secured transaction may waive the obligor's rights and the secured party's duties under Section 9-618 or 9-619 only by signing a record containing a statement to that effect after default.

[(c) In a consumer goods secured transaction, a statement authenticated by the debtor or a consumer obligor is ineffective under subsection (a) or (b) unless the secured party establishes by clear and convincing evidence that the debtor or consumer obligor expressly agreed to its terms.]

Reporters' Comments

1. **Source.** Former Sections 9-504(3); 9-505; 9-506.

2. **Waiver.** This section is a limited exception to Section 9-602, which generally prohibits waiver by debtors or by consumer obligors in consumer goods secured transactions. It 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 9-619.

The brackets around subsection (c) indicate division among 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 consumer goods secured transactions.

[SUBPART 2. NONCOMPLIANCE WITH ARTICLE.]

SECTION 9-624. REMEDIES FOR SECURED PARTY'S FAILURE TO COMPLY WITH THIS ARTICLE.

(a) If it is established that a secured party is not proceeding in accordance with this article, 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 article. Except as otherwise provided in Section 9-627, 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 Section 9-625 may recover damages for the loss of any surplus, but a debtor or consumer obligor whose deficiency is eliminated or reduced under Section 9-625 may not otherwise recover under this subsection for noncompliance with [Sections 9-607 through 9-614] [the provisions of this part relating to collection, enforcement, disposition, or acceptance].

(c) Except as otherwise provided in Section 9-627, in a consumer goods secured transaction, a person that was a debtor at the time a secured party failed to comply with this part 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 Section 9-625 and any amount for which the secured party is liable under subsection (b).

(d) A secured party that fails to comply with Section 9-208, a person that files an initial financing statement or an amendment in violation of Section

9-508(a), a secured party of record that fails to file or send a termination statement as required by Section 9-511(c), or a secured party that fails to comply with Section 9-614A is liable to the debtor in each case for \$500 and, in addition, for any damages under subsection (b).

(e) A person that, without reasonable excuse, fails to comply with a request under Section 9-209 is liable to the debtor for \$500, for damages in the amount of any loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing, and, in addition, for any damages under subsection (b). A recipient of a request under Section 9-209 which never claimed an interest in the collateral or obligations that are the subject of a request under that section has a reasonable excuse for failure to comply with the request.

(f) As against a person reasonably misled by a secured party's failure to comply with a request regarding a list of collateral or a statement of account under Section 9-209, the secured party may claim a security interest only as shown in the statement contained in the request.

Reporters' Comments

1. **Source.** Former Section 9-507.

2. **Scope.** Subsections (a) and (b) no longer are limited to noncompliance with provisions of this part of Article 9; rather they apply to noncompliance with any provision of this Article. The change makes this section applicable to noncompliance with Sections 9-207 (duties of secured party in possession of collateral); 9-208 (duties of secured party having control over deposit account); 9-209 (duty to comply with request for accounting, etc.); 9-508(a) (duty to refrain from filing unauthorized financing statement); and 9-511(c) (duty to provide termination statement). Subsections (d), (e), and (f) impose supplemental damages for violation of those sections. Subsection (c), which gives a minimum damage recovery in consumer goods secured transactions, applies only to noncompliance with the provisions of this part.

3. **Injunctions.** Subsection (a) modifies the first sentence of former subsection (1) by adding the references to "collection" and "enforcement."

4. **Damages for Noncompliance with this Article.** Subsection (b) sets forth the basic remedy for failure to comply with the requirements of this Article: a damage recovery in the amount of loss caused by the noncompliance. This

subsection 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 6. The remedy is available even to holders of senior security interests and liens. The exercise of this remedy is subject to the normal rules of pleading and proof. A person that has delegated the duties of a secured party but that remains obligated to perform them is liable under this subsection. The last sentence of subsection (b) eliminates the possibility of double recovery or other over-compensation arising out of noncompliance with [Sections 9-607 through 9-614] [the provisions of this part relating to collection, enforcement, disposition, or acceptance]. Assuming no double recovery, a debtor whose deficiency is reduced or eliminated under Section 9-625 can pursue a claim for a surplus.

