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An Introduction to the Revised UCC Article 9

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Introduction

Status. The Article 9 Drafting Committee[1] has completed its work. The sponsoring organizations, the American Law Institute and the National Conference of Commissioners on Uniform State Laws, have given their approval. Article 9[2] has now moved to the States for consideration. If everything goes according to plan, Article 9 will become the law[3] in a significant number of (if not all) states,[4] effective July 1, 2001.[5]

Purposes of changes. The revisions to Article 9 represent the first major revision to Article 9 since 1972. There are significant changes in scope, substantive rules, and procedures. The revisions are intended to bring greater certainty to financing transactions. This certainty should reduce both transaction costs and the cost of credit.

Implementation. The revised Article 9 seeks greater certainty through two primary techniques:

- Expanding the scope of property and transactions covered by Article 9, and
- Simplifying and clarifying the rules for creation, perfection, priority and enforcement of a security interest

Revised Article 9 also clarifies the rules that apply to consumer transactions

Simplification. The Article 9 Drafting Committee established a Simplification Task Force to work with the Reporters and the Drafting Committee to make the revised Article 9 as "user friendly" as possible. Revised Article 9 achieves this goal to a significant extent.

Electronic transactions. Article 9 recognizes emerging methods of engaging in electronic commerce. Article 9 provides throughout its text for the "authentication" of a "record" instead of signing a piece of paper. This follows the lead of other recent revisions to the UCC.

Consumer matters. Article 9 contains many special rules for consumer trans-

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[2] All statutory references to Article 9 are to the final version of the new Article 9 (as modified through January 15, 2000), including the Official Comments, unless otherwise indicated. Copies of the final draft may be purchased from the sponsors: NCCUSL, 312.915.0195; and ALI, 800.253.6397, x 7000 or online: http://www.ali.org/ali/com_ucc.htm. The final draft is also available for purchase from the ABA (800.285.2221) and commercial publishers. Copies of the drafts prior to the final draft may be obtained at no cost at: http://www.law.upenn.edu/library/ulc/ulc.htm.

[3] Revised Article 9 has been adopted in approximately a dozen states.

[4] Revised Article 9 is pending in approximately 25 states and jurisdictions.

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actions. This article sometimes, but not always, refers to special consumer rules in the course of discussing a commercial rule. There is a section devoted to consumer rules near the end of this article that should be referred to for a collection of the principal consumer rules.

Scope

Introduction. Revised Article 9 brings into the fold of Article 9 several kinds of property and transactions that previously resided outside of Article 9. The application of non-Article 9 common law rules to these transactions made the legal results of these transactions uncertain and accordingly made the transactions more expensive. This is particularly true for securitization transactions.

Goods v. software. Article 9 draws a line between "goods" and "software." Where software is "embedded" in goods so that the software becomes "part of" the goods, Article 9 treats the software as "goods" for all purposes under Article 9 (such as how to perfect a security interest and buyer in ordinary course rules). When software maintains its independent status it will constitute a general intangible. § 9-102(44), (75).

Accounts. Article 9 has always applied to the *sale* of "accounts." Revised Article 9 continues this rule. § 9-109(a)(3). Former Article 9 defines "accounts" to include only payment obligations arising out of the sale or lease of goods or the provision of services. Under former law, this leaves many kinds of payment rights within the definition of "general intangible." The sale of these types of payment rights often serves as a financing transaction, but former Article 9 does not apply to these transactions.

Revised Article 9 broadens the definition of "accounts" to include:

- payment obligations arising out of the sale, lease or license of all kinds of tangible and intangible property (for example, "accounts" will include license fees payable for the use of software), and
- credit card receivables.

§ 9-102(a)(2). The broader definition expands the scope of Article 9 by bringing into Article 9 more transactions through the continued application of Article 9 to the sale of "accounts" (as newly defined).

Revised Article 9 also clarifies that a seller of accounts (and other property where the sale is an Article 9 transaction) retains no interest in the property sold. § 9-318(a). This rejects the holding in *Octagon Gas Systems v. Rimmer*, 995 F.2d 948 (10th Cir. 1993). *See* PEB Commentary No. 14 (June 10, 1994)

Payment intangibles. The inclusion of many kinds of payment rights in the definition of "accounts" does leave behind in the definition of "general intangible" some important types of payment rights, such as payment rights that arise out of loan agreements that do not constitute "instruments." Revised Article 9 calls a general intangible where the obligor's "principal" obligation is the payment of money a "payment intangible." § 9-102(a)(61). The sale of a payment

intangible often functions as a financing transaction.

