

**SECURED TRANSACTIONS**

**ARTICLE 9**

**OF THE UNIFORM COMMERCIAL CODE**

**WHAT THE GENERAL PRACTITIONER**

**NEEDS TO KNOW**

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## **1. Insuring That a Security Agreement and Financing Statement are Valid**

Before considering the requirements for a valid security agreement, it is necessary to understand some of the new terminology found in Revised Article 9 of the UCC. Some of the key terms to know are debtor, obligor, secondary obligor, authenticate, record, and communicate.

The term “debtor” means the following:

- (A) a person having an 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, payment intangibles, or promissory notes; or
- (C) a consignee.

§ 9-102(a)(28). In other words, the debtor is generally the person that owns the collateral.

An “obligor” is a person that, with respect to an obligation secured by a security interest in the collateral:

- (i) owes payment or other performance of the obligation, (ii) has provided property other than the collateral to secure payment or other performance of the obligation, or (iii) is otherwise accountable in whole or in part for payment or other performance of the obligation.

§ 9-102(a)(59). In most situations, the obligor will be the person who owes payment or performance of the secured obligation. The same person may be both a debtor and an obligor.

A “secondary obligor” is an obligor whose obligation is secondary or who “has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor, or property of either.” § 9-102(a)(71). The most common secondary obligor would probably be a guarantor.

“Authenticate” means to sign or “to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person

to identify the person and adopt or accept a record.” § 9-102(a)(7). Until the electronic execution of documents becomes more common, authenticate will generally mean to sign a document.

A “record” is “information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form.” § 9-102(a)(69). In short, a record is a document that is either printed on paper or stored electronically.

The term “communicate” has been added to Article 9 to reflect the multiple means by which information can be communicated in our e-commerce age. The term means:

- (A) to send a written or other tangible record;
- (B) to transmit a record by any means agreed upon by the persons sending and receiving the record; or
- (C) in the case of transmission of a record to or by a filing office, to transmit a record by any means prescribed by filing-office rule.

§ 9-102(a)(18).

#### **A. Requirements of a Valid Security Agreement**

A security agreement works only if it creates a valid security interest that will attach to the designated collateral. A security interest attaches to collateral only when it becomes enforceable against the debtor. Three requirements must be satisfied before a security interest is enforceable against the debtor:

1. Value has been given.
2. The debtor has rights in the collateral or the power to transfer rights in the collateral to the secured party.
3. The Debtor has authenticated a security agreement that provides a description of the Collateral or the collateral is in the possession of the secured party pursuant to the debtor’s security agreement or the secured party has control of the collateral if the collateral is deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights.

The requirement that value be given requires that the secured party gives value for the rights it receives from the debtor in the collateral. A person gives value for rights if he acquires them (i) in return for a binding commitment to extend credit; (ii) as security for or in total or partial satisfaction of an antecedent debt; or (iii) in return for any consideration sufficient to support a simple contract. § 1-201(44). As a result, no funds need actually be advanced in order for the giving of value requirement to be satisfied.

There is no requirement under Article 9 that the person or entity whose assets are pledged must receive the value. For example, when a creditor loans money to a debtor's corporate affiliates, it has given value for purposes of obtaining an enforceable security interest in the debtor's assets even though the debtor does not receive any loan proceeds. Similarly, there is no requirement that the value be given by the secured party. If a third party gives value for the benefit of the secured party, attachment still may occur.

The second requirement for attachment of a security interest is that the debtor have rights in the collateral. If the debtor owns the collateral outright, it is obvious that the security interest may attach. On the other hand, if the collateral is stolen property, a security interest will not attach since the debtor cannot pass to the secured party better rights in the collateral than the debtor possesses. Rights in collateral include remedies with respect to the collateral. Thus, if the debtor has the right to replevy goods held by a third person, the debtor would have rights in the goods sufficient for a security interest to attach. In short, as long as the debtor has a sufficient level of rights in the collateral, the pledge of those rights will be sufficient for a security interest to attach. Remember, however, that the secured party will obtain only the limited rights held by the debtor.