5. Supplemental Damages. Subsection (d) imposes an additional \$500 liability upon a person who makes an unauthorized filing in violation of Section 9-508(a). It imposes the same sanction on a person who fails to relinquish control over investment property, a deposit account, or a letter of credit under Section 9-208, fails to file or send a termination statement as required by Section 9-511(c), or fails to provide notification of calculation of surplus or deficiency under Section 9-614A.

Under subsection (e), a person that fails to comply with a request for an accounting or a request regarding a list of collateral or statement of account under Section 9-209 is liable not only for the loss caused (subsection (b)) but also for \$500 and for damages in the amount of any loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing.

6. Estoppel. Subsection (f) limits the extent to which a secured party who fails to comply with a request regarding a list of collateral or statement of account may claim a security interest.

7. Minimum Damages in Consumer Goods Secured Transactions. Subsection (c) provides a minimum damage recovery for debtors in a consumer goods secured transaction. It is designed to insure that every noncompliance with the requirements of Part 6 results in liability, regardless of any injury that may have resulted. If an aggrieved person is entitled to recover damages under subsection (b) or a reduction of personal liability for a deficiency under Section 9-625, those amounts are deducted from the amount available under this subsection. Regarding calculation of the principal amount of the obligation for purposes of this subsection, see the Comments to Section 9-622.

Alternative A
(“Absolute Bar” Rule for Consumer Goods Secured Transactions;
“Rebuttable Presumption” Rule for Other Transactions)

SECTION 9-625. ACTION IN WHICH DEFICIENCY OR SURPLUS IS IN ISSUE. 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 [Sections 9-607 through 9-614] [the provisions of this part relating to collection, enforcement, disposition, or acceptance] unless the debtor or a secondary obligor places the secured party's compliance in issue. In that case, the secured party has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with [Sections 9-607 through 9-614, as applicable] [the applicable provisions of this part].

(2) Except as otherwise provided in Section 9-627, if a secured party fails to [establish] [meet the burden of establishing] that the collection, enforcement, disposition, or acceptance was conducted in accordance with [Sections 9-607 through 9-614] [the provisions of this part relating to collection, enforcement, disposition, or acceptance]:

(A) In a consumer goods secured transaction for which no other collateral remains to secure the obligation, neither the debtor nor a secondary obligor is liable for a deficiency.

(B) In other cases, the liability of a debtor or a secondary obligor 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 the proceeds of the collection, enforcement, disposition, or acceptance or the amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with [Sections 9-607 through 9-614] [the provisions of this part relating to collection, enforcement, disposition, or acceptance]. However, the amount that would have been realized is equal to the sum of the secured obligation, expenses, and attorney's

fees unless the secured party [establishes] [meets the burden of establishing] that the amount is less than that sum.

(C) In a consumer goods secured transaction, liability under paragraph (B) is not a personal liability of a consumer obligor but may be satisfied only by enforcing a security interest or other consensual lien against property securing the obligation.

Alternative B

(“Rebuttable Presumption” Rule for All Transactions)

SECTION 9-625. ACTION IN WHICH DEFICIENCY OR SURPLUS IS IN ISSUE. 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 [Sections 9-607 through 9-614] [the provisions of this part relating to collection, enforcement, disposition, or acceptance] unless the debtor or a secondary obligor places the secured party's compliance in issue. In that case, the secured party has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with [Sections 9-607 through 9-614, as applicable] [the applicable provisions of this part].

(2) Except as otherwise provided in Section 9-627, if a secured party fails to [establish] [meet the burden of establishing] that the collection, enforcement, disposition, or acceptance was conducted in accordance with [Sections 9-607 through 9-614,] [the provisions of this part relating to collection, enforcement, disposition, or acceptance,] the liability of a debtor or a secondary obligor 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 the proceeds of the collection, enforcement, disposition, or acceptance or the amount of proceeds that would have

been realized had the noncomplying secured party proceeded in accordance with [Sections 9-607 through 9-614] [the provisions of this part relating to collection, enforcement, disposition, or acceptance]. However, the amount that would have been realized is equal to the sum of the secured obligation, expenses, and attorney's fees unless the secured party [establishes] [meets the burden of establishing] that the amount is less than that sum.

Reporters' Comments

1. **Source.** New.