Revised Article 9 brings certainty to these transactions by bringing the *sale* of a "payment intangible" into the scope of Article 9. § 9-109(a)(3). However, to permit financial institutions that sell loan participations to avoid having a financing statement filed against them, Article 9 provides for the automatic perfection of a security interest created upon the *sale* of a payment intangible (but not a security interest given to secure an obligation). § 9-309(3).

Sale of promissory notes. The sale of a promissory note will also often function as a financing transaction. Revised Article 9 recognizes this fact and treats the *sale* of a promissory note as a transaction subject to Article 9. § 9-109(a)(3). Revised Article 9 defines a "promissory note" as a subset of "instruments." § 9-102(a)(65) "Promissory notes" include "promises," but not "order paper" (*e.g.* checks).

As with the *buyer* of a payment intangible, the *buyer* of a promissory note enjoys automatic perfection of its security interest. § 9-309(4). Unlike payment intangibles where there is nothing to possess and the first buyer of the payment intangible will always have priority, a buyer of a promissory note that relies on automatic perfection, and does not take possession of the promissory note, will generally lose to a subsequent purchaser (including a secured party) of the promissory note that does take possession of the promissory note. § 9-330(d). The buyer that relies on automatic perfection would still defeat a lien creditor, including a trustee in bankruptcy.

Investment property. Revised Article 9 continues the rules grafted onto Article 9 at the time of the adoption of revised Article 8. Revised Article 9 distributes those rules, which previously resided largely in former § 9-115, to their proper homes throughout revised Article 9. Various aspects of these rules are discussed below.

Deposit accounts. Article 9 will apply to security interests in deposit accounts as original collateral. The application of Article 9, instead of non-Article 9, common law, rules to security interests in deposit accounts will make the legal results of these transactions more certain and accordingly make the transactions less expensive. As discussed below, the only way to perfect a security interest in a deposit account will be to obtain "control" of the deposit account.

Health-care-insurance receivables.[6] Former Article 9 excludes insurance claims from the scope of Article 9 (except to the extent they may constitute proceeds under former § 9-306). Originators of insurance receivables arising from the provision of health care services frequently sell them in financing transactions. To bring certainty to these transactions, revised Article 9 brings them into Article 9. § 9-102(a)(2), (46). Other insurance claims remain outside of Article 9 (except to the extent they constitute "proceeds"). § 9-109(d)(8).

[6] The "-'s" are officially part of the term.

Commercial tort claims. Former Article 9 excludes tort claims from the coverage of Article 9 (except to the extent they constitute "proceeds"). Revised Article 9 continues this rule, except for "commercial tort claims." §§ 9-102(a)(13), 9-109(d)(12). Revised Article 9 defines "commercial tort claims" as those tort claims:

- where the claimant is an organization, or
- if the claimant is an individual, the claim (i) arose in the course of the claimant's business, and (ii) does not involve personal injury.

A secured party may not obtain a security interest in an after-acquired commercial tort claim. § 9-204(b)(2). The security agreement must describe the commercial tort claim with some specificity. § 9-108(e)(1).

Creation of the security interest

Introduction. The former rules for the creation and attachment of the security interest remain substantially the same under revised Article 9.

Attachment. Attachment generally continues to require a security agreement, value, and that the debtor have rights in the collateral. § 9-203.

The security agreement. The security agreement may be an authenticated record. § 9-203. The security agreement still requires the debtor's authentication and a sufficient description of the collateral. § 9-203(b)(3)(A). Revised Article 9 confirms that the exception to the requirement of a signature where the secured party has possession pursuant to "agreement" means that the "agreement" for possession has to be an agreement that the person will have possession for purposes of *security*.

Description of collateral. Revised Article 9 clarifies that a description of collateral by Article 9 "type" (*e.g.* "equipment") suffices to "describe" the collateral (except in certain consumer transactions, as described below). § 9-108(b)(3). If the collateral is a commercial tort claim, the description requires some specificity beyond the category of "commercial tort claims" (*e.g.* "all claims arising out of the explosion occurring at the debtor's Chicago fireworks factory on July 4, 2001"). § 9-108(e)(1). Unlike financing statements (as discussed below), a description of collateral in a security agreement may not use a generic statement, such as "all my personal property." § 9-108(c).

