Secured Transactions under Revised Article Nine: Recognition of Legal Issues through Identification and Phase Analyses

Michael I. Swygert

Follow this and additional works at: https://via.library.depaul.edu/law-review

Recommended Citation
Available at: https://via.library.depaul.edu/law-review/vol22/iss2/1

This Article is brought to you for free and open access by the College of Law at Via Sapientiae. It has been accepted for inclusion in DePaul Law Review by an authorized editor of Via Sapientiae. For more information, please contact wsullivan@depaul.edu, c.mcclure@depaul.edu.
SECURED TRANSACTIONS UNDER REVISED ARTICLE NINE: RECOGNITION OF LEGAL ISSUES THROUGH IDENTIFICATION AND PHASE ANALYSES

MICHAEL I. SWYGERT*

INTRODUCTION

On December 20, 1971 the Permanent Editorial Board for the Uniform Commercial Code gave final approval to the first major revision of Article Nine, Secured Transactions of the Uniform Commercial Code since its initial promulgation in 1951.1 Under chairmanship of Herbert Wechsler, with the consultation of Soia Mentschikoff, the Board suggested a revamping of many of Article Nine’s detailed provisions.2 The suggested revisions have as of the date of this writing been adopted by Illinois.3

Revised Article Nine of the Uniform Commercial Code is a lengthy and complex statute.4 By its own terms, it applies to any transaction intended to create a security interest in personal property or fixtures,5 and thus, is important in structuring and analyzing se-

---

* Visiting Associate Professor of Law, DePaul University; B.A., J.D., Valparaiso University; LL.M., Yale University. The author wishes to acknowledge the helpful assistance in the preparation of this article of Mr. Thomas Nelson of Ephrata, Washington, and Mr. Gary Case of Globe, Arizona, students at the Valparaiso University School of Law and Editors of the Valparaiso University Law Review.

1. All cited and quoted provisions of the Uniform Commercial Code (UCC) in the article refer to the 1972 Official Text and Comments as published by the American Law Institute and the Permanent Editorial Board.

2. See, e.g., UCC §§ 9-103 (Multistate Transactions); 9-203 (Enforcement and Attachment); 9-401 et seq. (Filing); 9-312 (Priorities); and 9-313 (Fixtures).


5. UCC § 9-102. “(1) Except as otherwise provided in Section 9-104 on excluded transactions, this Article applies (a) to any transaction (regardless of its form) which is intended to
cured transactions within the commercial and consumer realms. Although complex, the provisions of revised Article Nine are not difficult to work with provided one has mastered the internal construct of the Article. The student's or attorney's focus should be upon those principles which relate and tie together the separate sections so as to produce a unified code within a code. It is the purpose of this article to outline an analytic procedure which affords the recognition of issues involving chattel or other personal property security arrangements within the purview of Article Nine. Before beginning the suggested analysis, however, it is necessary to set up a discussion hypothetical.

create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts; and also

(b) to any sale of accounts or chattel paper.

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

(3) 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."


7. Prior to the widespread adoption of the UCC (forty-nine states plus the District of Columbia), few law schools' curricula included a separate course in personal property security, in part due to the absence of any uniform comprehensive statute or case law. Up until about 1960, most law students took courses in negotiable instruments (often called bills and notes based upon the Uniform Negotiable Instrument Law), and in sales (dealing primarily with the Uniform Sales Act and English Sales of Goods Act). As a result, the majority of practicing lawyers in the United States today have had little law school exposure to personal property security, let alone Article Nine. Even after adoption of the Uniform Commercial Code, most case books and most law school courses were still emphasizing negotiable instruments and sales, Articles Three and Two. Scant attention was given to Article Nine. Certain authors of more recent teaching materials, however, have shifted the commercial law emphasis to Article Nine, going so far as to begin their books with this subject. Recent examples include Professors Kaufman and Countryman's text entitled COMMERCIAL LAW (1971), and Professors Speidel, Summers and White's TEACHING MATERIALS IN COMMERCIAL LAW (1969).

Jones Industrial Supply Company is a jobber engaged in wholesaling machine tools to industrial and commercial buyers. Jones desires to acquire a new line of "Oblet" machine tools manufactured by the K-C Manufacturing Company. K-C has informed Jones that it will sell Oblets only on a cash basis.

To finance the purchase of 100 Oblet machine tools and to pay off a portion of his existing accounts payable, Jones goes to Secure Bank which agrees to advance Jones $15,000 pursuant to a "secured loan agreement." Under this agreement, Secure Bank takes a "security interest" in Jones' "inventory whenever acquired, and proceeds thereof; accounts whenever acquired and proceeds thereof; and equipment." Secure Bank files a "financing statement" covering the above items of collateral with the Secretary of State office and also files a copy with the county recorder.

Jones takes $5,000 of the $15,000 loan and pays off some but not all of the unsecured (accounts payable) creditors. Jones then advances the remaining $10,000 to K-C Manufacturing Company with a purchase order for 100 "Oblet Machine Tools" to be manufactured and "shipped upon completion." Subsequently, four months later, Jones files a voluntary petition for adjudication of bankruptcy. The amount of outstanding unsecured claims against Jones as of the date of his petition in bankruptcy is $20,000.

Only $300 of Secure Bank's $15,000 loan against inventory and proceeds has been repaid. The value of Jones' inventory and proceeds on hand as of the date of bankruptcy amounts to only $7,000. The 100 K-C Oblets which Jones had paid for in advance (using funds extended by Secure Bank) have not yet been shipped by K-C. The wholesale value of these Oblets is $10,000.

An officer of Secure Bank asks the bank's attorney whether the Bank "owns" these 100 Oblets which it turns out have been manufactured and are awaiting shipment at K-C's factory. The bank officer explains that a customer of the bank, another machine tool jobber, might purchase the Oblets from the bank provided the bank "has clear title." The officer is aware that Jones is in the midst of a bankruptcy adjudication in federal district court. The officer explains that by selling the 100 K-C Oblets, and, if Secure Bank can
also take possession of the on-hand machine tool inventory and sell these items as well, the Bank will likely be able to liquidate all or most of its $15,000 loan to Jones.

The officer then asks the attorney the following questions:

1. May the Bank take possession and sell the on-hand inventory of Jones?
2. Does the Bank have the right to direct K-C to ship the 100 Oblets per the Bank’s instructions?
3. If the Bank does have the right to take control over the 100 Oblets, may the Bank sell these items to the Bank’s customer (a private sale)?
4. How may the bankruptcy proceeding affect the Bank’s rights?

Assume you are Secure Bank’s attorney in this hypothetical. As the attorney, you will have to go to the controlling authorities—the Federal Bankruptcy Act and your state’s authoritative version of the Uniform Commercial Code. How should you begin your analysis? Where should you start in the Code? Is it possible to “underanalyze,” that is, to find an apparently applicable provision not realizing that the provision may raise additional issues found elsewhere in the Code?

9. 11 U.S.C.A. § 1 et seq. Congress is empowered in article 1, section 8, clause 4 of the Constitution to enact “uniform laws on the subject of Bankruptcies.” The first Bankruptcy Act was passed in 1800. The statute in force today is the Act of 1898 as amended in 1938 by the Chandler Act. For an introduction to the Bankruptcy Act and its intermesh with the UCC, see COUNTRYMAN & KAUFMAN, COMMERCIAL LAW 163-228 (1971).

10. Forty-nine states and the District of Columbia have enacted the Uniform Commercial Code. To compare these fifty separate enactments and to note variances, the four-volume U.L.A. work, published by West, is especially useful, except that it does not contain the 1972 Article Nine revisions. U.L.A. (UNIFORM COMMERCIAL CODE) (1968).

11. Underanalysis may result not only from a lack of knowledge of all relevant UCC law, but may also result from a lack of awareness that other state and federal law may apply. In commercial finance situations such non-Article Nine law may include, for example:

(1) the Federal Consumer Credit Protection Act; (2) the Federal Bankruptcy Act; (3) state reclamation statutes; (4) state small loan, usury, retail installment and/or conditional sales acts; (5) the Federal Bills of Lading Act; or (6) the Federal Tax Lien Act. See UCC § 9-203(4).

In addition, underanalysis may result not from a lack of knowledge of applicable law, but from an awareness of relevant business or commercial facts. See, for example, Note, Custom and Trade Usage: Its Applications to Commercial Dealings and the Commercial Law, 55 COLUM. L. REV. 1192 (1955).
IDENTIFICATION AND PHASE ANALYSIS—AN OVERVIEW

To apply Article Nine's provisions to the above facts, an attorney needs an analytic framework. Fortunately, Article Nine contains most of the analytic structure necessary for legal analysis. Indeed, Article Nine's set of definitions\textsuperscript{12} coupled with its extensive and unified terminology\textsuperscript{13} facilitate an "identification process" whereby all the parties (and collateral) are defined in terms of their legal relationships to each other.

To answer the bank officer's questions in the above hypothetical, moreover, requires an analysis of the Jones loan transaction from its incipiency through its eventual breakdown (Jones' default). The suggested methodology to be explained in this article involves two processes—an identification analysis followed by a transactional phase analysis.

In the identification analysis, the secured transactions themselves are identified. Next, the parties are identified and labelled on the basis of their legal relationship to each other. The "type" of collateral is then designated within Article Nine's terminologic classification. Then, the particular "kind" of security interest is identified and labelled, and finally, third parties (e.g., trustees, buyers in the ordinary course of business, unsecured creditors, lien creditors, and holders of instruments or documents of title) are identified and labelled, all according to the Code's precise definitions.

After completing the initial identification analysis, the second step of the suggested methodology—the transactional phase analysis—becomes applicable. Every commercial transaction may be viewed

\textsuperscript{12} Definitions applicable to Article Nine secured transactions may be found, "outside" Article Nine in the UCC. For examples, see UCC §§ 1-201, 1-205, 2-103, 2-104, 3-102 and 7-102. For "inside" definitions see especially UCC § 9-105.