2. **Scope.** The basic damage remedy under Section 9-624(b) is subject to the special rules contained in this section. This section addresses situations in which the amount of a deficiency or surplus is in issue, i.e., situations in which the secured party has collected, enforced, disposed of, or accepted the collateral. It contains special rules applicable to a determination of the amount of a deficiency or surplus. The rules in this section apply only to noncompliance under [Sections 9-607 through 9-614, as applicable] [the applicable provisions of this part]. For other types of noncompliance with Part 6, the general rule liability rule, recovery of actual damages under Section 9-624(b), applies. Consider, for example, a repossession that does not comply with Section 9-609 for want of a default. The debtor's remedy is under Section 9-624(b). In a proper case the secured party also may be liable for conversion under non-UCC law. If the secured party thereafter disposed of the collateral, however, it would violate Section 9-610 at that time, and this section would apply.

3. **Alternative Versions of Section 9-625.** Courts construing former Section 9-507 have disagreed about the consequences of a secured party's failure to comply with the requirements of former Part 5. Three general approaches have emerged. Some courts have held that a noncomplying secured party may not recover a deficiency (the "absolute bar" rule). Other courts have held that the debtor can offset against a claim to a deficiency all damages recoverable under former Section 9-507 resulting from the secured party's noncompliance (the "offset" rule). A plurality of courts considering the issue has held that the noncomplying secured party is barred from recovering a deficiency unless it overcomes a rebuttable presumption that compliance with former Part 5 would have yielded an amount sufficient to satisfy the secured debt (the "rebuttable presumption" rule). In addition to the nonuniformity resulting from court decisions, some States have adopted special rules governing the availability of deficiencies.

This Article adopts a version of the rebuttable presumption rule for transactions other than consumer goods secured transactions. The Article leaves to each legislature the decision whether to adopt the rebuttable presumption rule for consumer goods secured transactions as well (Section 9-625 Alternative B), or to adopt the absolute bar rule for consumer goods secured transactions (Section 9-625 Alternative A).

4. Rebuttable Presumption Rule. Under paragraph (1), the secured party need not prove compliance with [Sections 9-607 through 9-614, as applicable] [the applicable provisions of this part] 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 paragraph (2) explains how to calculate the deficiency. In cases other than consumer goods secured transactions (Alternative A), or in all cases (Alternative B), 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 [Sections 9-607 through 9-614, as applicable] [the applicable provisions of this part]. If a deficiency remains, then the secured party is entitled to recover it. The references to “the secured obligation, expenses, and attorney’s fees in paragraph (2) (Alternative A) and paragraph (2)(B) (Alternative B) embrace the application rules in Sections 9-608(a) and 9-614(a).

Unless the secured party proves that compliance with Part 6 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 attorney’s fees. Thus, the secured party may not recover any deficiency unless it meets this burden of proof. (The UCC does not generally use the terms “prove” or “establish.” Rather, it defines “burden of establishing” to mean “the burden of persuading the triers of fact that the existence of the fact is more probable than its non-existence.” Section 1-201(8).)

5. Consumer Goods Secured Transactions. Paragraph (2)(A) of Alternative A provides an “absolute bar” rule for consumer goods secured transactions in which no other collateral remains to secure the obligation. If other collateral remains, then the debtor remains liable for a deficiency as calculated under the rebuttable presumption rule (paragraph (2)(B)), but the secured party may collect the deficiency only from other property subject to a security interest or other consensual lien (e.g., real property mortgage). The deficiency may not be collected as a personal liability of the debtor. See paragraph (2)(C).

6. Delay in Applying This Section. There is an inevitable delay between the time a secured party engages in noncomplying collections or dispositions and the time of a subsequent judicial determination that the secured party did not comply with Part 6. During the interim, the secured party, believing that the secured 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 this section would impose liability on the secured party for the amount of the excess, unwarranted recoveries.

SECTION 9-626. DETERMINATION OF WHETHER CONDUCT WAS COMMERCIALLY REASONABLE.

(a) 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.

(b) 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.

(c) A collection, enforcement, disposition, or acceptance that has been approved in any judicial proceeding or by any [court appointed] bona fide creditors' committee[,] [or] [court appointed] representative of creditors[, or assignee for the benefit of creditors] is commercially reasonable. However, approval need not be obtained, and lack of approval does not mean that the collection, enforcement, disposition, or acceptance is not commercially reasonable.

Reporters' Comments

1. **Source.** Former Section 9-507(2).