Proceeds. As with former Article 9, a security interest automatically attaches to "proceeds" of the collateral. §§ 9-203(f), 9-315(a)(2). Revised Article 9 expands the definition of "proceeds" to include:

- rights arising out of the license of property, and
- distributions on stock.

§ 9-102(a)(64).

Supporting obligations. Revised Article 9 collects into a new concept several kinds of rights, such as guaranties, that are understood under former law to follow the debt. Revised Article 9 calls

these rights "supporting obligations." § 9-102(a)(77). Under revised Article 9:

- the creation of a security interest in a payment obligation automatically attaches to "supporting obligations" related to the obligation. § 9-203(f), and
- the perfection of a security interest in the supported obligation automatically perfects the security interest in the supporting obligation. § 9-308(d).

similar rules apply to a security interest that secures an obligation that itself is collateral. § 9-308(e).

Transfers of intangibles. Former § 9-318(4) renders ineffective any restriction in an account or a general intangible consisting principally of a right to payment that would prevent the sale of the account or the creation of a security interest in the general intangible. Revised Article 9 builds on this. §§ 9-406 and 9-408

Revised Article 9 renders wholly ineffective any restriction in an account, promissory note, payment intangible, or chattel paper, or under other law, that would interfere with the:

- creation or perfection of a security interest in the right to payment, or
- enforcement of the secured party's security interest in the right to payment.

§ 9-406(d) and (f). These rules do not apply to the *sale* of a payment intangible. The next paragraph describes the rules that apply to the *sale* of that type of collateral (as well as in other circumstances).

For other kinds of rights, such as payment intangibles (when sold) and a *licensee's* rights under a license, revised Article 9 renders ineffective a restriction on transfer, in the contract or arising under other law, *to the extent* the restriction would interfere with the creation, attachment or perfection of the security interest. § 9-408(a) and (c). In the transactions subject to § 9-408, Revised Article 9 does *not* interfere with the enforceability of an otherwise effective restriction (in the contract or under other law) on the secured party's *enforcement* of its security interest in the general intangible. § 9-408(d).

Perfection: other than filing

Introduction. Revised Article 9 clarifies the application of the former rules. It also applies to additional kinds of collateral methods of perfection that under former Article 9 apply to a more limited set of collateral.

Possession by bailee. Revised Article 9 modifies the former method of perfecting a security interest by possession where a third party has possession of the collateral. Most decisions under former law hold that the secured party can perfect its security interest by giving notice of the security interest to the bailee. Revised Article 9 requires that the bailee:

- receive notice, *and*
- acknowledge in an authenticated record that it is holding the collateral "for the secured party's bene-

fit."

§ 9-313(c).

Control. As a result of amendments to Article 8 completed in 1994, former Article 9 permits "control" of investment property to serve as a method of perfecting a security interest in investment property. For a security entitlement, this requires an agreement between the secured party and securities intermediary that the securities intermediary will comply with entitlement orders originated by the secured party without further "consent" of the debtor. §§ 8-106, 9-106(a). Revised Article 9 clarifies that the secured party's agreement with the debtor that the secured party will not exercise its control rights until a subsequent event happens, such as the debtor's default, does not interfere with the present existence of control (and therefore perfection). § 8-106, Official Comment 4 (revised). Present control (and therefore perfection) will not exist if the secured party's future exercise of control requires the consent of the debtor.

Revised Article 9 also provides for the use of control as a method of perfection for:

- deposit accounts,
- letter of credit rights, and
- electronic chattel paper.

§ 9-314(a).

The meaning of "control" for deposit accounts closely resembles that for a security entitlement. § 9-104. For electronic chattel paper, control requires a unique "marking" of the electronic chattel paper. § 9-105. A secured party has "control" of a letter of credit right when it obtains the consent of the issuer of the letter of credit to the assignment to the secured party of the proceeds of the letter of credit under § 5-114(c), § 9-107. This does not give the secured party the right to make the draw under the letter of credit.

Automatic. As noted above, revised Article 9 provides for automatic perfection of a security interest in several circumstances, including the following:

- *Sale* of payment intangibles
- *Sale* of promissory notes

§§ 9-308(d), 9-309. These automatic perfection rules do not apply to an obligation secured by payment intangibles or promissory notes, as opposed to a *sale* of one of those two types of property. There is also automatic perfection of a security interest in a supporting obligation and in a security interest that secures an obligation that itself is collateral.