\textsuperscript{13} The importance of the Code's precise terminology may be illustrated by considering Article Nine's recognition of the special set of rules needed in cases where a seller desires to retain a security interest in goods he sells to secure the payment of the purchase price. Under pre-Code law, a device known as a "conditional sale" was used to establish for the seller his desired protection. Conditional sellers were protected in more circumstances than were chattel mortgagees (secured lenders) under pre-Code statutes. The Code, recognizing the need for continuing the special protections for credit sellers vis-a-vis lenders, uses the term "purchase money security interest" in UCC § 9-107. This designation is often crucial since specific rules of attachment, perfection and remedies are applicable only to transactions involving a purchase money security interest. See, e.g., UCC § 9-312(3).
conceptually in a number of ways. One way is to perceive a transaction in a purely time-sequential fashion. The parties meet, negotiate and enter into a legally-binding relationship typically represented by documents such as a bill of sale, warehouse receipt, retail installment contract plus a promissory note, etc. Following the agreement and execution of appropriate documents, the parties commence their performances, ultimately completing their respective obligations and receiving their mutual benefits.

The above illustration assumed the transaction ran smoothly, that it did not break down. When difficulty arises, however, the legal relationships between or among the parties and in the collateral become altered. A lawyer must ascertain not only how the transaction broke down, but must determine what alternative legal avenues may be available to the client. To analyze a financing arrangement, a lawyer should have a conceptual understanding of Article Nine, an understanding of the various legal phases of the transaction. To view the transaction in a time-sequential manner (negotiation, agreement, performance, breakdown, remedies) does not go far enough, whereas to structure the transaction through its various legal stages is to study it sequentially as to when legal events occur (rather than when factual events take place). Phase analysis thus makes easily recognizable often legally dispositive issues.

Consider a secured transaction. A sequential legal-phase analysis of an Article Nine security interest views an ordered sequence of legal events from its incipiency or negotiation phase through its creation, enforcement, attachment, perfection, priority, default and remedial phases.

This phase-process model is helpful not only for analysis of transactional breakdowns (default, insolvency, improper care or conversion of collateral, non-maintenance of a required collateral-to-loan ratio) but also is useful for competent transactional planning since the model highlights drafting and planning pitfalls. Indeed, an ordered sequential perception of legal events affords the placing of potentially legally dispositive issues into the seven distinct legal phases of the transaction.

The seven distinct legal phases of an Article Nine security transaction may be summarized as follows:
(1) The NEGOTIATION PHASE includes all events and dealings, communications and statements between or among the parties occurring before the creation of the security interest. These dealings and events may be relevant to possible dispositive issues relating to warranties,\textsuperscript{14} disclaimers,\textsuperscript{15} parol evidence,\textsuperscript{16} basis of the bargain\textsuperscript{17} and good faith.\textsuperscript{18}

(2) The CREATION PHASE is that stage in a secured transaction when an Article Nine security interest arises, predicated upon the secured party entering into a security agreement with the debtor. A lawyer should study the language of the security agreement and related documents to identify possible issues relating to unconscionability,\textsuperscript{19} negotiability,\textsuperscript{20} warranties,\textsuperscript{21} waiver of defense,\textsuperscript{22} definition of default events\textsuperscript{23} and assignability.\textsuperscript{24} Also, the Code permits freedom of contract thus affording the possibility that the parties may have altered by agreement particular Code prescriptions.\textsuperscript{25}

(3) The ENFORCEMENT-ATTACHMENT PHASE consists of those legal events constituting conditions precedent to the secured party's having certain Article Nine rights as against the debtor and the debtor's collateral.\textsuperscript{26} Attachment of a security interest requires

\textsuperscript{14} See UCC § 2-312 through § 2-318. See also UCC § 9-206(1), (2). But see Uniform Consumer Credit Code 2.404, hereinafter referred to as UCCC.
\textsuperscript{15} See UCC § 2-316.
\textsuperscript{16} See UCC § 2-202.
\textsuperscript{17} See UCC §§ 1-201(3) and (11) and 9-105(1)(l).
\textsuperscript{18} See UCC §§ 1-201(19), 1-203, 2-103(1)(b), and Comment 1 to UCC § 9-507.
\textsuperscript{19} See UCC § 2-301.
\textsuperscript{20} See UCC § 3-104 through § 3-115.
\textsuperscript{21} See UCC § 2-312 through § 2-317.
\textsuperscript{22} See UCC § 9-206 and UCCC § 2.404 Alternative 1 and 2.
\textsuperscript{23} See note 123 infra and accompanying text.
\textsuperscript{24} See UCC § 9-206, UCCC § 2.404, and supplemental contract principles under UCC § 1-103. See also CORBIN, CORBIN ON CONTRACTS 856-64 (1952).
\textsuperscript{25} UCC § 9-201. "Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. . . ." UCC § 1-102. "... (3) The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable. . . ." See also UCC §§ 9-501(3), 9-201, 9-312, and 9-307.
\textsuperscript{26} UCC § 9-203.
that it be enforceable. To be enforceable, there generally must be an agreement, value must be given, and the debtor must have rights in the collateral. At the moment all three events have taken place, the security interest is said to be enforceable, and under Section 9-203(2), "attaches" to the collateral. Attachment is one of the essential requirements for a security interest to be properly "perfected," the next legal phase.

(4) The perfection phase is that stage where the secured party takes steps to maximize his rights to a debtor's collateral versus third parties, and consequently, in many instances will be determinative of a secured party's rights against other creditors of the debtor.27 A lawyer need know, for example, that in certain kinds of security interests, perfection automatically occurs at the moment of attachment.28 In most cases, however, the filing of an appropriate "financing statement" will be required.29 Possible dispositive issues at the perfection phase relate not only to the fact of filing, but often to the place and time of filing and to the contents of the "financing statement" itself.30

(5) The priority phase analysis is the application of the intricate Article Nine rules to determine the relative positions of a number of creditors in the collateral of a single debtor.31 In other words, a determination must be made as to which claimant among all possible actual and representative creditors of a debtor has the best right to satisfy an indebtedness by taking and disposing of particular collateral. In addition to other secured creditors, priority determinations often involve resolution of conflicting claims between a secured creditor and unsecured creditors, or a lien creditor, a bankruptcy trustee, a purchaser of the collateral, or a holder of an instrument or document of title representing the collateral.

(6) The default phase analysis involves, first, the determination of exactly what factual developments as contemplated

27. See UCC § 9-303(1).
28. E.g., UCC § 9-302(1)(d) (which indicates that a financing statement need not be filed in order to perfect a purchase money security interest (PMSI) in consumer goods). A PMSI is defined in UCC § 9-107(a) and (b).
29. UCC §§ 9-302, 9-304, and 9-402.
30. See UCC § 9-401.
under the security agreement constitute default events and, second, whether an agreed-upon default event has in fact occurred in a particular transaction, and if so, the determination of exactly when the default occurred.

(7) The remedial phase analysis delineates what remedies are available to an aggrieved party following transactional breakdown. Additional general principles of law and equity, outside Article Nine, will be applicable, as well as the remedies within Article Nine. Issues including the manner in which collateral is taken, notice of sale and subsequent sale, availability of deficiency judgment, and remedies of subordinate creditors often arise in this phase.

An attorney must not only be aware of these seven legal phases of a secured transaction, but moreover, must understand the inter-relation of the seven phases. For example, for Secure Bank (in the above hypothetical) to have a right to take possession without judicial process of the 100 Oblet machine tools as against the trustee (an Article Nine remedy currently under attack), there must have occurred an earlier default event. Jones' non-payment of one installment due under the loan agreement would constitute a default event. The default makes available to Secure Bank the Article Nine remedies but only if Secure Bank's interest in the 100 Oblets is deemed to have priority over the trustee's interest under Section 9-301(1)(b) of the Code, applicable to the trustee via Section 70c of the Bankruptcy Act. Indeed, priority status often depends in part upon the secured party's having timely perfected its security interest. Secure Bank, you will recall, did file a financing statement (often required for perfection under Section 9-302). But perfection in part is predicated upon the security interest having properly attached under Section 9-303(1). Attachment requires that the se-

32. UCC § 1-103. "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions."
33. See UCC § 9-503.
34. See UCC § 9-504 and 9-505.
35. See UCC § 9-504(2).
36. See UCC § 9-504(1)(c) and 9-505(2).
security interest be enforceable which in turn requires that there be an agreement that the security interest attach, that value be given, and that the debtor have rights in the collateral, all as set out in Section 9-203(1). In the Jones' hypothetical, there was an agreement, value was given by Secure Bank, but did the debtor, Jones, at the time of the filing his bankruptcy petition have rights in the 100 Oblets which had not yet been shipped by K-C?

Indeed, the debtor's "rights-in-the-collateral" requirement for attachment may turn out to be the analytically dispositive issue in answering the bank officer's inquiries. For now, should one conclude that Jones did not have rights in the 100 Oblets at the time of the bankruptcy petition, then Secure Bank's security interest never became enforceable under Section 9-203(1), and thus did not attach under Section 9-203(2). It then follows that since perfection requires attachment, Secure Bank's security interest was not perfected at the moment of bankruptcy in the 100 Oblets. Consequently, Secure Bank's unperfected security interest under the Code would not give the Bank priority as against the trustee, a lien creditor under the rule of Section 9-301(1)(b). But we shall put the discussion hypothetical aside and come back to it later for a more detailed and precise analysis. The point to understand now is that to properly analyze problems involving secured financing, an attorney must be aware of the seven legal phases of the transaction and be cognizant, moreover, of the relationship of the seven phases to each other.

Let's go over this model once more in summary. An attorney in analyzing a secured transaction, must identify: (1) the secured transactions; (2) the parties to the transactions; (3) the type or types of collateral involved; (4) the kind of security interests which have arisen; and (5) any third-parties. Throughout this identification process, the appropriate Article Nine designations must be used. This identification analysis is crucial since the specific classification of the collateral along with the specific designation of the kind of security interest involved will indicate the applicable and specific Code rules regarding attachment, perfection and priority determination. After completing the identification analysis one should then proceed through the transactional phase analysis, that is, a review of the transaction through its seven distinct legal phases.
identification and phase analyses follow, in which the discussion hypothetical will be referred to from time to time.