An authenticated security agreement is the third requirement for attachment of a security interest. Unless the secured party has possession or control of the collateral, the security agreement must be written and signed by the debtor or otherwise constitute an authenticated record.

The security agreement need not be called a “security agreement.” The substance of the agreement will prevail over the form of the agreement. As long as the necessary requirements for a security agreement are present, an agreement will work under any name. In addition, multiple documents can be “combined” to find all of the requirements for a security agreement.

No magic words are required to create a security interest. The documentation simply must reflect a meeting of the debtor’s and the secured party’s minds to create a security interest. Nevertheless, it is best to be clear and avoid any ambiguities. The record that is creating the security interest should explicitly state something like the following:

The debtor grants the secured party a security interest in the Collateral to secure the Obligations.

With this sentence, the secured party has a valid security agreement as long as the parties, the Collateral, and the Obligations are adequately defined.

The description of the collateral is sufficient if it reasonably identifies what is described. § 9-108(a). A description reasonably identifies the collateral if it identifies the collateral by any of the following: (1) specific listing, (2) category, (3) a type of collateral (except commercial tort claims or certain consumer transaction property), (4) quantity, (5) computational or allocational formula or procedure, (6) any other method other than a supergeneric description, if the identity of the collateral is objectively determinable. § 9-108(b). Although a supergeneric description, such as “all of the debtor’s personal property” may not be used in a security agreement, it may be used in a financing statement.

## **B. After-Acquired Property and Future Advances Clauses**

A security agreement may create or provide for a security interest in after-acquired collateral. § 9-204(a). This is often referred to as a “floating lien.” A security interest arising by virtue of an after-acquired property clause is no less valid than a security interest in collateral in which the debtor has rights at the time value is given.

There are two exceptions to general rule allowing after-acquired property clauses in security agreements. First, an after-acquired property clause is ineffective against consumer goods, other than accessions, acquired more than 10 days after the secured party gives value. § 9-204(b)(1). Second, an after-acquired property clause will not reach commercial tort claims. § 9-204(b)(2). A security interest can only attach to commercial tort claims in existence when the security agreement is authenticated.

A security agreement may provide that collateral secures future advances or other value, whether or not the advances or value are given pursuant to commitment. § 9-204(c). Indeed, the secured party and the debtor are free to agree that a security interest shall secure any obligation whatsoever. The rule governing future advances in Revised Article 9 rejects the holdings of cases decided under former Article 9 that applied other tests, such as whether a future advance or other subsequently incurred obligation was of the same or a similar type or class as earlier advances and obligations secured by the collateral.

## **C. Debtor’s Rights to Use or Dispose of Collateral**

A security interest is not invalid or fraudulent by reason of the debtor’s liberty to dispose of the collateral without being required to account to the secured party for proceeds or substitute new collateral. § 9-205. This rule rejects the 1925 decision of the U.S. Supreme Court that

unfettered dominion by the debtor over the collateral and proceeds worked a fraud on other creditors and was voidable in bankruptcy. *Benedict v. Ratner*, 268 U.S. 353 (1925).

Section 9-205 leaves to the agreement of the parties to determine the procedures by which the secured party polices or monitors collateral or the restrictions on the debtor's dominion over the collateral. In some situations the secured party may want only limited oversight, while in other situations the secured party may want strict controls on the debtor's use and disposition of collateral. As an example of some standard limitations that a secured party may wish to impose upon the debtor in connection with the collateral, a security agreement could include the following provision:

The Borrower covenants with the Lender as follows: (a) the Collateral, to the extent not delivered to the Bank, will be kept at those locations listed in the attached Schedule A and the Borrower will not remove the Collateral from such locations, without providing at least 30 days prior written notice to the Bank, (b) except for the security interest herein granted and liens described in Schedule B, the Borrower shall be the owner of the Collateral free from any lien, security interest, or other encumbrance, and the Borrower shall defend the same against all claims and demands of all persons at any time claiming the same or any interests therein adverse to the Bank, (c) the Borrower shall not pledge, mortgage, or create, or suffer to exist a security interest in the Collateral in favor of any person other than the Bank, except for liens described in Schedule B, (d) the Borrower shall keep the Collateral in good order and repair and will not use the same in violation of law or any policy of insurance thereon, (e) the Borrower shall permit the Bank, or its designee, to inspect the Collateral at any reasonable time, wherever located, (f) the Borrower will pay promptly when due all taxes, assessments, governmental charges, and levies upon the Collateral or incurred in connection with the use or operation of such Collateral or incurred in connection with this Agreement, (g) the Borrower will continue to operate its business in compliance with all applicable provisions of the federal Fair Labor Standards Act, as amended, and with all applicable provisions of federal, state, and local statutes and ordinances dealing with the control, shipment, storage, or disposal of hazardous materials or substances, and (h) the Borrower will not sell or otherwise dispose, or offer to sell or otherwise dispose, of the Collateral or any interest

therein except for (i) sales and leases of inventory and licenses of general intangibles in the ordinary course of business, and (ii) so long as no Event of Default has occurred and is continuing, sales or other dispositions of obsolescent items of equipment in the ordinary course of business consistent with past practices.

#### **D. Possession of Collateral**

No filing is required to perfect a security interest in certain collateral if the secured party takes possession of the collateral. This rule applies when the collateral is goods, instruments, negotiable documents, money, or tangible chattel paper. § 9-313(a). Accounts, commercial tort claims, deposit accounts, investment property (other than a certificated security), letter-of-credit rights, letters of credit, and oil, gas, or other minerals before extraction are excluded. Perfection by possession of a certificated security is permitted as long as the possession is achieved by delivery of the certificated securities in accordance with Section 8-301 of the UCC.

Possession can be accomplished by an agent of the secured party as long as the agent is not also an agent of the debtor. In such a situation, the secured party will be deemed to have taken possession of the collateral. The debtor cannot qualify as an agent for the secured party for purposes of the secured party's taking possession. Under the right circumstances, a court may determine that a person in possession is so closely connected to or controlled by the debtor that the debtor has retained effective possession, even if the person in possession has agreed to take possession on behalf of the secured party. In such circumstances, the person's taking possession would not constitute the secured party's taking possession and would not be sufficient for perfection. In a typical escrow arrangement, where the escrowee has possession of collateral as agent for both the secured party and the debtor, the debtor's relationship to the escrowee is not such as to constitute retention of possession by the debtor.

Perfection by possession is possible when the collateral is possessed by a third person who is not the secured party's agent. Perfection occurs when the third person authenticates an acknowledgment that it holds possession of the collateral for the secured party's benefit. The authenticated acknowledgment may also provide that the third person will hold for the secured party's benefit collateral to be received in the future. In that case, perfection by possession occurs when the third person obtains possession of the goods.

A third person in possession of collateral is not required to acknowledge that it holds for a secured party. If an acknowledgment is given by the third person, it is effective even if it is wrongful as to the debtor. The mere acknowledgment by a third person that it holds for a secured party does not create any duties or responsibilities for the third person. An acknowledging third person does not become obliged to act on the secured party's direction or to remain in possession of the collateral unless it agrees to do so or other law so provides. Consequently, it is best for a secured party to obtain some minimal agreements from the third person in the authenticated acknowledgment as to handling of the collateral.