Perfection: filing

Introduction. Revised Article 9 makes extensive changes to the rules of the filing system. These are designed to:

- simplify procedures,
- reduce the costs of compliance, and
- reduce the risk of inadvertent errors.

Kinds of collateral subject to filing. Article 9 greatly expands the kinds of col-

lateral where a secured party can use the filing of a financing statement to perfect its security interest. These now include the following types of property, where a secured party could formerly perfect only by possession:

- Instruments
- Investment property (including stock certificates) (until the 1994 revisions to Article 8)

§ 9-310(a). The availability of perfection by filing does not preclude perfection by other available means, such as possession or control (as appropriate). As discussed below, there are special, non-temporal priority rules for some of these types of collateral when a secured party perfects *only* by filing and another secured party perfects by possession or control (as appropriate).

Location of the debtor. Article 9 changes the rules for the location of filing a financing statement. Generally former law provides for the filing of a financing statement in the state where goods are located for goods and in the state of the debtor's chief executive office for intangible collateral, such as accounts and general intangibles. New Article 9 provides for only one place to file for all kinds of collateral: the place of the debtor's "location." § 9-301.

Article 9 then defines "location":

- for an entity created by a filing with a state, the entity's location is that state. § 9-307(f). For example, for a debtor incorporated in Maryland, with its chief executive office in New Jersey, a secured party would file the financing statement in Maryland, the state of the debtor's formation, for *all* kinds of collateral;
- for an entity not created by a filing, the entity's location is the place of its chief executive office (§ 9-307(b)); and
- for an individual, the person's location is her principal residence (§ 9-307(b)).

The debtor's name. Article 9 continues the requirement that the financing statement include the debtor's name. § 9-502(a)(1). Article 9 also continues the disapproval of the use of a fictitious name in place of the debtor's "real" name. § 9-503(c).

Article 9 also contains a statutory rule to determine when a mistake in the debtor's name is so incorrect as to make the financing statement ineffective. § 9-506(c). The financing statement *is* effective if a computer search run under the debtor's correct name turns up the financing statement with the incorrect name. If it does not, then the financing statement is *not* effective as a matter of law. The court has no discretion to determine that the incorrect name is "close enough." As a result the secured party is dependent on the kind of computer search logic used by a particular state's filing office. The simple answer is to get the name right.

Article 9 rejects decisions that suggest that if the secured party is acting on behalf of others that the financing state-

ment must indicate that the secured party is acting in a representative capacity. § 9-503(d).

Indication of the collateral. Most decisions under former law do *not* permit a "supergeneric" "all assets" indication of collateral in a financing statement. New Article 9 will permit the use of this type of description in a *financing statement*, assuming of course that the description accurately describes the deal between the secured party and the debtor. § 9-504(2). Article 9 continues the former rule that a supergeneric description will *not* suffice in a *security agreement*. § 9-108(c).

The debtor's signature. In perhaps the most dramatic change, Article 9 has done away with the requirement that the debtor sign the financing statement. § 9-502, Official Comment 3. This will facilitate electronic filing of financing statements and, as a result, electronic searches.

A secured party can file a financing statement (without the debtor's signature) only if authorized by the debtor to make the filing. § 9-509(a)(1). Article 9 provides for automatic authorization to file a financing statement consistent with the security interest granted by the debtor in the security agreement. § 9-509(b). A secured party would need express authorization (or subsequent ratification) to pre-file a financing statement if the debtor has not yet authenticated a security agreement.

This change should not have any effect on the possibility of the filing of fraudulent financing statements. Under former law and procedures a person could forge a debtor's signature on a financing statement and file it with the filing office. The filing office has no way of checking the validity of a signature.

Priority

General rule. Generally Article 9 continues the long-standing rule that the first secured party to file a financing statement or to perfect its security interest has priority. § 9-322(a)(1). There are a number of non-temporal exceptions, generally based on the method of perfection. Some of these are described below.

Effect of other articles of UCC. Article 9 defers to the rights of holders in due course under Article 3 and protected purchasers under Article 8 "to the extent" those articles provide rights to those persons. § 9-331. The provisions in other articles do not always give priority to persons protected by those articles in all disputes with a secured party under Article 9. *See* §§ 3-305, 3-306, 8-303. *See also* § 8-501 (revised).