**STEP ONE
IDENTIFICATION ANALYSIS**

1. Identify the secured transactions.

(a) **DISTINGUISH SECURITY FROM NON-SECURITY AGREEMENTS.** A “credit” or executory sales contract is not necessarily a secured (Article Nine) transaction even though covering identified, existing goods, and even though payment of the purchase price may not be due until a subsequent date.\(^\text{37}\) Article Nine applies to any transaction regardless of form *but only if it is intended to create a security interest* in personal property or fixtures.\(^\text{38}\) Thus, the intent of the parties in a particular transaction is determinative. A lawyer must look at a particular “agreement” (as defined in Section 1-201(3)) and ascertain if it is a “security agreement”—one which creates or provides for a security interest (as defined in Section 9-105(1)). A “security interest,” in turn (as defined in Section 1-201(37)), means “an interest in personal property or fixtures which secures payment or performance of an obligation. . . .”\(^\text{39}\)

Although a “credit” sale is not automatically a secured transaction, an agreement between buyer and seller that the seller retain a security interest in goods pending completion of a buyer’s payment obligation does establish an Article Nine security interest, one which the Code categorizes and labels as a purchase money security interest.\(^\text{40}\) Note also that the definition of a security interest includes the interest of a *buyer* of accounts or chattel paper in most cases, and the interest of

\(^{37}\) UCC §§ 2-102 and 2-105(1), (2).

\(^{38}\) UCC § 9-102. *See note 5, supra.*

\(^{39}\) The Code permits a security interest to be taken in personal property to secure a performance obligation other than payment. This often is illustrated by the “financing buyer” situation where, for example, a producer-grower obtains initial funds for seeds and fertilizer from a cannery in return for the grower’s promise to sell his crop to the cannery after harvest. The cannery (buyer) is the secured party; the grower (seller) is the debtor. The security interest is in the crop and secures the grower’s obligation to sell and convey the harvested crop to the cannery. For a discussion of financing farmers, *see* Note, *Secured Interests in Growing and Future Growing Crops under the Uniform Commercial Code,* 49 IOWA L. REV. 1269 (1964).

\(^{40}\) UCC § 9-107.
a lessor or consignor of personal property if a security interest is intended.\textsuperscript{41}

(b) IDENTIFY THE SECURED TRANSACTIONS CHRONOLOGICALLY IF A SERIES OF TRANSACTIONS ARE INVOLVED. A problem may incorporate a series of transactions—none, some or all of which may involve Article Nine security arrangements. Consider the following transactional chain:

Green Bank advances a sum of money to Red Department Store enabling Red Department Store (RDS) to finance a shipment of color TV's. Having over-estimated color TV demand for this particular season, RDS sells six of the color TV's to White Department Store (WDS), on credit, retaining an interest in the six TV sets to secure WDS's payment to RDS. WDS, in turn, sells one of these six sets to B, a consumer, on credit pursuant to a revolving-charge account agreement between B and WDS. B later sells his new color TV set to his neighbor, C, who pays cash. C subsequently goes to a finance company which lends C money on the color TV but which does not take possession of it. C, who owes money to his brother, D, gives the set to his brother D to hold until the debt is paid off.

In the above chain, there are six sale and/or credit transactions involving goods. Five of the transactions involve Article Nine security agreements. Only the cash sale to C is outside Article Nine, although within Article Two, which applies to sales of goods.

2. Identify the parties to the various transactions.

(a) IDENTIFY THE VARIOUS SECURED PARTIES. Article Nine defines a secured party as a lender, seller, or other person in whose favor there is a security interest, including a person to whom accounts or chattel paper have been sold.\textsuperscript{42} In the above transactional chain the secured parties include Green Bank, Red Department Store, White Department Store, the finance company and D. Neither B nor C are secured parties since no security interest runs in their favor.

\textsuperscript{41} UCC § 1-201(37).

\textsuperscript{42} UCC § 9-105(m).
(b) IDENTIFY THE VARIOUS DEBTORS. Every security arrangement includes at least two parties—the secured party and the debtor. A debtor is a person "... who owes payment or other performance of the obligation secured. ..." In credit-sales, the debtor typically is the purchaser, in loan situations, the borrower. In a chain of transactions a party may wear two Article Nine hats. Red Department Store, above, is the debtor under the inventory-financing arrangement with Green Bank, but is the secured party in the White Department Store "purchase money" secured transaction. Similarly, WDS is both a debtor (as to the RDS credit sale) and a secured party (as to the revolving charge, consumer-credit transaction with B).

(c) IDENTIFY ALL PARTIES INCLUDING THIRD PARTIES BY THEIR ARTICLE NINE DESIGNATIONS.

(i) Identify all buyers in ordinary course of business (BIOCOB). Note especially that a BIOCOB requires that the purchaser not only buy "in ordinary course" but must buy from a person in the business of selling goods of that kind. In short, a BIOCOB requires a SIOCOB, a seller in ordinary course of business, even though the latter phrase is not in the Code. This BIOCOB identification may be critical for subsequent priority determinations under the phase analysis.

---

43. UCC § 9-105. "... (d) 'Debtor' means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term 'debtor' means the owner of the collateral in any provision of the Article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires ... ."

44. UCC § 1-201. "... (9) 'Buyer in ordinary course of business' means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind. 'Buying' may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt. ... ."

45. The phrase "seller-in-the-ordinary-course of business" (SIOCOB) is not contained in the Code's definitional sections except to the extent that the section defining a buyer-in-the-ordinary-course refers to the SIOCOB.

46. See UCC § 9-307(1), (2), (3).
Identify any unsecured creditors. The Code contains no specific definition of an unsecured creditor except by way of negative inference. That is, an unsecured creditor of a debtor is one who does not have a security interest in specific collateral, nor is he one who qualifies as a lien creditor. Essentially, unsecured creditors are creditors having a chose in action against a debtor not secured by any interest in the debtor's collateral, and which chose in action has not yet been reduced to a judgment and executed upon.

Identify lien creditors. A lien creditor is a "... creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors ... and a trustee in bankruptcy ... or a receiver in equity. ..." 

Identify holders and holders-in-due-course of negotiable commercial paper. In addition to a written security agreement, the secured party may require a debtor to sign a promissory note (which may or may not be negotiable) obligating the debtor under the instrument to repay the loan on credit. Thus it becomes essential to trace the path of any commercial paper generated in a secured transaction and to determine the legal status of both the paper and of the subsequent possessors of the paper. Here, many of the core concepts of Article Three (Commercial Paper) bear directly upon the analysis and resolution of Article Nine security arrangements. These Arti-

47. UCC § 9-301(3).
48. Following a debtor's default on a payment obligation, an unsecured creditor in attempting to persuade the debtor to pay must not go so far as to commit the tort of "wrongful collection." The unsecured creditor's basic remedy is to proceed to obtain a "satisfied judgment." This means filing a complaint; perhaps obtaining a "writ of attachment" by filing bond and necessary affidavits; often winning a "default judgment," followed by seeking execution and levy. Throughout this judicial process, third party claims may arise. The basic path to a "satisfied judgment," as the "first principle of creditor rights" is a road with many turns and many dangers making uncertain the creditor's ultimate arrival at his destination of satisfied judgment. Often it is not worth the long and hazardous journey, and a creditor may detour to the relatively safe but less attractive village of Bad Debt Write Off.
49. UCC § 9-301(3). The priority of an Article Nine security interest over the claim of a lien creditor when the lien creditor's interest arose after the perfection of the Article Nine interest is implied by the language of UCC § 9-301(1)(b).
50. See UCC §§ 3-104 through 3-115. But see UCCC § 2.403 (negotiable instruments proscribed in consumer-credit sales).
Three concepts include negotiability, negotiation, holder-in-due-course, primary liability, and signature liability. A holder-in-due-course (HDC) is defined in Section 3-302 as "... a holder who takes the instrument for value; and in good faith; and without notice that it is overdue or has been dishonored or of any defense against a claim to it on the part of any person." Identification of HDC status, the key legal principle of Article Three, is crucial since the rights of a HDC as set out in Section 3-305 often operate to cut off the rights of prior holders or makers, at least as to the obligations evidenced by the instrument itself (even though defenses under the security agreement may still exist).

(v) Identify all holders of documents of title. A common secured financing method is the field warehouse arrangement whereby collateral of a debtor is pledged or segregated in a field warehouse under the control of a third-party bailee or warehouseman. The holders of documents of title issued by the warehouseman (specifically, warehouse receipts) must be identified. Here, Article Seven (Documents of Title) becomes applicable. Warehousemen must be identified as well as holders of negotiable warehouse receipts who took the documents "by due negotiation." Note that not all warehousing

51. See UCC §§ 3-104 through 3-115.
52. See UCC § 3-202.
53. See UCC §§ 3-302 and 3-305.
54. See UCC §§ 3-401, 3-410, 3-411, 3-413, and 3-501.
55. See UCC §§ 3-401 through 3-407.
56. See UCC § 9-206 and UCCC § 2.404.
57. UCC § 7-102. "(1) In this Article, unless the context otherwise requires: (a) Bailee” means the person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them. (h) ‘Warehouseman’ is a person engaged in the business of storing goods for hire. . . .”
58. UCC § 1-201. “. . . (45) ‘Warehouse receipt’ means a receipt issued by a person engaged in the business of storing goods for hire. . . .” See also UCC §§ 7-102(1)(g) (definition of “issuer”); 7-104(1) (definition of negotiable warehouse receipt); 7-202 (form of warehouse receipt including necessary terms). For a discussion of warehousing as a security device, see 1 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 146-96 (1965).
59. UCC § 7-501. “. . . (4) A negotiable document of title is ‘duly negotiated’ when it is negotiated in the manner stated in this section to a holder who purchases it in good faith without notice of any defense against or claim to it on the part of any person and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a money obligation. . . .” See also UCC
Arrangements necessarily involve security interests. "Terminal warehouses" usually are repositories for storage, and basically the arrangement is a bailment between the depositor-owner of the goods and the warehouseman (bailee).60 Warehouse receipts issued by a terminal warehouseman pursuant to a storage agreement, however, may be subsequently "pledged" to third parties (e.g., a bank) to raise capital. In such an event, the storage bailment becomes part of a security arrangement within the purview of Article Nine in addition to being within the scope of Article Seven.61

(vi) Identify all merchants. Finally, an attorney should note whether any merchants are involved in a security arrangement. A merchant is a person "... who deals in goods of the kind ... or otherwise holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction. ..."62 There are two reasons why the merchant status might be important in the later phase analysis. First, the Code imposes a specially defined obligation of good faith in the case of merchants: "'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."63 This merchant good-faith standard is more specific and arguably imposes stricter standards than imposed under the general good-faith obligation as defined in Article One: "'Good faith' means honesty in fact in the conduct of the transaction involved."64 Secondly, recognition of the merchant-seller status often will be useful in identifying buyers in ordinary course—an important identification since Biocob's often cut off prior security interests in the purchased collateral.65
3. Identify and classify the collateral for each secured transaction by type.