## **E. Financing Statements**

### **1. Valid and Invalid Financing Statements**

Under Revised Article 9, to be effective, a financing statement must provide only three things: (i) the debtor's name, (ii) the name of the secured party or its representative, and (iii) indicate the collateral covered by the financing statement. § 9-502(a). Additional information is required in the financing statement when the collateral is timber to be cut, as-extracted collateral, or fixtures. The filing office may reject a financing statement if it does not contain certain additional information, but once accepted the filing is effective notwithstanding that there may be errors or omissions as to

information other than the three required elements. The additional information that the filing office will require is the following: mailing address of secured party, mailing address of debtor, indicate whether the debtor is an individual or an organization. If the debtor is an organization, the financing statement also must provide the debtor's type of organization, jurisdiction of organization, and organizational identification number, if any.

The debtor's name must be absolutely correct on the financing statement for the filing to be effective. Signatures are no longer required, and the form no longer has a place for signatures.

## **2. Proper Filing of Financing Statements**

Revised Article 9 provides for automatic authorization to file a financing statement consistent with the security interest granted by the debtor in the security agreement. § 9-509(b). A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. § 9-509(d). A secured party will need express authorization to pre-file a financing statement if the debtor has not yet authenticated a security agreement.

In general, a financing statement must be filed in the jurisdiction where the debtor is located. A registered organization is located in its state of organization. Any other entity is located in the state of its chief executive office. An individual is located in the state of his or her principal residence.

Once the correct jurisdiction for filing is identified, most filings will be made in the state-wide office designated by the jurisdiction. A local filing is required when the collateral is as-extracted collateral, timber to be cut, or fixtures. In those situations, the proper filing office is the office where one would file or record a record of a mortgage on the real property related to the collateral. All other filings are in the state-wide office.



## **2. Secured Creditors vs. Third Parties**

### **A. Competing Rights of Lien Creditors**

A lien creditor is defined in Section 9-102(a)(52) of Article 9 to mean a creditor that has acquired a lien on the property at issue by attachment, levy, or the like. A lien creditor also includes an assignee for benefit of creditors and a trustee in bankruptcy. State law outside Article 9 determines when the lien creditor has acquired a lien in the property at issue. In some states the lien may arise at the instant the lawsuit is filed. In other states the lien may not arise until the sheriff actually levies upon the property by seizing possession. In other states, the lien may arise between these two extremes. In any case, Article 9 will not provide the answer.

Under Section 9-317(a), a perfected security interest is prior to the rights of a person who becomes a lien creditor. In addition, a security interest will have priority over the rights of a lien creditor if a financing statement has been filed and either the debtor has authenticated a security agreement or the secured party has possession or control of the collateral. § 9-317(a)(2)(B). In other words, a security interest that has not yet attached and become perfected simply because the secured party has not yet advanced any loan proceeds or otherwise given value, will still have priority over a lien creditor whose lien attaches before the value is given.

A lien creditor's knowledge of the existence of an unperfected security interest does not affect the lien creditor's rights. In other words, the lien creditor is put on par with a competing secured creditor for whom knowledge of the existence of another security interest is irrelevant.

A special grace period for filing is provided to purchase money security interests when determining priority with respect to a lien creditor. If a purchase money security interest is perfected by filing no later than 20 days after the debtor receives delivery of the collateral, the security interest

takes priority over the rights of a lien creditor that arise between the time the security interest attaches and the time of filing. § 9-317(e).

Section 9-311(b) provides that compliance with the perfection requirements of certain statutes such as a certificate of title statute covering automobiles, trailers, boats, and the like, “is equivalent to the filing of a financing statement.” It follows, then, that a person who perfects a security interest in goods covered by a certificate of title by complying with the perfection requirements of an applicable certificate-of-title statute “files a financing statement” within the meaning of Section 9-317(e) and is entitled to the benefits of the filing grace period for purchase money security interests.

#### **B. Secured Party’s Rights to “Proceeds”**

A security interest attaches to any identifiable proceeds of collateral. § 9-315(a)(2).

Proceeds means the following property:

- (A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;
- (B) whatever is collected on, or distributed on account of, collateral;
- (C) rights arising out of collateral;
- (D) to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or
- (E) 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 or infringement of rights in, or damage to, the collateral.