Filing v. control. As discussed above, a secured party with a security interest in investment property or electronic chattel paper may perfect its security interest by filing or control. A secured party that perfects a security interest in investment property *only* by filing will *not* have priority against a secured party that *later* perfects by control, even if the second secured party knows of the prior perfected security interest. §§ 9-328(1), 9-329(1). A secured party that does not fear a debtor double-financing collateral

can rely on the simple filing of a financing statement to perfect the security interest and defeat a lien creditor, including a trustee in bankruptcy and debtor in possession.

Filing v. possession. Similarly, the new right to perfect a security interest in an instrument by the filing of a financing statement does not protect the secured party that perfects by filing against a subsequent secured party that perfects by taking possession of the instrument, unless the second secured party knows that its purchase violates the rights of the first secured party. § 9-330(d). Once again, the decision of whether to depend solely on the filing of a financing statement to perfect a security interest will turn on the secured party's level of confidence in the debtor.

Automatic v. other methods of perfection. As noted above a security interest arising out of the *sale* of a promissory note is automatically perfected. Generally, a subsequent secured party that takes possession of the promissory note will have priority over a secured party that perfects its security interest solely through the automatic perfection rules, unless the subsequent secured party knows that its security interest violates the rights of the first secured party. § 9-330(d). Nevertheless, a secured party purchasing promissory notes, but leaving them in the hands of the seller for servicing, will often take this approach, confident that the secured party's rights will survive the seller's bankruptcy.

The security interest created upon the *sale* of a payment intangible is also automatically perfected. Because there is no alternative means of perfection (such as possession), the buyer ("secured party") does not have to worry about non-temporal priorities.[7]

Control v. control. Former Article 9 generally provides that two secured parties that each have control of investment property rank equally. New Article 9 changes the rule to temporal priority. § 9-328(2). The same rule applies to perfection of a security interest in a deposit account, where control is the only method of obtaining perfection. § 9-327.

A securities intermediary that obtains a security interest in a security entitlement or securities account maintained with the intermediary or a depositary that obtains a security interest in a deposit account maintained with the depositary will each have automatic "control" of the collateral for purposes of perfection. §§ 8-106, 9-104(a)(1) and 9-106. Each of those persons will have priority over another secured party, even if the other secured party has previously perfected its security interest. §§ 9-327(3) and 9-328(3).[8] The same is true for the depositary's set-off rights. § 9-340.

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[7] These priority rules between multiple assignees do not necessarily control the question of whom the account debtor should pay. *See* § 9-406(a) – (c), Official Comment 7.

[8] The securities intermediary and the depositary may of course agree to subordinate their priority. In addition, the special priority rule does not apply if the other secured party has obtained control by becoming the entitlement holder under § 8-106(d)(1) or the customer of the depositary under § 9-104(a)(3).

Purchase-money security interests. Article 9 continues the priority for purchase-money[9] security interests. § 9-324. It is not clear under former § 9-312(4) whether a secured party can obtain a purchase-money security interest in intangible collateral. New Article 9 resolves that ambiguity with a rule that a secured party may obtain a purchase-money security interest only in goods, with one exception. § 9-103(a)(1). The exception permits a purchase-money security interest in software if the debtor acquired its interest in the software:

- for the principal purpose of running the software in hardware in which the secured party also has a purchase-money security interest, *and*
- in an integrated transaction with the acquisition of the related hardware.

§ 9-103(c).

Except for consumer-goods transactions, Article 9 rejects the "transformation rule" that some courts applied under former Article 9. That rule provided that purchase-money security interest could lose its "purchase-money" character in certain circumstances, such as a refinancing of the purchase-money debt or having other collateral secure the purchase-money debt. § 9-103(f). Article 9 validates the "dual status" rule that permits collateral to have both purchase-money and non-purchase-money status. § 9-103, Official Comment 7.

[9] The "-" is officially part of the term.

Transfers of collateral

General. As under former law, a security interest continues in collateral that the debtor has transferred. § 9-315.

Money. The priority of rights to money and its close equivalents, such as checks, often raise disputes. Article 9 resolves many of these disputes.

A secured party with a junior security interest in accounts may collect checks in which another secured party has a prior security interest. The junior secured party's security interest in the checks will prevail if the junior secured party can establish holder in due course status. § 9-332. It may very difficult (if not impossible) for the junior secured party to establish that fact if it has notice of the senior secured party's claim to the instrument. §§ 3-302, 9-331. *See also* § 9-332. The junior secured party may also have rights under § 9-330(d) as a secured party that has perfected its security interest in an instrument by possession over another secured party that has perfected its security interest in the instrument only by a method other than possession.