(a) **COLLATERAL MAY BE GOODS.** Collateral refers to personal property or fixtures subject to a security interest.\(^\text{66}\) Goods as one form of collateral include all things movable at the time the security interest attaches.\(^\text{67}\) The Code divides "goods" into six sub-divisions: first, *consumer goods* which are goods used or bought primarily for "personal, family or household purposes;"\(^\text{68}\) second, *equipment* or goods used or bought for use primarily in business and goods not otherwise classified as inventory, farm products or consumer goods;\(^\text{69}\) third, *farm products*, crops, livestock, or supplies which are used or produced in farming operations if in possession of a debtor engaged in farming operations;\(^\text{70}\) fourth, *inventory*, or goods held for sale or lease or to be furnished under service contracts, or goods in the form of raw materials, work in process or materials used or consumed in business;\(^\text{71}\) fifth, *fixtures*, which are recognized under the Code but the definition of which is explicitly left for state law determination;\(^\text{72}\) and sixth, *accessions*, or goods installed or affixed to other goods.\(^\text{73}\)

(b) **COLLATERAL MAY BE ACCOUNTS OR GENERAL INTANGIBLES.**

(i) An *account* is defined as "... any right to payment for goods sold or leased or for services rendered which is not evidenced by an

\(^{66}\) UCC § 9-105(1)(c).

\(^{67}\) UCC § 9-105. "(1) In this Article unless the context otherwise requires: . . . (h) 'Goods' include all things which are movable at the time the security interest attaches or which are fixtures (Section 9-313), but does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like (including oil and gas) before extraction. 'Goods' also includes standing timber which is to be cut and removed under a conveyance or contract for sale, the unborn young of animals, and growing crops . . . ."

\(^{68}\) UCC § 9-109(1).

\(^{69}\) UCC § 9-109(2).

\(^{70}\) UCC § 9-109. "Goods are: . . . (3) 'farm products' if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory . . . ."

\(^{71}\) UCC § 9-109(4).

\(^{72}\) UCC § 9-313(1)(a).

\(^{73}\) UCC § 9-314(1).
instrument or chattel paper, whether or not it is earned by performance.”

In identifying accounts which serve as collateral under a particular security agreement, the attorney should also identify the “account debtors” or the persons obligated under the accounts.

Typically, account debtors are credit purchasers of goods. In these situations, the principal debtor sells inventory items which are subject to a prior security interest held by the debtor’s “floor financier.” The sale of items of collateral in floor financing is usually authorized in the original security agreement.

Consider the following hypothetical. New Bank finances the inventory of Grants Department Store by advancing the cost of new inventory and securing repayment by retaining a security interest in Grants’ “inventory and proceeds whenever acquired.” Inventory purchased by Grants selling inventory items on credit to customers, New Bank’s security interest in the items sold will likely be cut off by Section 9-307(1), but there will arise an account (Section 9-106) in which a security interest in behalf of New Bank is automatically created under Section 9-306(2). The credit purchasers of Grants’ inventory items are the account debtors (Section 9-105(1)(a)), and although the bank’s security interest in the inventory items themselves may have been extinguished upon sale, its security interest “shifts” to the accounts which arise out of the sale. Upon Grants’ default, New Bank may collect the payments due Grants from existing account debtors.

74. UCC § 9-106. “‘General intangibles’ means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, and money. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts. . . .”

75. UCC § 9-105(1)(a).

76. See UCC § 9-306(2).

77. UCC § 9-307. “(1) A buyer in the ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence. . . .” This section applies primarily to inventory (in the hands of the seller) as defined in UCC § 9-109. Thus, a consumer purchasing an automobile from a dealer which has financed its entire inventory under a floor-plan arrangement is protected by the above section since the automobile in the seller-dealer's hands is inventory (although it becomes a consumer good in the hands of the buyer).

78. UCC § 9-502.
Prior to the 1972 revisions of Article Nine, a separate category of collateral, "contract right," was recognized. Pre-1972 versions of Article Nine defined a contract right as any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper.\(^7\) This definition appeared to limit "contract rights" to rights to payment while the contract remained executory. For example, under a building contract, an advance due a contractor prior to performance was considered a contract right in behalf of the contractor. The balance due the contractor following completion of his performance, however, became either an account or a general intangible. It was no longer a "contract right" since the right to payment had been earned. The distinction between a contract right and a general intangible, for example, would often be important under pre-1972 versions of Article Nine in ascertaining the correct state in which to file a financing statement to properly perfect a security interest under the pre-revised rules of Section 9-103 (dealing with multi-state transactions). Because of the difficulties of determining in many situations whether specific collateral was a contract right, or an account or a general intangible, the Permanent Editorial Board elected to delete the "contract right" classification entirely from the 1972 Official Text of Article Nine.\(^8\) Under the 1972 revisions, consequently, there should not be any confusion in ascertaining the "type" of collateral involving "performance" obligations.

(ii) A general intangible is defined as personal property including a chose in action other than goods, accounts, chattel paper, documents, instruments or money.\(^9\)

---

79. UCC § 9-106 (prior to the 1972 revision). See also, In re Varney Wood Products, Inc., 458 F.2d 435 (4th Cir. 1972) (questions of whether term "accounts receivable" in a financing statement covered accounts and contract rights as defined by the parties' security agreement).

80. The 1972 Official Text of UCC § 9-106 deletes the "contract right" definition, and now reads: "'Account' means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance. . . ." (emphasis added)

81. UCC § 9-106. The comment to this section indicates that the term "general intangibles" includes miscellaneous types of contractual rights or personal property which are used or may become customarily used as commercial security. Examples listed in the comment include: goodwill, literary rights, rights to performance, copyrights, trademarks and patents. See also Coogan, Intangibles As Collateral Under the Uniform Commercial Code, 77 Harv. L. Rev. 997 (1964).
(c) COLLATERAL MAY BE CHATTEL PAPER. One of the more widely used forms of commercial paper subject to Article Nine is chattel paper. The Code defines chattel paper as a writing or writings which evidence both a monetary obligation and a security interest in or lease of specific goods.\(^8\) Moreover, when a transaction is evidenced both by such a security agreement and by an instrument or instruments, the group of writings together constitutes chattel paper.\(^8\) Thus, retail installment contracts or chattel mortgages or conditional sales contracts, along with accompanying promissory notes, represent typical chattel paper. Remember that Article Nine applies not only to pledges of chattel paper as security but also to the sale of chattel paper.\(^8\)

(d) COLLATERAL MAY BE INSTRUMENTS. Article Nine defines an instrument as a negotiable instrument (in turn defined in Article Three),\(^8\) or a security (defined in Article Eight),\(^8\) or any other writing which evidences a right to payment of money, and which in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment.\(^8\)

Typically, the security arrangements utilizing instruments will involve “notes” which may or may not be independently negotiable.\(^8\) Instruments may be pledged for security or discounted for cash through “negotiation” provided the instruments meet the form requirements to be negotiable.\(^8\) Moreover, instruments may take the

\(^{82}\) UCC § 9-105(1)(b).
\(^{83}\) See UCC §§ 9-304(1) and 9-305.
\(^{84}\) UCC § 9-102(1)(b).
\(^{85}\) See UCC § 3-104(1).
\(^{86}\) See UCC § 8-102.
\(^{87}\) UCC § 9-105(1)(i).
\(^{88}\) See UCC § 3-104(1).

\(^{89}\) One of the difficulties encountered in attempting to determine whether the Section 3-104(1) prerequisites for negotiability have been satisfied centers around the requirement of an “unconditional promise to pay.” If the promise to pay on the face of the instrument indicates that it is conditional upon another party’s performance, then the instrument is non-negotiable although probably assignable. For example, UCC § 3-105(2) explicitly provides that a promise is conditional if the instrument states that it is “subject to” another agreement or is to be “governed by” a security agreement. On the other hand, UCC § 3-105(1)(b) provides that a promise is unconditional even though it states the promise is made in accordance with, as per, or pursuant to a separate transaction. Most so-called “long form” collateral promissory notes are non-negotiable because they do not satisfy the “unconditional promise” requirement of UCC §§ 3-104 and 3-105. See
form of original collateral (pledged for value) or take the form of derivative collateral, that is, as a form of proceeds arising from the sale or conversion of the original collateral.

(e) **COLLATERAL MAY BE DOCUMENTS OF TITLE.** Documents of title include warehouse receipts and bills of lading. To be a document of title, the document "... must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession...."91

For collateral purposes, warehouse receipts (receipts issued by a person engaged in the business of storing goods for hire)92 constitute the most widely used form of "documentary" security. Whenever warehouse receipts are pledged or assigned for the purpose of raising capital, the arrangement immediately involves three parties—the debtor (bailor), the secured party (usually holder of documents) and the warehouseman (the bailee—issuer of the documents). To analyze the respective rights and obligations of these three parties (as well as the rights of other possible holders of the documents and of the purchasers of the goods covered thereby) an attorney must be familiar with various provisions of Article Seven (Documents of Title).

(f) **COLLATERAL MAY BE PROCEEDS OF COLLATERAL.** "Proceeds" includes whatever is received when collateral or proceeds is sold or otherwise disposed of.93 Therefore, proceeds may include cash, accounts, instruments including checks and notes, documents, chattel paper, or other goods (when exchanged). A security interest

---

90. UCC § 1-201(15).
91. UCC § 1-201(15). See also UCC §§ 7-102(1)(a) (definition of a "bailee"); 7-102(1)(g) (definition of "issuer"); 7-102(1)(h) (definition of a "warehouseman"); 7-104 (requirements for a document of title to be negotiable).
92. UCC § 1-201(45).
93. UCC § 9-306. "(1) 'Proceeds' includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Money, checks, deposit accounts, and the like are 'cash proceeds.' All other proceeds are 'non-cash proceeds.'"
can be created in the security agreement to cover not only particular types of collateral but also to attach to any proceeds derived from the disposition of the "original" collateral (or derived from the disposition of proceeds themselves).94

(g) COLLATERAL MAY BE AFTER-ACQUIRED PROPERTY. Proceeds (as a permissible form of collateral) coupled with the Code's authorization that a security interest may attach to property subsequently acquired by the debtor together produce one of the more important innovations of Article Nine, the "floating lien." The floating lien validation permits a secured party to maintain a perfected security interest in a constantly changing mass of collateral and proceeds by a single act of creation and by a single filing.