§ 9-102(a)(64). Subparagraph (B) covers cash or stock dividends distributed on account of securities or other investment property that is original collateral. It also covers collections on and distributions on account of collateral consisting of various credit-support arrangements. For property to qualify

as proceeds it need not be “received” by the debtor. It is necessary only that the property be traceable, directly or indirectly, to the original collateral.

A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected. § Generally, such a perfected security interest in proceeds becomes unperfected on the 21<sup>st</sup> day after the security interest attaches to the proceeds unless certain requirements are satisfied. The requirements are:

- (1) the following conditions are satisfied:
  - (A) a filed financing statement covers the original collateral;
  - (B) 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
  - (C) the proceeds are identifiable cash proceeds;
- (2) the proceeds are identifiable cash proceeds; or
- (3) the security interest in the proceeds is perfected other than under [the temporary automatic perfection in proceeds] when the security interest attaches to the proceeds or within 20 days thereafter.

§ 9-315(d). In general, if a secured party wants to be sure that its security interest will continue in proceeds, the secured party must file a financing statement covering the proceeds within 20 days after the security interest attaches to the proceeds unless the secured party’s financing statement already covers the proceeds. If the security interest in the original collateral was perfected, a security interest in identifiable cash proceeds will remain perfected indefinitely.

### **C. Rights of Persons Who Buy Collateral From Debtor**

In general, a buyer in the 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 the buyer knows of its existence. § 9-320(a). A buyer in the ordinary course of business means a buyer “from a person, other than a

pawnbroker, in the business of selling goods of the kind.” § 1-201. In other words, this rule is primarily applicable to inventory collateral.

To be a buyer in the ordinary course of business, the buyer must be one who buys “in good faith, without knowledge that the sale violates the rights of another person and in the ordinary course.” § 1-201. Consequently, the buyer will take free of a security interest if the buyer merely knows that a security interest covers the goods, but will take subject to the security interest if the buyer knows, in addition, that the sale violates a term in the seller’s agreement with the secured party.

The rule for a buyer in the ordinary course of business applies only to security interests created by the seller of the goods to the buyer in the ordinary course. The following example illustrates the importance of this limitation.

*Example:* Manufacturer, who is in the business of manufacturing appliances, owns manufacturing equipment subject to a perfected security interest in favor of Creditor. Manufacturer sells the equipment to Dealer, who is in the business of buying and selling used equipment. Buyer buys the equipment from the Dealer.

In this example, even if the Buyer qualifies as a buyer in the ordinary course of business, Buyer does not take free of lender’s security interest under the rule of Section 9-320(a), because Dealer did not create the security interest and the rule only applies to security interests created by the *buyer’s* seller.

The rule of Section 9-320(a) does not affect a security interest in goods that are in the possession of the secured party pursuant to Section 9-313.

### 3. Priorities Among Creditors

#### A. Priority Rules

Section 9-322 of Article 9 sets forth the general priority rules for competing security interests. There are three general rules. First, if neither security interest is perfected, the first security interest or agricultural lien to attach or become effective has priority. Second, a perfected security interest or agricultural lien has priority over a competing security interest or agricultural lien. Third, when there is more than one perfected security interest, the security interests rank according to their priority in time of filing or other means of perfection. This rule is often referred to as the first-to-file-or-perfect rule. “Filing” refers to the filing of an effective financing statement, and “perfection” refers to the perfection of an attached security interest by any means of perfection other than filing.

Some examples readily illustrate these basic priority rules. Many of these examples come from the Official Comment to Section 9-322.

*Example:* On February 1, Debtor grants Creditor A a security interest in Debtor’s equipment to secure a non-purchase-money loan to the Debtor. Creditor A does not file a financing statement or otherwise perfect the security interest. On March 1, Debtor grants Creditor B a security interest in Debtor’s equipment to secure a non-purchase-money loan to the Debtor. Creditor B does not file a financing statement or otherwise perfect the security interest. The equipment is at all times in the possession of the Debtor.