2. **Relationship of Price to Commercial Reasonableness.** Some observers have found the notion contained in subsection (a) (former Section 9-507(2)) (the fact that a better price could have been obtained does not establish lack of commercial reasonableness) to be inconsistent with that found in Section 9-610(b) (former Section 9-504(3) (every aspect of the sale, including its terms, must be commercially reasonable)). The Drafting Committee perceives no inconsistency, but it favors an explanation of the relationship between price and commercial reasonableness in the Official Comments. 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 law long has grappled with the problem of dispositions of personal and real property that comply with applicable procedural requirements (e.g., advertising, notice to interested persons, etc.) but which yield an extremely low price. This Article addresses that issue in Section 9-614. That section contains a special rule for determining deficiencies in complying dispositions that yield an unreasonably low price. The section applies only when the transferee is the secured party, its affiliate, or a secondary obligor.

This Article thus rejects the view that the price is one of the “terms” that, under Section 9-610(b), must be commercially reasonable. Rather, except as otherwise provided in Section 9-614(b), 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. In fact, 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 the disposition complies with the requirements of this Article.

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.

3. **“Recognized Market.”** The concept of a “recognized market” in subsections (b)(1) and (2) is quite limited; it applies only to markets where there are standardized price quotations for property that is essentially fungible, such as stock exchanges.

SECTION 9-627. NONLIABILITY AND LIMITATION ON LIABILITY OF SECURED PARTY; LIABILITY OF SECONDARY OBLIGOR.

(a) 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 lienholder that has filed a financing statement against the person for failure to comply with this article; and

(2) the secured party's failure to comply with this article does not affect the liability of the person for a deficiency.

(b) A secured party is not liable to any person and a person's liability for a deficiency is not affected because of any act or omission, other than the failure to

send a notification required by Section 9-611(b)(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.

(c) A secured party is not liable to any person and a person's liability for a deficiency is not affected because of any act or omission arising out of the secured party's reasonable belief that a transaction is not a consumer goods secured transaction or 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.

(d) A secured party is not liable to any person under Section 9-624(c) if the secured party [establishes] [meets the burden of establishing] that its failure to comply with this part was not intentional and resulted from a good-faith error notwithstanding the secured party's maintenance of procedures reasonably adapted to avoid the failure. Examples of a good-faith error include clerical, calculation, computer malfunction, programing, and printing errors. An error of legal judgment concerning the secured party's rights and duties under this part is not a good-faith error.

(e) The total recovery under Section 9-624(c) in a class action or a series of class actions arising out of the same noncompliance by the same secured party shall not be more than the lesser of \$500,000 or one percent of the net worth of the secured party.

Reporters' Comments

1. **Source.** New.

2. **Exculpatory Provisions.** Subsections (a), (b), and through (c) contain exculpatory provisions that should be read in conjunction with Section 9-605.

Without this group of provisions, a secured party could incur liability to unknown persons and under circumstances that would not allow the secured party to protect itself. The broadened definition of the term “debtor” underscores the need for these provisions.

3. **Bona Fide Error.** Subsection (d) immunizes a noncomplying secured party from liability only for the minimum damages imposed under Section 9-624(c). The standard for “intentional” under this subsection is whether the secured party actually intended to fail to comply with the Article, as is the case under § 130(c) of the Truth in Lending Act, 15 U.S.C. § 1640(c).

SECTION 9-628. ATTORNEY’S FEES IN CONSUMER GOODS

SECURED TRANSACTIONS. If the secured party's compliance with this article is placed in issue in an action with respect to a consumer goods secured transaction, the following rules apply:

(1) If the secured party would have been entitled to attorney's fees as the prevailing party, the court shall award to a consumer debtor or consumer obligor prevailing on the issue the costs of the action and reasonable attorney's fees.

(2) 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.

(3) 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.

Reporters’ Comments

1. **Source.** New.

2. **Attorney’s Fees.** In an action involving a secured party’s compliance with Article 9, this section requires a court to award attorney’s fees to a prevailing consumer debtor or consumer obligor if the secured party would have been entitled to attorney’s fees had it prevailed. For purposes of awarding attorney’s fees, a consumer debtor or consumer obligor is a prevailing party if it is determined that the secured party failed to comply with Article 9, even though Section 9-627(d) excuses the secured party from liability under Section 9-624(c).