If the *debtor* collects the accounts and then transfers *money* (in cash or by using the debtor's check) to a junior secured party (or anyone else), the transferee will take free of a security interest unless the transferee acts in "collusion" with the debtor in violating the rights of the secured party that had a security interest in the check as proceeds. § 9-332.

New debtor. A person (a "new debtor") will "become bound" by a security inter-

est that another person entered into if under other law:

- the other person's security agreement becomes effective to create a security interest in the property of the second person, or
- the second person becomes generally obligated for the obligations of the other person and the second person acquires all or substantially all of the assets of the other person.

§§ 9-102(a)(56), 9-203(d). The financing statement filed against the original debtor will be effective against the new debtor if it would have been effective against the original debtor and is filed in the proper jurisdiction to file a financing statement naming the new debtor. § 9-508(a). The financing statement will not be effective against the new debtor unless the name of the new debtor is sufficiently close to the name of the original debtor to pass the computerized "seriously misleading" test of § 9-506(c). The financing statement must also have been filed in the "location" of the new debtor. § 9-316, Official Comment 2, Example 5; § 9-508, Official Comment 4.

Buyers of goods. Buyers in ordinary course will continue to "take free" of a security interest created by the buyer's immediate seller. § 9-320.

Licensees. A licensee under a *non*exclusive license in ordinary course will also "take free" of a security interest created by its immediate licensor.[10] It is important to note that the nonexclusive licensee will not "take free" of a security interest created by a remote licensor. For example, if a licensor grants a security interest in its intellectual property and then grants an *exclusive* license to a licensee, the exclusive licensee would not "take free" of the security interest. A person who obtained a *non*exclusive *sub*license from the original licensee in this circumstance would *not* "take free" of the security interest created by the *original* licensor.

Enforcement

Introduction. Much of the litigation under Article 9 arises in connection with the enforcement of a security interest. New Article 9 resolves many of the disputes that have arisen in litigation.

Commercial reasonableness. Each "aspect" of a foreclosure sale must be "commercially reasonable." § 9-610(b). Some debate has occurred over the years on whether the foreclosure sale price *itself* must satisfy that test. New Article 9 indicates that a low price "of itself" will not make a foreclosure sale not commercially reasonable. § 9-627(a). However a low price obtained at the foreclosure sale "suggests that the court should scrutinize carefully all aspects of a disposition." § 9-610, Official Comment 10. There is one circumstance discussed below where it can have an additional effect.

[10] In this circumstance "takes free" means that the nonexclusive licensee can continue to enjoy its rights under the license following a foreclosure by the licensor's secured party against the licensor so long as the licensee performs its obligations under the license.

Guarantors. Article 9 makes clear that a guarantor of an obligation subject to Article 9 is entitled to the same notices and protections as the debtor and may not waive those rights before default to the extent the debtor could not waive them. §§ 9-102(a)(59), 9-602.

Notices. New Article 9 returns to the rule of the original Article 9, abandoned in the 1972 revisions, that a secured party must give enforcement notices to other secured parties, as well as the debtor. § 9-611(c)(3)(B). Article 9 implements this rule in a way where the secured party can have confidence it has given notice to all necessary persons without going to extraordinary efforts to identify and locate them. § 9-611(c).

Rebuttable presumption rule. The courts have long debated whether a failure to meet the notice or commercial reasonableness requirements of former Article 9 would:

- bar all deficiencies (the "absolute bar rule"), or
- reduce the secured party's deficiency *to the extent* that the failure to comply affected the price obtained at the foreclosure sale (the "rebuttable presumption rule").

Except in consumer transactions, Article 9 establishes by statute the rebuttable presumption rule. § 9-626(a)(3).

Certain low-priced foreclosure sales. Article 9 contains a special rule where:

- a secured party, a person related to the secured party, or a guarantor of the secured debt, purchases the collateral at a foreclosure sale, *and*
- The purchase price is "significantly below the range of proceeds that a complying disposition to a person [other than one of those persons] … would have brought."

§ 9-615(f). In that circumstance alone, Article 9 reduces the secured party's deficiency claim by the amount that the foreclosure sale would have brought had some other person purchased the collateral at the sale instead of the amount that the secured party or other specified purchaser paid a the foreclosure sale. A secured party should be able to protect itself from this problem by credit bidding an amount that is at least the "strike price" that the secured party would credit bid if there were competitive bidding.