At this point in the Example, Creditor A has priority because its security interest was the first to attach. Creditor B can easily change this result if it perfects its security interest before Creditor A perfects its security interest. Creditor B would then have priority as the first to file or perfect. It makes no difference whether Creditor B knows of Creditor A’s security interest when it perfects its own security interest.

*Example:* On February 1, Creditor A files a financing statement covering a certain item of Debtor’s equipment. On March 1, Creditor

B files a financing statement covering the same item of equipment. On April 1, Creditor B makes a loan to Debtor and obtains a security interest in the equipment. On May 1, Creditor A makes a loan to Debtor and obtains a security interest in the same collateral.

In this Example, Creditor A has priority under the first-to-file-or-perfect rule even though Creditor B's loan was made earlier and was perfected when made. It makes no difference whether Creditor A knew of Creditor B's security interest when Creditor A advanced its loan.

A creditor will generally maintain the same priority in after-acquired property as long as the collateral in which the debtor granted a security interest includes the after-acquired property.

*Example:* On February 1, Creditor A makes advances to Debtor under a security agreement covering all of Debtor's machinery "now existing or hereafter acquired." Creditor A files a financing statement covering this collateral on the same date. On March 1, Creditor B takes a security interest in all of Debtor's existing and after-acquired equipment to secure its loan to Debtor. Creditor B files a financing statement covering its collateral on the same date. On April 1, Debtor acquires a new item of equipment.

Creditor A has priority in the new item of equipment. Both creditors acquired a security interest in Debtor's new equipment once Debtor acquired rights in the property. Both security interests are perfected at the same time. Since Creditor A filed before Creditor B, Creditor A has priority.

Except for a few special circumstances, the priority of a security interest in proceeds will be determined by the basic priority rules. Remember that a security interest as to particular collateral cannot attach until the collateral exists and the Debtor has rights in the collateral. Consequently, a security interest in proceeds will not attach and is not perfected until the proceeds comes into existence and the Debtor has rights in the proceeds. At that point the security interest in the proceeds has the same priority as in the original collateral.

*Example:* On February 1, Debtor grants Creditor A a security interest in all of Debtor's existing and after-acquired inventory. Creditor A files a financing statement the same day. On March 1, Debtor grants Creditor B a security interest in all of Debtor's existing and future accounts. Creditor B files a financing statement the same day. On April 1, Debtor sells some of its inventory to customer on 30-day unsecured credit.

In this example, when Debtor sold some inventory to a customer on account, Debtor naturally acquired an account. At that point Creditor B's security interest attached to the account since the collateral came into existence and Debtor obtained rights in the collateral. The security interest is perfected by Creditor B's financing statement. At the same time, Creditor A's security interest attaches to the account as proceeds of Debtor's inventory and is automatically perfected. Creditor A's priority in the account is determined the same as in the inventory. The time of filing for the inventory was February 1, so the time of filing for the account as proceeds of the inventory is the same date. The time of filing for Creditor B's security interest in the account is March 1. Since Creditor A filed first, Creditor A has priority in the account.

Some exceptions to the general rules governing priority in proceeds are made for certain collateral known as "non-filing collateral." Non-filing collateral is collateral of a type for which perfection may be achieved by a method other than filing, such as possession or control, and for which secured parties who so perfect generally do not expect to need to conduct a filing search. This collateral is chattel paper deposit accounts, negotiable documents, instruments, investment property, and letter-of-credit rights.

Section 9-324 of Article 9 provides special priority rules to purchase money security interests. A purchase money security interest is a security interest in goods or software that secures a purchase money obligation incurred with respect to that collateral. A purchase money obligation

is an obligation incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire the rights in or the use of the collateral as long as the value is in fact so used.

