THE UNIFORM COMMERCIAL CODE

Article 9 - Secured Transactions
OBJECTIVES

• What and Why of the UCC

• Some history of the UCC

• Article 9 – The nuts and bolts

• Purchase Money Security Interest (PMSI)

• Default, Enforcement & Bankruptcy
WHY TEACH THIS?

• Practical application – real world stuff

• Hard lessons learned
What is the Uniform Commercial Code?
**UCC IS A **UNIFORM ACT**

- A uniform act is proposed state law that is intended to bring uniformity between the states
- Legislative proposal to the states
- Aka a “model code”
- The UCC is not federal law
STATE ADOPTION OF THE UCC

- Only becomes law once adopted by the states
- States adopt as they see fit – verbatim or with changes
- What appears to be uniform is not truly “uniform”
UNIFORMITY TODAY

• Adopted by all 50 states – differing degrees

• Overall goal of uniformity essentially achieved

• Result – simply easier to do business across state lines
POLLING QUESTIONS

Which of the following statement is true about the UCC?
HISTORY OF THE UCC

• Longest and most elaborate of the Uniform Acts

• Began drafting 1st version in 1942

• 10 years to develop – 1st version released in 1952

• Revisions and amendments are made as our business environment evolves

  ➢ Amendments follow the same process
  ➢ Proposed and then adopted by the states
The UCC is broken into Articles (think chapters)

- Article 1: General Provisions & Definitions
- Article 2: Sales & Leases
- Article 3: Negotiable Instruments
- Article 4: Bank Deposits and Funds Transfers
- Article 5: Letters of Credit
- Article 6: Bulk Transfers
- Article 7: Documents of Title
- Article 8: Investment Securities
- Article 9: Secured Transactions
ARTICLE 9 – SECURED TRANSACTIONS

• **WIFM:**

  - Gain a security interest in personal property (assets) of a customer

**Become a secured creditor**
SECURED CREDITOR

• What is a secured creditor?
  - Creditor that has a perfected interest (valid claim) in an asset of a customer

• What does being a secured credit give me?
  - Right of repossession of the asset
  - Elevated priority in bankruptcy
  - Defense to preference in bankruptcy
NUTS AND BOLTS “THE DEFINITIONS”

• **Personal property**: the assets

  ➢ Exclusions include real property, aircraft, ships, and motor vehicles

• **Security agreement**: written document that describes the debtor’s assets (aka the collateral)

• **Security Interest**: creditor’s interest in the assets

• **Authentication**: action of signing the security agreement
NUTS AND BOLTS  “THE DEFINITIONS”

• **Attachment**: The acquired rights in the assets
  ➢ Occurs once security agreement is authenticated (signed)

• **Perfection**: steps taken by the secured party to ensure that the security interest in the assets will withstand attack by competing creditors or a bankruptcy trustee

• **UCC Financing Statement**: formal document filed with the proper authorities to “perfect” a security interest
PUT IT TOGETHER

• To obtain a perfected security interest in a debtor’s assets, a credit manager would . . .
  ➢ Draft a **security agreement**
  ➢ Have debtor **authenticate** (sign) the security agreement
  ➢ Creditor’s interest **attaches** to the asset and the **security interest** is created

• **File a UCC-1 Financing Statement**
  ➢ Form filed with the proper authorities
  ➢ Your security interest is now **PERFECTED**
POLLING QUESTION

If you have a security interest that is not perfected, are you a secured creditor?
NO PERFECTION = NO VALUE

• There is no real value in having a security agreement if you do not perfect your position

• You must file a UCC Financing Statement

• No perfection = Unsecured creditor

• Perfection = Secured creditor
THE SECURITY AGREEMENT

• Minimum requirements

  ➢ Identification of parties
    ➢ Debtor and secured party

  ➢ Granting clause
    ➢ Magic words “expressly grants security interest”

  ➢ Collateral Description
SECURITY AGREEMENT
EXAMPLE FROM CREDIT APP

To secure payment and performance of all obligations, Applicant hereby grants Seller a Purchase Money Security Interest in all inventory, equipment, and materials distributed by Seller, whenever sold, consigned, leased, rented or delivered, directly or indirectly, to or for the benefit of Applicant by Seller. This includes all construction related materials and services sold by Seller including but not limited to building materials, plumbing, appliances, waterworks, heating and air conditioning along with tools, safety accessories and related supplies ("Collateral")

• You can build a security agreement into your credit application
  ➢ Essentially obtain a security interest on every customer
  ➢ You decide if you perfect the interest
NO SECURITY AGREEMENT IN APPLICATION?