The commercial importance of the legally sanctioned floating lien should not be underestimated.95 Nearly all inventory financing as well as a large percentage of consumer financing depend on the legal validity of the floating lien. The Code in permitting a security interest to automatically attach to after-acquired property of a debtor, and also permitting future advances without re-perfecting, obviate the burdensome and complex procedures required in pre-Article Nine inventory financing under the Uniform Trust Receipts Act.96

Thus, it is significant that the Code, although not specifically referring to a floating lien by that name (except in the Comments) does provide for the "changing mass" security interest.97 Section 9-204 explicitly authorizes a security agreement to cover after-ac-

94. UCC § 9-306(3) and (4).
95. UCC § 9-306(3). The level of inventory financing would arguably be at a considerably lower amount but for the legally sanctioned floating lien.
96. Following promulgation of the Uniform Trust Receipts Act in 1933, "cross-security" clauses became common. The clause provided that goods covered by the trust receipt would secure not only theadvance made against them but also any other obligations of the trustee (debtor) to this entruster (secured party). See 1 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 124-26 (1965). The cross-collateral clause is only one attribute of the modern day floating lien which goes far beyond the trust receipt practice of pre-Article Nine time. For a discussion of the development of floating liens see Gilmore, supra, at 26-46, 250-85, and especially 354-64.
97. UCC §§ 9-108, 9-204, 9-205. For discussions of the floating lien's commercial importance, see Stroh, Reduction of Lending Risks in Inventory Financing, 31 Mo. L. REV. 209 (1966); and Coogan and Bok, The Impact of Article Nine of the UCC on the Corporate Indenture, 69 YALE L. J. 203 (1959) (comparing the Article Nine floating lien to the English floating charge).
quired collateral, as well as permitting future advances to be made. Section 9-205 in effect repudiates the rule of *Benedict v. Ratner*, in which the Supreme Court (in an opinion written by Mr. Justice Brandeis) held a floating lien situation invalid under common law because the debtor had control to use and dispose of the collateral. Indeed, the Permanent Editorial Board's comment to Section 9-205 states that Article Nine validates the "floating lien on a shifting stock," and thus repudiates the *Benedict v. Ratner* policing rule.

4. Identify the type of Article Nine security interest which arises in each transaction. Having designated in Article Nine terminology the secured transactions, the parties to the various transactions (including third parties) and the types of collateral under the transactions, an attorney reaches the final step in the identification analysis—the distinguishing of the "kinds" of security interests involved. Article Nine places security interests into three categories: possessory security interests; purchase money security interests; and all others, or, non-possessory and non-purchase money security interests.

---

98. UCC § 9-204. "(1) Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral. . . . (3) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment (subsection (1) of Section 9-105)."

99. 268 U.S. 353 (1925). For a discussion of *Benedict v. Ratner* and its significance in the evolution of accounts receivable financing, see 1 Gilmore, SECURITY INTERESTS IN PERSONAL PROPERTY 250-86 (1965). In the *Benedict* case, a creditor (Ratner) loaned a sum of money to a carpet company which assigned over to the creditor all of the debtor's present and future accounts receivable. Subsequently, lists of the accounts, the amounts and the account debtors, were periodically delivered to the creditor while the carpet company (debtor) continued to collect the accounts and use the proceeds so collected. The debtor in time became insolvent and Benedict was appointed receiver. Ratner petitioned in the bankruptcy proceedings that proceeds of the accounts receivable be paid to Ratner to satisfy the loan indebtedness. Mr. Justice Brandeis wrote: "... a transfer of property which reserves to the transferor the right to dispose of the same or to apply the proceeds thereof, for his own uses is, as to creditors, fraudulent in law and void." 268 U.S. 353 at 360.

100. UCC § 9-205. "A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. . . ."
(a) **Identify pledge or possessory security interests.** In possessory-security arrangements, the secured party has retained or taken possession of the collateral. A field warehousing arrangement, on the other hand, creates a quasi-possessory security interest, since a warehouseman has possession of the collateral.

(b) **Identify any purchase money security interests.**

(i) **Identify all seller's PMSI's.** A seller's purchase money security interest (PMSI) is one taken or retained by the seller of the collateral to secure all or part of its price. Consequently, virtually all consumer-credit sales incorporating (or pursuant to) a security agreement (for example, a revolving charge account) constitute sellers' PMSI's as defined by Section 9-107(a).

(ii) **Identify all non-seller's PMSI's.** A non-seller's purchase money security interest is one taken by a secured party who gives value to enable a debtor to acquire rights in (or the use of) collateral if such value is in fact so used. This common security interest is typified by a loan to a commercial enterprise enabling the business to acquire new inventory or equipment. Note that the loan must be used to purchase the collateral. To be sure an advance is so used, a lawyer should advise a lending client to pay loan funds directly to a debtor's supplier.

Recall the Jones-Secure Bank hypothetical set out earlier. Jones desired new inventory but K-C, Jones' supplier, would not sell on credit. Jones thus procured a loan from Secure Bank secured in part by the existing inventory and proceeds, but also secured in part

---

101. See UCC § 9-203(1)(a) and § 9-305. The Code's "possessory security interest" is an outgrowth of the common law pledge. Today's economy has limited use for the pledge since by putting the collateral in the possession of the secured party it is removed from the stream of commerce and thus its utility is diminished. See Spivack, Secured Transactions 78-79 (1963).

102. The lender's security in warehouse arrangements consists of his rights in the goods represented by the warehouse receipts backed up by rights against the warehouseman for non-delivery or mis-delivery under UCC § 7-403(1). See also Spiedel, Summers & White, Teaching Materials on Commercial Transactions 158-59 (1969).

103. UCC § 9-107. "A security interest is a 'purchase money security interest' to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used."

104. See Comment 2 to UCC § 9-107.
by new inventory to be acquired with the loan funds advanced by Secure Bank. Jones used $10,000 of the Secure loan to purchase 100 Oblet Machine Tools from K-C. Thus, assuming that the Oblets had in fact arrived at Jones’ warehouse, Secure Bank would have a non-seller's purchase money security interest in the 100 Oblets, since Secure’s funds were actually used to enable the debtor, Jones, to acquire new collateral.\(^\text{105}\)

(c) IDENTIFY ALL OTHER SECURITY INTERESTS BY TYPES OF COLLATERAL. Finally, identify all other security interests by type of collateral: for example, Johnson Finance Company's security interest in a consumer good (automobile used by a family); or Johnson Finance Company's security interest in equipment (automobile used by a taxi company), thus completing the identification analysis model.

PART TWO

PHASE ANALYSIS

1. Determine the validity and enforceability of each security interest as well as the validity of any supporting documents or instruments.

(a) DETERMINE THE VALIDITY OF THE SECURITY AGREEMENTS. A security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors.\(^\text{106}\) Freedom of contract is the rule rather than the exception. No particular language or form is essential so long as the security intent is evidenced.\(^\text{107}\) Although freedom of contract is the rule there are exceptions.\(^\text{108}\)

(b) DETERMINE WHETHER THE SECURITY AGREEMENT IS ENFORCEABLE. A valid security agreement is unenforceable against

\(^{105}\) UCC § 9-107(b).

\(^{106}\) UCC § 9-201.

\(^{107}\) UCC § 1-201(37).

\(^{108}\) The UCC § 9-501 Comment 4 indicates that the limitation on freedom of contract codifies a "... long standing and deeply rooted attitude: the specified rights of the debtor and duties of the secured party may not be waived or varied except as stated." Limitations in the Code include: UCC §§ 1-202(3) which denies the parties' freedom to disclaim their good faith obligation; and 9-501(3) which limits parties' freedom to alter certain rights and remedies of the parties following a debtor's default.
the debtor unless it complies with the "modified" statute of frauds rule of Article Nine. Under the 1972 revisions to Article Nine, the concepts of enforceability and attachment have been virtually equated. The requirements for creating an enforceable non-possessory security interest are kept to a minimum. Specifically, the agreement will be unenforceable unless: (1) the debtor has signed an agreement containing a description of the collateral (and in certain cases, a description of land upon or in which collateral such as crops, timber, minerals, oil or gas are to be found); (2) value has been given; and (3) the debtor has rights in the collateral. Even the description of the collateral requirement is non-burdensome since a description is sufficient if it "... reasonably identifies what is described."

This reasonable identity test will on occasion call for a narrow, specific description (for example, when the collateral consists of a single automobile in a dealer's showroom), while under other circumstances it will permit a general description (for example, when the collateral consists of all the equipment used by a debtor in a manufacturing process).

Incidentally, in the case of possessory security arrangements—where the secured party has possession of the collateral pursuant to an agreement—no writing is required to make the agreement enforceable, on the theory that the secured party's possession is evi-dentiary of the parties' security relationship. A warning for trans-actional planners: Even though the Code sets out minimal formal writing requirements for a security interest to be enforceable, good preventive law requires thorough, explicit and well-thought-out drafting

---

109. UCC § 9-203. "(1) Subject to the provisions of Section 4-208 on the security interest of a collecting bank and Section 9-113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless
(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned; and
(b) value has been given; and
(c) the debtor has rights in the collateral.
(2) A security 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 (1) have taken place. . . ."