The general rule for purchase money priority is that a perfected purchase money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, in general, a perfected security interest in identifiable proceeds also has priority, as long as the purchase money security interest is perfected when the Debtor receives possession of the collateral or within 20 days thereafter.

Some additional rules apply to a purchase money security interest in inventory. The purchase money security interest must be perfected when the debtor receives possession of the inventory. The 20-day grace period for other goods does not apply. In addition, the purchase money secured party must give an authenticated notification to the holder of a conflicting security interest who filed against the same item or type of inventory before the purchase money secured party filed. The notification must state that the purchase money secured party has or expects to acquire a purchase money security interest in inventory of the Debtor and describe the inventory. The holder of the conflicting security interest must receive the notification within five years before the debtor receives possession of the inventory.

## **B. Rights in Fixtures**

Section 9-334 of Article 9 contains rules governing the priority of security interests in fixtures as against persons who claim an interest in real property. Fixtures are goods that are the subject of personal property financing and become so affixed or otherwise related to real property that they become part of the real property.

The general rule with respect to fixtures is set forth in Section 9-334(c) as follows:

[A] security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property other than the debtor.

The general rule is subject to several exceptions. One exception is the usual priority rule of conveyancing, that is, the first to file or record has priority. § 9-334(e)(1). In order to achieve priority under this rule, however, the security interest must be a properly perfected “fixture filing.” In other words, if the fixture filing is perfected before the interest of the encumbrancer or owner is of record, the fixture filing has priority.

Another principal exception is the exception for purchase money security interests. Purchase money security interests in fixtures have priority over prior recorded real-property interests as long as the purchase money security interest is filed as a fixture filing in the real property records before the goods become fixtures or within 20 days thereafter. § 9-334(d). This 20-day grace period is only good for real property interests that arise *before* the goods become fixtures. A real property interest that is recorded after the goods become fixtures, but before the fixture filing is recorded will have priority over a purchase money security interest in the fixtures.

Another exception is found in Section 9-334(e)(2). It affords priority to a security interest in readily removable goods if the security interest is perfected before the goods become fixtures and the fixtures are readily removable factory or office machines, equipment that is not primarily used or leased for use in the operation of the real property, or replacements of domestic appliances that are consumer goods.

Special rules apply in the case of construction mortgages. A construction mortgage that is recorded before the filing of a purchase money security interest in fixtures is given priority by Section 9-334(g) over the security interest in the fixtures. The priority under this section applies only to goods that become fixtures during the construction period leading to completion of the

improvements. The construction priority will not apply to additions to the building made long after completion of the improvements. A refinancing of a construction mortgage has the same priority as the construction mortgage.

### **C. Rights to Commingled or Processed Goods**

The rules applicable to commingled goods are set forth in Section 9-336 of Article 9. “Commingled goods” means “goods that are physically united with other goods in such a manner that their identity is lost in a product or mass.” § 9-336(a). This covers not only goods whose identity is lost through manufacturing or production, such as 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, such as ball bearings.

A security interest does not exist in commingled goods, but a security interest in goods that become commingled goods attaches to the product or mass into which the goods are commingled. § 9-336(c) and (d). Such a security interest that attaches to the product or mass is perfected if the security interest in the goods that become commingled is perfected before the goods become commingled. § 9-336(d).

If more than one security interest arises under this section of Article 9 and each is perfected by operation of this section, then the security interests rank equally in proportion to the value of the collateral at the time it became commingled goods. § 9-336(f). Naturally, a security interest in the product or mass that is not perfected will be junior to a competing security interest that is perfected under this section.

#### **4. Rights of Secured Creditors Upon Default**

##### **A. Secured Party's Rights to Repossess Upon Default**

A secured party has the right to seize collateral without judicial process, subject to three limitations. § 9-609. First, a creditor cannot repossess the collateral unless a default exists. A creditor may be liable for conversion if it repossesses the collateral without the existence of an actual default.

Second, even if a default exists, the contract terms may limit the creditor's ability to take possession of the collateral. Thus, before repossessing any collateral, the secured party must confirm that the loan documents do not impose any restrictions or limitations on repossession.