Noncash proceeds. A secured party may sometimes receive something other than cash at a foreclosure sale – such as a note from the foreclosure sale buyer. The secured party does not have to apply the noncash proceeds to the debt unless not to do so would be commercially unreasonable. If a secured party does apply the noncash proceeds to the secured debt, it must do so in a commercially reasonable manner. This gives the secured party some flexibility in placing a value on the noncash proceeds and applying appropriate discounts. § 9-615(c).

Retention in satisfaction of debt. Former Article 9 is ambiguous on whether a secured party can retain collateral in satisfaction of the debt if the secured

party does not have possession of the collateral. This ambiguity effectively limits the ability to retain collateral in satisfaction of the debt to tangible collateral. Except in a consumer transaction, new Article 9 would permit the secured party to retain collateral in satisfaction of the debt even if the secured party was not in possession and also if the collateral is intangible. § 9-620, Official Comment 7. The debtor retains its right to require the secured party to sell the collateral in a foreclosure sale by objecting to the secured party's proposal to retain the collateral. § 9-620(c)(2).

Article 9 rejects decisions that held that a secured party could discover that its extended possession of collateral without disposing of it could result in a constructive retention in full satisfaction of the debt. § 9-620(b).

New Article 9 also clarifies that, except in consumer transaction, the secured party and the debtor can agree that the secured party will retain the collateral in *partial* satisfaction of the debt. § 9-620(a). An acceptance in partial satisfaction can take place only if the debtor affirmatively agrees to have that happen.

Consumer matters

Introduction. Article 9 contains many provisions providing special rules in consumer transactions. In some instances, the compromise reached was to say nothing in Article 9 and to leave it to the courts to decide what to do in a consumer transaction.

Definition. Article 9 defines a "consumer transaction" as one in which:

- an individual incurred an obligation primarily for personal, family or household purposes,
- a security interest secures the obligation, *and*
- *any* of the collateral is held primarily for personal, family or household purposes

Some of the consumer rules apply only to "consumer-goods transactions,"[11] which are consumer transactions where the collateral is goods.

Creation of security interest. In a non-consumer transaction, a security agreement may, among other ways, describe the collateral by Article 9 type. § 9-108(b)(3). In a consumer transaction, a description by type is not sufficient if the collateral is consumer goods, a security entitlement, or a securities account. § 9-108(e).

Enforcement. There are a variety of special notices that consumers receive in connection with the foreclosure of a security interest. *See generally* §§ 9-612 – 9-616. The "rebuttable presumption" rule that applies to commercial transactions (§ 9-626(a)(3)) does *not* apply to a consumer transaction. § 9-626(a). The courts are directed "not [to] infer" anything from the fact that the rebuttable presumption rule does not apply by statute to consumer transactions and the courts are free to adopt that rule or any other rule.

[11] The "-" is officially part of the term.

Transition rules

Introduction. The many changes in Article 9, especially the perfection rules, inevitably make the transition rules complex. Generally, unless Part 7 of the new Article 9 states an exception, the new Article 9 applies to all aspects of a transaction subject to the new Article 9. There are some important exceptions. The proposed uniform effective date of July 1, 2001 is intended to reduce any disruptive effect of the transition rules by having as many states as possible have the new Article 9 go into effect on the same day.

Pre-effective date transactions (§ 9-702). Earlier transactions outside of Article 9 that are now subject to Article 9 remain effective except *to the extent* provided in Part 7. For example, a security interest in a commercial tort claim effective under other law prior to the effective date of the new Article 9 remains effective and secured party may enforce the security interest under either non-Article 9 law or under the new Article 9. However, as discussed below, perfection may lapse after one year.