PART 7
TRANSITION

SECTION 9-701. EFFECTIVE DATE. This [Act] takes effect

SECTION 9-702. SAVINGS CLAUSE.

[To be added]

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 under 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 2-807 (specific performance) and 2-824 (prepaying buyer) of the May 16, 1997, 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 9-112.

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 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:

(A) the value of the goods is \$[1,000] or less at the time of delivery;

(B) the goods are goods immediately prior to delivery;

(C) 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

(D) 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’ Comments

“Consignment.” The definition of “consignment” is drawn in part from the October 1, 1995, draft of Article 2. The definition excludes, in paragraphs (A), (B), and (C), transactions for which filing would be inappropriate or of insufficient benefit to justify the costs. The definition also excludes, in paragraph (D), 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 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) As 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 under 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. **Source.** New.

2. **Article 5 Security Interest.** This section 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.

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.

SECTION 8-106. CONTROL.

* * *

[Revised] Official Comment
[marked to show changes from Official Comment]

1. The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See Sections 8-303 (protected purchasers); 8-503(e) (purchasers from securities intermediaries); 8-510 (purchasers of security entitlements from entitlement holders); ~~9-115(4)~~ 9-312 (perfection of security interests); ~~9-115(5)~~ 9-324 (priorities among conflicting security interests).

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

* * *

Example 8. Able & Co. a securities dealer, holds a wide range of securities through its account at Clearing Corporation. Able enters into an arrangement with Alpha Bank pursuant to which Alpha provides financing to Able secured by securities identified as the collateral on lists provided by Able to Alpha on a daily or other periodic basis. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation agrees that if at any time Alpha directs Clearing Corporation to do so, Clearing Corporation will transfer any securities from Able's account at Alpha's instructions. Because Clearing Corporation has agreed to act on Alpha's instructions with respect to any securities carried in Able's account, at the moment that Alpha's security interest attaches to securities listed by Able, Alpha obtains control of those securities under subsection (d)(2). There is no requirement that Clearing Corporation be informed of which securities Able has pledged to Alpha.

* * *

7. The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting subsection (c)(2) or (d)(2). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the ~~present~~ ability to have the securities sold or transferred without further action by the transferor. There is no requirement that the powers held by the purchaser be exclusive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, or to direct the disposition of the uncertificated security or security entitlement. Subsection (f) is included to make clear the general point stated in subsection (c) that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (f) is inconsistent with the purchaser having control. Moreover, the purchaser's right to direct the intermediary may be subject to conditions. For example, a purchaser may have present control of a security entitlement even though the purchaser's right to give entitlement orders to the

securities intermediary is conditioned on the entitlement holder's default or the purchaser's informing the securities intermediary that the entitlement holder is in default. Better practice for both the intermediary and the purchaser would be to insist that any conditions be effective only as between the purchaser and the entitlement holder. That would avoid the risk that the intermediary could be caught between conflicting assertions of the entitlement holder and the purchaser as to whether the conditions in fact have been met. Nonetheless, the existence of unfulfilled conditions effective against the intermediary would not preclude the purchaser from having control.

SECTION 8-110. APPLICABILITY; CHOICE OF LAW.

* * *

(e) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

(1) If an agreement between the securities intermediary and its entitlement holder expressly specifies ~~that it is governed by the law of a particular jurisdiction~~, the securities intermediary's jurisdiction for purposes of this part, this article, or this act, that jurisdiction is the securities intermediary's jurisdiction.

(2) If an agreement between the securities intermediary and its entitlement holder does not specify the ~~governing law~~ securities intermediary's jurisdiction as provided in paragraph (1), but expressly specifies that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(3) If an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in paragraph (1) or (2), the securities intermediary's jurisdiction is the jurisdiction in which is located the office identified in an account statement as the office serving the entitlement holder's account.

(4) If an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in paragraph (1) or (2) and an account statement does not identify an office serving the entitlement holder's

account as provided in paragraph (3), the securities intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the securities intermediary.

(f) A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other record keeping concerning the account.

Reporters' Comments

This section has been revised to provide more flexibility for the parties to select the security intermediary's jurisdiction. See also Sections 9-304(1) (depository institution's jurisdiction); 9-305(a)(4)(A) (commodity intermediary's jurisdiction).