110. UCC § 9-110. "For purposes of this Article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described."
of all the important elements of the agreement to mitigate against the possibility of later "interpretation" disputes arising between the parties.\textsuperscript{111}

\textbf{(c) DETERMINE THE VALIDITY AND POSSIBLE NEGOTIABILITY OF SUPPORTING DOCUMENTS AND INSTRUMENTS.} An attorney must review all supporting documents to ascertain conformity with the minimal formal requisites prescribed by the Code. For example, a promissory note to be negotiable must satisfy the requisite formalities of a negotiable instrument set out in Section 3-104. In turn, Section 3-104 leads to a review of Sections 3-105 through 3-112 which explain in greater detail the negotiability requisites. Similarly, in the case of a document of title in the form of a warehouse receipt, an attorney must check to see if all the significant terms have been included.\textsuperscript{112}

\textbf{(d) DETERMINE WHETHER ISSUES OF BAD FAITH, FRAUD, OR UNCONSCIONABILITY AROSE AT OR BEFORE THE CREATION PHASE.} Even though the security agreement and supporting documents or instruments appear on their face to be valid and enforceable, a debtor nonetheless may have legal defenses available against the secured party. For example, if a secured party who is a merchant failed to observe a "reasonable commercial standard of fair dealing" in his trade (to wit, a used car dealer who turned back the odometer), then the Section 2-103(1)(b) good faith standard is violated and presumably the debtor-purchaser could seek a rescission or other equitable remedies.\textsuperscript{113}

In addition, a security agreement (particularly a sales-related agreement) is within the purview of Section 2-302, dealing with unconscionable contracts or clauses. This limitation on private autonomy principle permits a court certain discretion in deciding whether to refuse to enforce particular agreements.\textsuperscript{114}

\textsuperscript{111} See Dickerson, Fundamentals of Legal Drafting (1965); and Mandel, The Preparation of Commercial Agreements (1968).

\textsuperscript{112} UCC § 7-202 provides that a warehouse receipt need not be in any particular form but goes on to list various terms the omission of which might make a warehouseman liable.

\textsuperscript{113} See UCC § 1-103.

\textsuperscript{114} UCC § 2-302. "(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract
2. Determine if and when each security interested attached. "Attachment" of the security interest is a legal event which is a prerequisite to "perfection" and which must occur before a secured party has a legally recognizable interest in the debtor's collateral. Attachment occurs when the security interest becomes enforceable under Section 9-203. There are three requirements: first, a security agreement (evidenced by a writing signed by the debtor in non-possessory arrangements); second, that the secured party give value, and third, that the debtor have rights in the collateral.

Let's return to the Jones-Secure Bank hypothetical. Having completed the identification analysis, an attorney should review the enabling agreements and supporting documents to ascertain their validity and enforceability. Assuming the form requirements of revised Section 9-203 have been complied with, the attorney next should determine if and when the security interest of the Bank actually attached in the various forms of collateral covered by the security agreement.

Applying the revised Section 9-203 attachment checklist, one notes that there has been a signed agreement as defined in Section 1-201 (3). Secure Bank's commitment to advance $15,000 constitutes the giving of value under Section 1-201(44)(a). Finally, an attorney must determine if the final requirement of Section 9-203 for attachment is satisfied, to wit, whether the debtor "has rights in the collateral."

As to the equipment, inventory and accounts on hand on the day of Jones' default, Jones certainly had "rights in" those items of the collateral; but how about the 100 Oblet Machine Tools which K-C has manufactured but which have not been shipped to Jones? Jones never had any "possessory" interest in the Oblets. But recall that Jones had expended a portion of Secure Bank's loan to pay K-C in advance for the Oblets. The question becomes whether Article Nine's provisions help in determining when a debtor-purchaser of collateral has rights in the collateral purchased.

Former Section 9-204, subsections (2) and (4) indicated certain circumstances when a debtor has rights in the collateral, but a scan

without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result. . . ."

115. UCC § 1-201(44).
of those former sections indicates that they are not helpful in determining whether Jones at the time of his default had "rights in" the 100 Oblets which he never received. Moreover, those subsections have been deleted in the 1972 revised Section 9-204. The only other Article Nine section which appears applicable is Section 9-202 labeled "Title to Collateral Immaterial." The thrust of this section is that the concept of title in personal property is not to be an operative decisional standard in secured financing. In short, Article Nine sets out the test in Section 9-203(1), but does not include standards for applying the test. Thus, other articles of the Code may be helpful. We will return to the solution later. For now, we return to the analytic model.

3. Determine if, how and when each security interest became perfected. Perfection of an Article Nine security interest is critical to a secured party who wants to increase potential rights in the debtor's collateral as against other creditors of the debtor. In most cases, perfection requires attachment plus some additional step—either the secured party taking possession of the collateral, or the filing of a financing statement. Section 9-303(1) is the Code's basic rule of perfection requiring attachment plus an additional step. The "correct" method of perfecting a security interest turns on the type of collateral and kind of security interest involved. Knowing the type and kind of security interest, one's determination of the specific perfection rules becomes an easy process.

(a) Determine the sufficiency of any financing statements. In those instances where perfection of the security interest was attempted by the filing of a financing statement, the first question

---

116. Perfection of a security interest in goods, instruments, negotiable documents, chattel paper and letters or advices of credit may occur upon attachment, UCC § 9-203(1), (2), and upon a secured party's taking possession of the collateral. See UCC § 9-305. In the case of a security interest in money or instruments (other than instruments constituting part of chattel paper), it can only be perfected by the secured party taking possession. A security interest of a credit seller of consumer goods in goods sold is automatically perfected by attachment alone. See UCC §§ 9-302(1)(d) and 9-107(a).

117. UCC § 9-303. "(1) A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9-302, 9-304, 9-305 and 9-306. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches. . . ."
should be whether the purported statement satisfies the minimal form requirements of revised Section 9-402. A financing statement satisfies the sufficiency test if the statement: (1) is signed by the debtor; (2) contains the name and address of the secured party; (3) contains the debtor's mailing address; and (4) contains a description of or reference to the collateral by types or items. The earlier version of Section 9-402 required both the debtor and the secured party's signatures, but the 1972 Amendments have obviated the necessity that the secured party sign the financing statement.

Note that a financing statement and a security agreement are two legally distinct documents. On the other hand, a particular "form" may satisfy both the revised Section 9-203 requirements regarding a security agreement and revised Section 9-402 requirements for a financing statement and thus, serve both functions.118 Good drafting, however, in most circumstances would demand the drafting of distinct documents since the security agreement defines the obligations while the financing statement serves primarily as notice to third parties of the financing relationship.

(b) DETERMINE THE SUFFICIENCY OF THE FINANCING-STATEMENT FILING. If perfection requires filing, not only must the financing statement contain sufficient data under the revised Section 9-402 guidelines, the statement also must be properly filed in the correct location or locations. If the secured transaction has interstate aspects (called by the Code a "multi-state transaction"), an attorney must consult Article Nine's limited conflict-of-laws rules to determine which state is the proper state in which to perfect a security interest. The rules, set out in revised Section 9-103, turn on the classification of collateral involved. Having determined by application of Section 9-103 which state's law of perfection governs, an attorney must then consult that state's version of Section 9-401 so as to determine where within that state to file in order to properly perfect the security interest. Many problems can arise due to the failure to file in the proper location(s) within a state.119

118. See UCC § 9-402(1).
119. See, for example, In re Plonta, Inc., 311 F.2d 44 (6th Cir. 1962) (failure to file in all places required resulted in a failure to perfect a security interest as against gap creditors the rights of whom are subrogated to a trustee in bankruptcy under § 70C of the Bankruptcy Act); and In re Babcock Box Co., Inc., 200 F.
4. Determine the priority of creditor claims among (or between) claimants. When two or more creditors of a particular debtor assert rights in the same collateral, to satisfy underlying claims against the debtor, a conflict results. The conflict is resolved by applying Article Nine's usually precise rules of priority. Priority status is not only the heart of Article Nine, it may be the very rationale for "secured" financing. It is in the priority determination area that Article Nine appears most perplexing. No fewer than twenty detailed provisions may bear on the issue. To memorize these intricate rules would take considerable effort. There is, however, a procedure which permits a lawyer to work through the priority rules with relative ease, without "memorizing" the jigsaw-puzzle rules.

An attorney should look first at revised Section 9-312(1). This section incorporates by reference other specific priority rules.120 Having gone through the checklist and, for example, having concluded that none of the incorporated by reference rules are applicable, an attorney should next look at revised Section 9-312(5), a section described as the "residual" Article Nine priority rule.121

Revised Section 9-312(5) (a) and (b) provide that in all cases not governed by the other Section 9-312 rules (including the list of sections incorporated by reference into revised Section 9-312(1)), priority between conflicting security interests in the same collateral shall be determined first, by the time of filing or perfection if one or both are perfected regardless of which attached first, or second, by the order of attachment if neither interest is perfected. The rules of Section 9-312(5) have been altered by the 1972 amendments; yet its significance remains unchanged. For it is still a residual rule. It applies only when none of the other specific priority rules apply.

Supp. 80 (D. Mass. 1961) (failure to file locally, thus a failure to perfect before bankruptcy, the trustee having priority under § 70C of the Bankruptcy Act).

120. UCC § 9-312(1) refers to § 4-208 (security interests of collecting banks); § 9-301 (security interests of certain lien creditors); § 9-306 (security interests in proceeds); § 9-307 (applying to purchasers of goods); § 9-308 (applying to purchasers of chattel paper and instruments); § 9-309 (applying to purchasers or holders of documents and instruments); § 9-310 (applying to liens by operation of law); § 9-313 (applying to security interests in fixtures); § 9-314 (applying to security interests in accessions); § 9-315 (applying to commingled or processed goods); and § 9-316 (applying to contractual subordinations). Revised Section 9-312 also includes a special priority rule as to interests in crops taken to finance a farmer's growing crops.

121. See 2 Gilmore, SECURITY INTERESTS IN PERSONAL PROPERTY (1965).
For example, after determining that none of the other Section 9-312 or other Part Three, Article Nine priority rules apply to the determination in question, an attorney only then may conclude that the residual rules of revised Section 9-312(5) apply.  

5. **Determine whether any events of default have occurred.** Before a secured party can move against the collateral, legally or extra-legally, a default event must have taken place. What factual occurrences will constitute default under a security arrangement depends on the parties' initial understanding as evidenced by the default clauses (if any) set out in the written agreement. Probably the most common default event is non-payment of the price, loan, advance or installment when due.