Earlier perfected security interests (§ 9-703). A security interest perfected under former Article 9 or outside of former Article 9 *remains* perfected if:

- the secured party perfected the security interest under prior law (under Article 9 or outside of Article 9), *and*
- the acts of perfection (under former Article 9 or outside of Article 9) would *also* perfect the security interest under new Article 9

Except for security interests perfected by filing under former Article 9 (discussed below), a security interest perfected under former Article 9 or outside of former Article 9 maintains perfected status for *only* one year after new Article 9 comes into effect if:

- the secured party perfected the security interest under prior Article 9 or outside of prior Article 9, *and*
- those perfection steps do *not* suffice to perfect the security interest under the new Article 9

Such a security interest *will* remain continuously perfected under new Article 9 if:

- the secured party had perfected the security interest under prior Article 9 or outside of former Article 9, *and*
- the secured party satisfies the creation and perfection requirements under new Article 9 within one year after the effective date of the new Article 9

Earlier attached, unperfected security interests (§ 9-704). A security interest that has attached under prior Article 9 remains *attached* (and enforceable) for one year *only* if:

- the security interest has attached (is enforceable) under prior law, *but*
- the security interest has not attached under new Article 9

The security interest remains enforce-

able *after* one year if the secured party takes any necessary additional steps for attachment under new Article 9 before or within one year after new Article 9 takes effect

An attached, but unperfected, security interest becomes *perfected* under new Article 9:

- if the secured party took appropriate steps to perfect the security interest under the rules of the new Article 9 *before* new Article 9 becomes effective, then when new Article 9 becomes effective
- if the secured party takes appropriate steps to perfect the security interest under the rules of the new Article 9 steps *after* new Article 9 becomes effective, then when the secured party takes those steps

Effect of action taken before effective date (§ 9-705). A security interest becomes perfected after the effective date of the new Article 9 and remains *perfected* for one year after the effective date of the new Article 9 if:

- the secured party has taken the acts effective to perfect (*other than by filing* a financing statement) under prior Article 9 at the time of effective date of new Article 9, *and*
- the security interest *attaches after* the effective date of new Article 9[12]

An act to perfect a security interest (other than by the filing of a financing statement) will perfect a security interest under new Article 9 for more than one year if:

- security interest attaches under new law, *and*
- the secured party has taken the acts sufficient to perfect under new Article 9 before *or* after the effective date of the new Article 9

The filing of a *financing statement prior* to the effective date of new Article 9 is effective to perfect a security interest under the new Article 9 to the extent it would be effective under new Article 9. This requires, among other things:

- a description of collateral that suffices under the new Article 9, and
- a filing in the correct state under the new Article 9

The filing of an effective financing statement under prior Article 9 remains effective under new Article 9 (including to perfect a security interest in collateral arising after the effective date of the new Article 9) until the *earlier* of:

- the normal lapse date of the financing statement (generally five years after filing of financing statement), and
- five years after the effective date of new Article 9

[12] § 9-703 (discussed above) deals with the circumstance of a security interest perfected before the effective date of the new Article 9 by a method other than the filing of a financing statement. Note that a security interest will not attach and thus not be perfected until the debtor has rights in the collateral. When the debtor acquires its rights in the collateral after the effective date of the new Article 9, § 9-705 applies.

A secured party may file a "real" "continuation statement" under new Article 9 to continue a financing statement filed under the prior Article 9 *only* if:

- the continuation statement is filed in the state where the financing statement was filed under prior law, *and*
- that state is the correct state for the filing of a *new* financing statement under the *new* Article 9

Initial financing statement filed in lieu of a continuation statement (§ 9-706). Unless a "real" "continuation" statement is filed under § 9-705 (as discussed above), a financing statement filed under the prior Article 9 is "continued" by:

- the filing of a complying *initial* financing statement under new Article 9, *and*
- the initial financing statement is filed in the correct state under the *new* Article 9 and contains certain required information concerning the continued financing statement in the other state

Effect of transition rules on priority (§ 9-709[13]). Prior Article 9 governs priorities if the relative priorities of the secured parties were "established" before new Article 9 came into effect. Otherwise, the new Article 9 governs priorities.

[13] The Standby Committee for Revised Article 9 has approved a new § 9-707 to resolve an ambiguity in Revised Article 9 dealing with how to amend or terminate a financing statement filed under former Article 9. This has resulted in the renumbering of §§ 9-707 and 9-708 to §§ 9-708 and 9-709.

Conclusion

Revised Article 9 brings Article 9 into the age of intangible property and adapts it to modern financing techniques. The adoption process moved on to the states. The effectiveness of the new Article 9 will:

- Facilitate financing,
- Reduce the cost of financing,
- Bring greater certainty to financing transactions, and
- Provide greater protections to debtors in the foreclosure process.

The Chair, the Reporters, the Drafting Committee, and the observers have worked hard and delivered an excellent product. We should all look forward to practicing under the new Article 9. ❾

April 1, 2000