• Draft a standalone security agreement

• Examples

  ➢ *NACM’s Manual of Credit and Commercial Laws, Volume II. Chapter 6 “Applicable Forms”*

  ➢ Email me – I’ll send you examples
    ➢ adam.easton@ferguson.com
UCC FINANCING STATEMENT

• The form is universal and known as a UCC-1
  ➢ Must be filed with the proper authorities - secretary of state

• Requirements
  ➢ Debtor’s exact legal name
  ➢ Name of secured party
  ➢ Description of the collateral

• Mistakes in information when filing can cost you
UCC FINANCING STATEMENT

FOLLOW INSTRUCTIONS (front and back) CAREFULLY

A. NAME + PHONE OF CONTACT AT FILER (optional)
Smith, Michelle 440-461-9651
ucc@ncscredit.com 440-461-0822

B. SEND ACKNOWLEDGMENT TO: (Name and Address)
NCS
P.O. Box 24101
Cleveland OH 44124

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1. DEBTOR'S EXACT FULL LEGAL NAME - insert only one debtor name (1a or 1b) - do not abbreviate or combine names

   OR

   1a. ORGANIZATION NAME
   Roller Man Plumbing & Heating Incorporated
   FIRST NAME
   MIDDLE NAME
   SUFFIX
   CITY
   STATE
   POSTAL CODE
   COUNTRY

   1b. INDIVIDUALS LAST NAME

2. ADDITIONAL DEBTOR'S EXACT FULL LEGAL NAME - insert only one debtor name (2a or 2b) - do not abbreviate or combine names

   OR

   2a. ORGANIZATION NAME

   2b. INDIVIDUALS LAST NAME

3. SECURED PARTY'S NAME (or NAME OF TOTAL ASSIGNEE OR ASSIGNOR 5.P) - insert only one secured party name (3a or 3b)

   OR

   3a. ORGANIZATION NAME
   Ferguson Enterprises, Inc.
   FIRST NAME
   MIDDLE NAME
   SUFFIX
   CITY
   STATE
   POSTAL CODE
   COUNTRY

   3b. INDIVIDUALS LAST NAME

4. This FINANCING STATEMENT covers the following collateral:

   See Attached

5. ALTERNATIVE DESIGNATION (if applicable): LESSEE/LESSOR CONSIGNEE/CONSIGNOR SELLER/BORROWER AG. LIEN NON-UCC FILING

6. This FINANCING STATEMENT is to be filed for record (or recorded in the REAL ESTATE RECORDS, Attached Affidavit [if applicable]).

7. Check is REQUEST SEARCH REPORTED on Deliver
   [ADDITIONAL FEES]
   [All Deliveries] Deliver 1 Deliver 2

8. OPTIONAL FILER REFERENCE DATA covers the following collateral:

   NCS UCC #136901 REF # Master# 308810

SECURED PARTY COPY - UCC FINANCING STATEMENT (FORM UCC 1) (REV. 05/22/02)

Attachment - Collateral Information: it is generated by the system.

To secure payment and performance of all obligations, Applicant hereby grants Seller a Purchase Money Security Interest in all inventory, equipment, and goods distributed by Seller, whenever sold, consigned, leased, rented or delivered, directly or indirectly, to or for the benefit of Applicant by Seller, wherever located, now owned and hereafter acquired including, but not limited to all Plumbing, fixtures, Tools, Safety Products, Waterworks Products, HVAC Products, PVF Mechanical & Industrial Products accessories and supplies. The security interest extends to all repossessions and returns; and all proceeds from the sale, lease or rental; and all existing or subsequently arising accounts and accounts receivable, chattel paper, general intangibles, and supporting obligations which may from time to time hereafter come into existence during the term of this Security Agreement. Seller's security interest is explicitly limited to outstanding obligations between Seller and Applicant.
ABC Plumbing LLC has granted you a security interest in inventory. You are going to perfect your interest. ABC is a registered LLC in NC, warehouses inventory in NC, SC and GA, and the principal owners live in NY. In what state must you file the UCC-1 financing statement to perfect your interest?
UCC-1 FILING RULES

• You file in the state where the business is registered
  ➢ Corporations, LLCs, etc

• Unregistered organizations like general partnerships are considered located in the state where they have their principal office

• Individuals are considered located in the state of their primary residence

• When in doubt, file in multiple states – nothing prevents you from doing this
UCC-1: NO SIGNATURE REQUIRED