In addition to non-payment, the parties may have agreed that default would occur, for example, upon: (1) the debtor's insolvency; (2) non-maintenance of an agreed-upon collateral-to-loan ratio; (3) the attachment of third-party liens or encumbrances to the collateral; (4) the improper care and preservation of the collateral; (5) the unauthorized sale or conversion of the collateral; or (6) the uninsured loss or theft of collateral.

Recall for a moment the Jones-Secure Bank hypothetical. Jones' non-payment of an installment due under the loan repayment schedule constituted a default under the security agreement. Even if Jones had remained current, however, the security agreement may

---

122. The problem area in priorities has been resolved by the 1972 revisions—the priority in proceeds of a purchase money security interest in inventory. Former Section 9-312(1) referred to Section 9-306 (dealing with proceeds) as a rule of priority. But a reading of former Section 9-306(3) suggested that it was a rule of perfection only. Commentators were divided as to whether former Section 9-306(3) or former Section 9-312(5) controlled in a priority determination involving proceeds. In a few cases it would have made a difference. The new revisions, however, clearly indicate the exact situations in which priority as to the original collateral continue in the proceeds derived thereof. See Speidel, **Teaching Notes for Commercial Transaction Teaching Materials** 34 (1969). See also Davenport and Henson, **Secured Transactions II** 99 (1966). Professors Speidel, Summers, and White note that while a few commentators argued that Section 9-306 is a priority provision in addition to a perfection provision, Professors Gilmore and Kripke argued that Section 9-306(3) is a perfection-only provision.

123. See Note, **Inventory**, 40 TUL. L. REV. 875 (1966); and Roth, **Auditing Floating Liens Created by the Uniform Commercial Code**, 35 N.Y.C.P.A. 167 (1965); and Stroh, ** Reduction of Lending Risks in Inventory Financing**, 31 Mo. L. REV. 209 (1966).
have provided that the debtor's filing of a bankruptcy petition constituted a default event.

Even a carefully drafted default clause may present problems. Consider the following provision contained in the hypothetical security agreement creating a security interest in a motor vehicle:

Any alteration, painting, structural change, accession or body tampering, regardless of who performs or causes to be performed the same, is a default event under this agreement on the part of the debtor should any such alteration, painting, structural change, accession or body tampering have the effect of depreciating the resale value of the subject motor vehicle in an amount greater than that resulting from normal use and passage of time.

Peace and Joy, two young people, purchased a used van under a retail installment contract containing the above default clause. They proceeded to paint flowers and ecology symbols on the van. Has a default occurred? The difficulty in answering the question results from the uncertainty of the "economic impact" of Peace and Joy's artistic tamperings. Although the value of the van would be lower for many potential buyers, contemporaries of Peace and Joy—the "Consciousness Free Van Set"—might be expected to pay more for the van in its newly painted condition. The obvious point is that the above rather standard but elaborately drafted default clause might still result in problems of interpretation in certain circumstances.

6. Determine what remedies are available to the respective parties following a transactional breakdown. For transactional planning, an attorney must attempt to structure a secured financing arrangement to minimize opportunities for breakdown while providing maximum remedies should the transaction nonetheless fall apart. "Preventive law" requires a knowledge of remedies before commercial dealings develop problems.

(a) Determine what remedies are available to a secured party having a priority security interest in specific collateral. The Code's remedies (with one exception)\(^\text{124}\) available to a secured party following a debtor's default are set out in Part Five of Article Nine. These remedies and procedures may be supplemented by provisions in the security agreement. Note, however, that although freedom of contract applies to remedies, Section

\(^{124}\) See UCC § 9-207 (rights of a secured party in possession of the collateral).
9-501(3) expressly limits the parties freedom to alter by agreement: (1) the debtor's Article Nine rights; (2) the rights of subordinate creditors; or (3) the duties imposed on the secured party as set out in detail in subsequent sections of Part Five of Article Nine. This section does, however, permit parties by agreement to determine the standards by which the rights (which cannot be varied) may be fulfilled. In spite of specific duties which cannot be varied by agreement, supplemental and not inconsistent remedies in the security agreement, are permitted. For example, the parties may incorporate a liquidated damage provision in the agreement, or a clause obligating the debtor following default to collect the collateral and make it available to the secured party.

After reviewing the security agreement, an attorney should review the detailed remedy provisions of Article Nine. Generally, as long as an aggrieved secured party has priority over other creditors to specific collateral of a debtor, available remedies may include the elective to proceed judicially, the elective to take possession of the collateral "without breach of the peace," a remedy under attack in several states, and the right following a proper taking to dispose of the collateral and to apply the proceeds thereof against the debtor's outstanding indebtedness. A secured party may elect to proceed by judicial process to judgment and execution. Should the collateral not be locatable, or non-existent, or if it were impossible to peacefully take possession (or should courts follow the California lead and decide that all pre-judgment non-judicial takings are unconstitutional), then the judicial course of action in effect becomes the only available alternative.

125. See UCC § 9-501(3)(a) and (b).
126. The parties to a security agreement may agree upon specific standards of commercial reasonableness as regards disposition of collateral by a secured party, e.g., notification of sale through trade journals, provided such standards are not "manifestly unreasonable." UCC § 9-501(3).
The principal non-judicial remedy expressly authorized by Article Nine is foreclosure by self-help whereby a secured party may take possession of the collateral and, in a majority of situations, subsequently sell or otherwise dispose of the collateral. Should this pre-judgment self-help remedy withstand its current challenge in the courts, troublesome problems likely will continue to crop up again and again. First, although Section 9-503 authorizes private, non-judicial taking by the secured party of the collateral in the debtor's possession, it does so only so long as the taking can be done "... without breach of the peace. . . ."129 There exists a body of case law which has attempted to develop standards for determining what factual circumstances indicate a breach of the peace.130

Another troublesome issue in private foreclosures under the Code concerns the terms, manner, time, price or other circumstances surrounding the secured party's disposal of the collateral. Specifically, collateral must be sold or disposed of in such a way, at such a time, and by such terms that are "commercially reasonable."131

---

129. UCC § 9-503. "Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides, the secured party may require the 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 the debtor's premises under Section 9-504."

130. See, e.g., Schanafett v. Seaboard Finance Co., 108 Cal. App. 2d 420, 239 P. 2d 42 (1951) (repossession of furniture amounted to a tort of false imprisonment against debtor); Girard v. Anderson, 219 Iowa 142, 257 N.W. 400 (1934) (clause in security agreement permitting secured party to "forcibly" take possession of collateral following a debtor's default held contra public policy and to be in violation of Article 1, § 8 of the Iowa Constitution). But see, Cherno v. Bank of Babylon, 54 Misc. 2d 277, 282 N.Y.S.2d 114, aff'd, 288 N.Y.S.2d 862 (S. Ct. App. Div. 1968) (bank employees using a lawyer to enter premises to take possession of collateral held not to constitute a breach of the peace since "public order" was not disturbed, nor was the conduct "likely to produce violence"). For a discussion of this problem see Hogan, The Secured Party and Default Proceedings Under the U.C.C., 47 MINN. L. REV. 205, 211-13 (1962).

131. UCC § 9-504(3). See also UCC § 9-507(2). Compare Alliance Discount Corp. v. Shaw, 195 Pa. Super. 601, 171 A.2d 548 (1961) (dealing with the commercial reasonableness regarding a secured party's disposition of a repossessed automobile); with Mallicoat v. Volunteer Finance & Loan Corp., 415 S.W.2d 347,
9-507(2) goes to the commercial reasonableness of the foreclosure price itself,\(^1\) but beyond that, the Code leaves the standards of commercial reasonableness to be determined by prevailing commercial practices and ultimately to the courts, or to be determined under standards which the parties incorporated in their security agreement.

(b) DETERMINE WHAT REMEDIES ARE AVAILABLE TO SUBORDINATE SECURED PARTIES. Under Section 9-504(1)(c), a subordinate party (one whose security interest is subordinate to another secured party's interest under UCC rules of priority), has the right to demand to the secured party (who is foreclosing against the debtor's collateral) that any proceeds available after satisfaction of the priority party's claim and expenses be distributed to the subordinate party. As a corollary, Section 9-504 imposes on the priority party the duty to distribute excess proceeds realized from the disposition of the collateral.

Similarly, under Section 9-505(2) a subordinate party may object to a priority party's announced intention to retain the collateral rather than sell it in full satisfaction of the debtor's obligations to the priority secured party. Although the Code in limited circumstances permits such "strict foreclosure," even under those circumstances stated in Section 9-505 a timely objection to such strict foreclosure by a subordinate party will compel the priority party to dispose of the collateral under Section 9-504. Thus, any excess proceeds upon sale will be available for the subordinate creditor. If a debtor's in-

---

350 (Tenn. Ct. App. 1966) (indicating "commercially reasonable" signifies that a disposition shall be "... in keeping with prevailing trade practices among reputable and responsible... enterprises engaged in the same... business...") as that of the secured party, defendant.

132. UCC § 9-507. "... (2) The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner. The principles stated in the two proceeding sentences with respect to sales also apply as may be appropriate to other types of disposition. A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable, but this sentence does not indicate that any such approval must be obtained in any case nor does it indicate that any disposition not so approved is not commercially reasonable."
solvency precipitated the default in the first place, a trustee will be in the picture. Consequently, priority and remedial analysis will involve the interplay of the Federal Bankruptcy Act and Article Nine. This is especially true in Article Nine floating lien contexts where elements of the collateral come into the debtor’s possession within four months of the filing of the bankruptcy petition.\textsuperscript{133}

(c) \textbf{DETERMINE WHAT RIGHTS ARE AVAILABLE TO A DEBTOR AFTER DEFAULT OR FOLLOWING THE SECURED PARTY’S BREACH OF THE SECURITY AGREEMENT.} Although a debtor’s default typically represents the source of transactional breakdown, non-performance or improper performance of a secured party’s obligations under a security agreement may be the cause. This may occur in the consumer-credit context where a dealer-secured party, for example, may breach the implied warranty of merchantability (prescribed by Article Two) by the credit selling of a motor vehicle with a defective transmission.\textsuperscript{134}

Regardless of possible affirmative claims against a secured party, the debtor, moreover, has certain rights following default. For example, a secured party’s foreclosure right is modified by the Code’s incorporated “equitable redemption” doctrine. Article Nine permits a debtor at any time before a secured party has disposed (or contracted to dispose) of collateral under Section 9-504, to redeem it by tendering fulfillment of all obligations due together with the reasonable expenses incurred by the secured party in consequence of the debtor’s default.\textsuperscript{135} Furthermore, Article Nine imposes liability on the secured party for not complying with the procedures for taking and disposing of collateral.\textsuperscript{136} As a corollary, the Code establishes a cause of action in favor of a debtor who has been injured by the secured party’s improper taking and/or disposing of the collateral.\textsuperscript{137} Finally, the Code expressly states that principles of law

\textsuperscript{133} See 11 U.S.C.A. § 96(a) and (b) (Section 60a and b of the Federal Bankruptcy Act); and UCC § 9-108. See also Grain Merchants of Indiana, Inc. v. Union Bank & Savings Co., 408 F.2d 209 (7th Cir. 1969), cert. denied, 396 U.S. 827 (1969), and DeBay v. Williams, 417 F.2d 1277 (9th Cir. 1969).