Third, the creditor must not breach the peace when repossessing collateral. Article 9 does not define what constitutes a breach of the peace. Determining whether certain actions will breach the peace is left to the courts to determine.

##### **B. Secured Party's Right to Dispose of Collateral**

Section 9-610 provides that "[a]fter default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing." The section provides the following guidance as to what constitutes a commercially reasonable disposition:

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.

The duty to dispose of collateral in a commercially reasonable manner cannot be waived or varied. The parties may, however, adopt contractual standards that define commercially reasonable conduct, as long as such standards are not manifestly unreasonable.

### **C. Compulsory Disposition of Collateral**

Under the Idaho's Revised Article 9, Section 620, a secured party who has taken possession of collateral must dispose of the collateral within the time periods described in the section if:

- (a) Sixty percent of the cash price has been paid in the case of a purchase-money security interest in consumer goods; or
- (b) Sixty percent of the principal amount of the secured obligation has been paid in a non-PMSI interest in consumer goods.

Idaho Code § 28-9-620(e). That time period is ninety days, unless all parties agree otherwise. *Id.* § 28-9-620(f).

### **D. Debtor's Right to Redeem Repossessed Collateral**

Under state law, a debtor, secondary obligor, or any other secured party or lienholder has the right to redeem collateral. For example, under Idaho Code § 28-9-623, those parties can redeem personal property collateral covered by Revised Article Nine, as long as the collateral has not already been collected, *see* 28-9-607, disposed of or contracted for disposition, *see* 28-9-610, or accepted in satisfaction of the debt, *see* 28-9-620. To redeem collateral under Revised Article Nine, the party must tender fulfillment of all obligations secured, plus expenses.

Except in consumer good transactions, a debtor or secondary obligor may waive the right to redeem collateral under Idaho Code § 28-9-623 only by an agreement entered into and authenticated after default. Idaho Code § 28-9-624(c).

### **E. Secured Creditor Liability**

The Revised Article Nine provides for certain remedies if a secured party fails to comply with Revised Article Nine's provisions. *See* Idaho Code § 28-9-625. Those remedies include

a court order restraining the secured creditor from collecting, enforcing or disposing of collateral; damages for any loss caused by the secured creditor's failure to comply with Revised Article Nine; elimination of any deficiency; damages for loss of any surplus that would have been realized had the secured creditor complied with Revised Article Nine; or a \$100 award for the wrongful filing of or failure to terminate a financing statement.

In addition to these remedies under Revised Article Nine, the debtor or secondary obligor could also bring claims against the secured party for breach of contract, and breach of the implied covenant of good faith and fair dealing.

## CHECKLIST FOR A PERFECTED SECURITY INTEREST

1. Does Article 9 apply to the transaction?
2. Has a proper search been conducted for conflicting interests?  
☐ Revised Article 9 locations  
☐ Prior Article 9 locations until July 1, 2006
3. Does the debtor have rights in the collateral?
4. Is there a valid security agreement?  
☐ Authenticated by the debtor  
☐ Collateral sufficiently described  
☐ After acquired property included, if desired  
☐ Secured obligation sufficiently described  
☐ Future advances included, if desired  
☐ Clear grant of security interest in the collateral
5. Has value been given by the secured party?
6. Has the security interest been perfected?  
☐ Possession  
☐ Control  
☐ Filing  
☐ Certificate of Title
7. Has a valid financing statement been filed, if possible?  
☐ Correct debtor name  
☐ Name of secured party  
☐ Indicate the collateral covered  
☐ All required information of the financing statement for completed
8. Has the financing statement been filed in the proper filing office?  
☐ Proper jurisdiction  
☐ Proper filing office within the jurisdiction

*This checklist covers the general requirements to obtain a perfected security interest, but care must be exercised to determine whether additional requirements apply to the specific collateral.*