SECURED TRANSACTIONS: TERMINOLOGY

- **Secured Transaction:** A transaction in which the payment of a debt is guaranteed, or secured, by *collateral* (i) owned by the debtor or (ii) in which the debtor has a legal interest.

- **Collateral:** Property, including accounts and *chattel paper* (i.e., a note evidencing a debt secured by personal property), which is subject to a security interest.

- **Security Interest:** An interest in personal property or *fixtures* -- i.e., improvements to real property -- which secures payment or performance of an obligation.

- **Security Agreement:** An agreement creating or memorializing a security interest granted by a debtor to a secured party.

- **Secured Party (a/k/a Secured Creditor):** A lender, seller, or any other person who is a *beneficiary* of a security interest, including a person to whom accounts or chattel paper has been sold.

- **Debtor:** A party who owes payment or performance of a secured obligation, whether or not he or she actually owns or has any right in the collateral.
CREATING A SECURITY INTEREST

In order for a creditor’s security interest to attach (i.e., to become enforceable):

1. The debtor must have rights in the collateral; and

2. The secured party must give value (e.g., binding commitment of credit, consideration) in exchange for an interest in the collateral; and either

3. The collateral must be in the secured party’s possession, or

4. When the collateral is not in the secured party’s possession, there must be a written security agreement

   a. describing the collateral in such a way that it can be reasonably identified and

   b. signed by the debtor.
PERFECTION BY FILING

- **Perfection:** The process by which secured parties protect their security interests in collateral against the claims of third parties who may look to the same collateral to satisfy the debtor’s obligations to them.

- A secured party can perfect a security interest by **filing** a *financing statement* with the appropriate state or local office.

  - **Financing Statement:** A document, *filed under the debtor’s name*, that is prepared by the secured creditor to give notice to third parties that the creditor claims an interest in the collateral and contains:

    1. the **debtor’s name** and **signature**,  
    2. the **addresses** of both the debtor and the secured party, and  
    3. a **description** of the collateral by item or type.

- All of the foregoing information must be accurate, otherwise the filing will not perfect the creditor’s security interest.
PERFECTION WITHOUT FILING

- **Perfection by Possession:** A secured creditor can perfect his or her security interest by taking possession of the collateral until the debtor has paid the debt for which the collateral was pledged.

  If the secured party possesses the collateral, he or she must use **reasonable care** in preserving it; otherwise, the secured party will be liable to the debtor for any loss in the collateral’s value.

- **Purchase-Money Security Interest (“PMSI”):** A security interest that arises when a seller or creditor extends credit for part or all of the purchase price of goods purchased by the buyer/debtor.

  Except in certain cases (e.g., automobiles), a PMSI is **automatically perfected** at the time of the credit sale.

- **Motor Vehicles** -- Most states require a **certificate of title** for any automobile, motorcycle, boat, or motor home. In those states, a security interest in the vehicle can only be perfected if it is reflected on the certificate of title.
MAINTAINING PERFECTION

- As a general rule, a perfected security interest in movable collateral remains perfected for up to four months after the debtor moves the collateral to another state. After that time, the secured creditor must re-perfect in the new state in order to retain the priority of his or her interest in the collateral.

- A financing statement is effective for five years from the date it is filed.

- **Continuation Statement:** A statement that, if filed within six months prior to the expiration of a financing statement, will extend the financing statement’s term for another five years from the expiration date of the original statement.
SCOPE OF SECURITY INTERESTS

- In addition to covering collateral already in the debtor’s possession, a security agreement can cover other types of property, including:
  
  - **Proceeds:** Money or other valuable asset(s) received when collateral is sold or otherwise disposed of (e.g., money from sale of inventory).
  
  - **After-Acquired Property:** Property acquired by the debtor after the execution of the security agreement (e.g., replacement inventory).
  
  - **Line of Credit:** Often a debtor will arrange with a bank to have a continuing line of credit under which the debtor can borrow funds as needed. **Future advances** against that line of credit are subject to a properly perfected security interest in the same collateral that secures the initial loan.
  
  - **Floating Lien:** A security interest in collateral that is retained even when the collateral changes in character, classification, and/or location.
PRIORITIES

- **Perfected vs. Unperfected Security Interests:** When one secured party has a perfected security interest in collateral and another secured party has an unperfected security interest in the same collateral, the **perfected interest prevails**.

- **Conflicting Perfected Security Interests:** When two or more secured parties have perfected security interests in the same collateral, generally the **first to perfect** has priority.

- **Conflicting Unperfected Security Interests:** When two or more secured parties have unperfected security interests in the same collateral, generally the **first to attach** (i.e., become enforceable) has priority.

- **Commingled or Processed Goods:** When goods subject to two or more perfected security interests are manufactured or commingled in such a way that they lose their identities, the perfected interests attach to the new product or mass proportionally to the percentage of the cost of the new product or mass attributable to the cost of the original goods.
DEBTORS’ AND CREDITORS’ RIGHTS

- **Information Requests:** A party who is considering taking a security interest is entitled by the U.C.C. to obtain a certificate from the relevant filing office(s) identifying all perfected financing statements on file for that debtor.

- **Assignment and Release:** A secured party may, at its discretion, assign part or all of a security interest to another party and/or release part or all of the collateral covered by a security interest.

- **Amending a Financing Statement:** A filed financing statement may be amended. The amendment must be agreed to and signed by both the debtor and the secured party.

- **Status of the Debt:** A debtor may request that the secured creditor confirm the debt remaining and/or the collateral covering the remainder of the debt.

- **Termination:** When a secured debt is fully paid, the secured party generally must send a termination statement to the debtor and file a copy with the appropriate filing office.
REMEDIES ON DEFAULT

- **Default:** A debtor’s *failure to pay* a debt when due and/or a secured party’s *failure to discharge* a debt when paid.

- **Execution and Levy:** A secured party can relinquish its security interest and proceed to judgment on the underlying debt. If successful, the secured party will proceed to:

  - **Execution:** The process of carrying out the effect of a court decree or judgment; and
  
  - **Levy:** Seizure and sale of property, subject to a writ of execution, to satisfy a debt.

- **Repossession:** A secured party can take possession of the collateral and either (i) *retain* it for satisfaction of the debt, or (ii) *resell* it and apply the sale proceeds to the debt remaining.
DISPOSITION PROCEDURES AND PROCEEDS

A secured party who chooses to dispose of collateral must:

1. sell it in a **commercially reasonable** manner, and

2. **notify** the debtor of the time and place of the sale.

**Proceeds from disposition** must be applied as follows:

1. reasonable expenses stemming from **retaking, holding, or preparing for sale** (which may include attorneys’ fees and other legal expenses);

2. satisfaction of the **balance of the debt** due to the secured party;

3. satisfaction of **other secured creditors** from whom written demand for proceeds has been received; and

4. any **surplus to the debtor**.

If some of the debt remains unsatisfied after all of the collateral has been disposed of, the secured creditor may obtain a **deficiency judgment** against the debtor.