\textsuperscript{134} See UCC § 2-314.

\textsuperscript{135} UCC § 9-506.

\textsuperscript{136} UCC § 9-507(1).

\textsuperscript{137} UCC § 9-507(1).
and equity relative, for example, to estoppel, fraud, misrepresentation, duress, coercion and mistake "shall supplement" its provisions.\textsuperscript{138}

We have completed the transactional phase analysis model, and have touched upon many of the core concepts and ordering principles of Article Nine. Let's return now to the Jones-Secure Bank hypothetical and apply the analytic models to those facts.

APPLICATION OF IDENTIFICATION AND PHASE ANALYSES

PART ONE

IDENTIFICATION ANALYSIS

Identify the secured transactions. The $15,000 loan from Secure Bank to Jones is a secured transaction. It is the result of a security agreement which evidences the intent of the parties for the loan's repayment to be secured by Secure Bank's retention of a security interest in the collateral specified in the agreement.

DISTINGUISH SECURITY FROM NON-SECURITY AGREEMENTS. Although the Jones-Secure Bank transaction is entered into pursuant to a security agreement, the Jones-K-C contract is not a secured transaction since the seller retained no interest in the goods sold, the purchase price having been paid in full. It is, however, a contract for the sale of "future goods" as defined and covered by Article Two of the Code.\textsuperscript{139}

IDENTIFY THE SECURED TRANSACTIONS CHRONOLOGICALLY IF A SERIES OF TRANSACTION ARE INVOLVED. In the discussion hypothetical, the Jones-Secure transaction is the only secured transaction involved directly in the problem.

Identify the parties.

IDENTIFY THE SECURED PARTIES. Secure Bank is the secured party to the Jones loan transaction.

IDENTIFY THE DEBTORS. Jones is the debtor under the loan from Secure Bank.

\textsuperscript{138} UCC § 1-103.

\textsuperscript{139} See UCC §§ 2-105(1) and 2-102.
IDENTIFY ANY THIRD PARTIES.

(i) Identify all buyers in the ordinary course of business (BIOCOB). Cash and credit customers of Jones may qualify as BIOCOB's under the criteria of Section 9-307, but their rights are not at issue.

(ii) Identify any general, unsecured creditors. Jones' accounts payable creditors may be unsecured. Consequently their claims will be represented by the trustee in bankruptcy.

(iii) Identify any lien creditors. The court-appointed trustee in bankruptcy becomes a lien creditor under the Code.140

PART TWO

TRANSACTIONAL PHASE ANALYSIS

Determine the validity of the security agreement and any supporting documents or instruments. We may assume from the facts that there was a valid and enforceable security interest created through agreement of the parties. There are no supporting or additional documents or instruments. Remember, however, that if documents of title or instruments had been used in the Jones-Secure Bank case, then relevant provisions of Articles Seven and Three would have had to be consulted.

Determine when each security interest attached. Secure Bank gave "value." There was an "agreement" that the security interest attach. At the moment of Jones' filing his bankruptcy petition, Jones "had rights in" then existing accounts, equipment, inventory and proceeds on hand.

The dispositive issue, however, is whether Jones had rights in the 100 Oblet Machine Tools manufactured but not yet shipped at the date of the initiation of the bankruptcy proceeding, as required for the security interest to attach. We already have indicated that the Code's principal attachment provision, revised Section 9-203, does not specify when a debtor has rights in the collateral. We also have observed that Section 9-202 indicates that title to collateral is immaterial in applying Article Nine. If Article Nine does not help, other portions of the Code might help, especially Article Two cover-

140. UCC § 9-301(3).
ing sales, since the Jones’ contract to purchase the 100 Oblets from K-C is a sale within the scope of Article Two.\textsuperscript{143}

Thus, we now turn to Article Two to see whether we might be able to borrow concepts to answer the question of whether Jones had any rights in the 100 K-C manufactured Oblets at the time of the bankruptcy petition filing.

Remember that the transaction entered into by Jones and K-C was a sale of goods, moreover, a sale of future “goods.”\textsuperscript{142} Under Article Two, a buyer has a property interest in future goods as soon as they exist and as soon as they are “identified” to the sales contract.\textsuperscript{143} Indeed, once the subject matter goods are produced by a manufacturer-seller and then marked, labeled or designated to be shipped to the buyer, “identification” occurs.\textsuperscript{144} Once the goods are identified, a buyer has an “insurable interest” which he can affirmatively exploit by insuring against possible risk of loss.

Arguably, for a debtor-purchaser of collateral to have an “insurable interest” in the subject matter of the sale is to “have rights in the collateral.” Therefore, an answer to the issue of whether Secure Bank had an “attached” security interest in the 100 Oblets could depend upon whether the 100 Oblets had been designated to be shipped to the buyer-debtor (Jones) at the time of the debtor’s petition. Thus, by borrowing the Article Two concept of “insurable interest” as one possible solution to the issue of when Jones first obtained “rights in the 100 Oblets,” we have stayed within the Code. This sort of internal Code resolution is similar to case law reasoning by precedent and analogies. This methodological technique is worth remembering when using the Code.

Now, let us assume that the 100 Oblets in the K-C warehouse had been marked to be shipped to Jones, and that this marking had taken place prior to the petition being filed. On this assumption, Secure Bank arguably had an attached security interest in the 100

\textsuperscript{141} UCC § 2-102. See also UCC § 2-105(1) and (2).

\textsuperscript{142} UCC § 2-105(2). This section indicates that goods which are not both in existence and identified as the subject matter of an executory sales contract are “future” goods. Sales contracts covering the sale of “future” goods means goods which have to be either identified, or manufactured and identified at the time the agreement to sell is reached.

\textsuperscript{143} UCC § 2-501(1)(b).

\textsuperscript{144} UCC § 2-501(1) and (2).
Oblet Machine Tools. Consequently, its interest was perfected under Section 9-303(1), and Secure Bank takes priority over the trustee via Section 9-301(1)(b).

**Determine if, how, and when each security interest became perfected.**

**DETERMINE THE SUFFICIENCY OF ANY FINANCING STATEMENTS.** Using the above assumptions, Secure Bank's attached security interest in the collateral (including the Oblet Machine Tools) was perfected by the filing of a sufficient financing statement.

**DETERMINE THE SUFFICIENCY OF THE FINANCING STATEMENT FILING.** We may assume that the financing statements were filed in the proper locations, and that the statement itself was sufficient under Section 9-402(1). Thus, we may conclude that Secure Bank has a perfected Article Nine security interest in the 100 Oblets still sitting in K-C's warehouse.

**Determine the priority of creditor claims among (or between) claimants.** Secure Bank and the trustee in bankruptcy representing the claims of the unsecured creditors are the only claimants. The trustee is a lien creditor under the Code.\(^{145}\) By application of the appropriate rule of priority, a lien creditor's interest is subordinate to the interest of an Article Nine interest perfected prior to the time of the lien creditor's interest arising.\(^{146}\) Consequently, Secure Bank has priority over the trustee as to Jones' property in which Secure Bank had a perfected security interest at the time of the bankruptcy petition, including the 100 K-C Oblets.

The only way now for the bankruptcy trustee to defeat the Bank's priority status *vis-à-vis* the 100 Oblets is to attempt to show that a Section 60a voidable preference situation exists. In short, the Bank may still not be "home free," but this issue is beyond the scope of this article.

**Determine whether a default event has occurred.** Jones' non-payment of an installment due under the security agreement with Secure Bank constituted a default event, as may have the filing of the bankruptcy petition.

---

145. UCC § 9-301(3).

146. UCC § 9-301(1)(b).
DETERMINE WHAT REMEDIES ARE AVAILABLE TO THE PARTIES FOLLOWING TRANSACTIONAL BREAKDOWN. Secure Bank, assuming it has priority over the trustee, may have the election to proceed judicially or extra-judicially against Jones and the collateral.\footnote{UCC § 9-501(1).} Recall that the precise question asked the Bank’s attorney was whether the Bank can demand K-C to ship the 100 Oblets pursuant to the Bank’s directive.

Although Article Nine expressly authorizes a secured party following a debtor’s default to notify account debtors and obligors under instruments to begin to make payments to the secured party directly, it does not expressly authorize a similar directive to be issued to the obligors of a debtor under sales contracts.\footnote{UCC § 9-502(1).} Such a demand if made would give rise to justifiable apprehension on the part of K-C, the supplier and obligor under the Jones—K-C sales contract. Thus, it appears that K-C should ship the goods to Jones’ place of business. Then Secure Bank may attempt to take possession of the equipment and inventory which is subject to its security interest provided Secure Bank can constitutionally do so “without breach of the peace.” Should Secure Bank take possession under Section 9-503 of any of the collateral, including the 100 Oblets, it may then proceed to dispose of the goods in accordance with the Section 9-504 procedures provided the disposition is “commercially reasonable.”

CONCLUSION

The application of the identification and phase analyses to the Jones-Secure Bank hypothetical has been set out in detail. For most applications, this protracted, writing-out of each step of the analytic processes is neither necessary nor advisable. In a real sense, the analytic models outlined above should be programmed into one’s legal thinking.

One final comment—the models described above will be useful only when applied with the authoritative source at hand—the Code itself. Using the model along with the Code, one should find that the recognition and resolution of legal issues in personal property secured financing has become a structured and ordered process.