- The debtor has already authenticated (signed) the security agreement authorizing the creditor to file the UCC-1

  From Ferguson credit application:

  “Applicant authorizes Seller to file financing statements describing the Collateral along with other notices, and will assist Seller in taking any other necessary action to perfect and protect Seller's security interest.”
UCC-1
DURATION AND CONTINUATION

• Duration
  ➢ Five (5) years from the date of filing
  ➢ Lapses if not continued

• Continuation
  ➢ Amendment must be filed within six (6) months prior to the expiration date
  ➢ Again, does not require customer signature
  ➢ Valid for another five (5) years
UCC-1 CONTINUATION
PURCHASE MONEY SECURITY INTEREST (PMSI)

• A security interest granted to a trade creditor in goods sold on credit terms to the customer for the purchase price of the goods

➢ From the FEI credit application:

Applicant hereby grants Seller a Purchase Money Security Interest in all inventory, equipment, and materials distributed by Seller . . .
PURCHASE / MONEY – 2 PARTS

• “Purchase” or Products

  ➢ Security interest in the goods sold on credit terms for the purchase price

• “Money” or Proceeds

  ➢ Security interest in the debtor’s proceeds (money) from the sale of the goods
PMSI “SUPERPRIORTY”

• Superpriority status

  ➢ PMSI is granted superpriority status over existing perfected security interests

  ➢ You move to the front of the line

• Superpriority status is not automatic

  ➢ Strict notification requirement for perfection
PMSI – PERFECTION

• Must notify all other secured creditors
  ➢ Documented proof of notification

• Must have the appropriate granting language
  ➢ From Ferguson’s security agreement:

  Applicant hereby grants Seller a Purchase Money Security Interest in all inventory, equipment, and materials distributed by Seller . . .
PMSI PERFECTION CONCERNS

• In the event a customer has a banking relationship (line of credit), bank will have a perfected security interest

• Typically, the bank has a “blanket” filing covering all assets

• Most banks will object to your PMSI’s superpriority status
  ➢ Loan covenants
  ➢ Banks expect to be #1 in priority
PMSI – COMMUNICATION IS KEY

• Always discuss the PMSI with your customer before proceeding

• Always do a UCC search so you know of other existing secured creditors

• Subordination to the bank’s position is a possible solution
PMSI – WHAT IS IT NOT

• It is not a means to gain a security interest in debt that has already been incurred
  ➢ Article 9 of the UCC does not allow this

• It is a means to acquire a security interest in goods sold on credit terms going forward
PMSI CONCERNS

• Proceeds or “money”
  ➢ How can you prove that the proceeds (from the customer’s sale of your goods) belong to you?

• Commingled funds
  ➢ Customers comingle funds all the time
  ➢ In the real world, proving that commingled funds belong to you is a “wish and a dream” per respected BK counsel
PMSI CONCERNS

• Product or “purchase”
  ➢ What if the debtor is no longer in possession of the goods?

• Product is gone
  ➢ You are only a secured creditor to the extent that your collateral actually exists

  ➢ Direct shipments that the customer never possessed
    ➢ Direct Buy BK example
PMSI IN THE REAL WORLD

• Most of the time . . .

  ➢ The product sold is gone
  ➢ Proceeds are gone or comingled
  ➢ Product (commodities) can’t be identified
  ➢ Customer never even possessed the product
DEFAULT & ENFORCEMENT

• Get your product back
  ➢ Reclaim goods still in possession of customer upon default
  ➢ Present security agreement and perfected security interest
  ➢ Repossess peacefully – voluntary surrender

• Debtor refuses
  ➢ Get judicial help
  ➢ Replevin order granted by courts
  ➢ Replevin = “give me my goods back”
INSOLVENCY (BANKRUPTCY)

- When a debtor becomes insolvent, are you subject to the US BK Code

- Forget the UCC, you’re now subject to the US BK Code
  - The automatic stay, baring collection action, applies to secured creditors
  - Collection action or repossession without court approval could result in contempt

- You must file a motion for relief before . . .
  - Collection action or repossession of any kind
LESSON I’VE LEARNED

• It is not a means to extend credit to a customer that is not credit worthy on their own merits
  ➢ By the time you know there’s a problem . . .
  ➢ Repossession of collateral is unlikely – product you sold is gone
  ➢ The chance of proving the proceeds belong to you is a “wish and a dream”

• In bankruptcy
  ➢ Most debtors have few assets to liquidate
  ➢ You’re a secured creditor hoping for the best but expecting the worst

• Resist the “warm and fuzzy” – understand the real value