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
My story

The “unicorn commercial code”
POLLING QUESTION

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

• Not federal law

• The Code itself is not the law – it’s a “model code”
STATE ADOPTION OF THE UCC

• Only becomes law once adopted by the states

• Remember - the Code is a proposal

• States adopt as they see fit – verbatim or with changes

• What appears to be uniform is not truly “uniform”
UNIFORMITY

• Adopted by all 50 states – differing degrees

• Overall goal of uniformity essentially achieved

• What has your state adopted?
What is the purpose of the Uniform Commercial Code?
PURPOSE OF THE UCC

• Make it easier to do business across state lines
  • Uniformity in law governing commercial transactions

• Flexibility in state adoption
  • States can decide what works for them

• Bring some clarify to contracts
  • Attempts to fill gaps when contracts are silent
Which of the following statements is false regarding the Uniform Commercial Code?
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 are 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

- Article 9 – provides a framework for a creditor to obtain a security interest in the personal property of a debtor to secure payment of a creditor’s claim

  Become a secured creditor in the personal property

- A security interest is ONLY valid if a creditor follows the requirements of Article 9 of the UCC
DEFINITIONS – “NUTS & BOLTS”

• Personal property: exclusions include real property (real estate)

• Security Interest: interest in personal property created by the debtor to secure repayment of a debt
  • Requires that the debtor authenticate (sign) a security agreement

• Security agreement: describes the debtor’s assets subject to the security interest, aka the collateral
DEFINITIONS – “NUTS & BOLTS”

• Attachment: The security interest “attaches” to the collateral when the security agreement is signed - the debtor has acquires rights in the collateral

• Perfection: steps taken by the creditor to ensure that the security interest in the collateral will withstand attack
  • Competing Creditors
  • Bankruptcy Trustee

• UCC Financing Statement: formal document filed with the proper authorities to “perfect” your security interest
  • Document is a matter of public record for all creditors to see
NUTS & BOLTS TOGETHER

To obtain a perfected security interest in a debtor’s assets, a credit manager would . . .

- Obtain a security agreement
  - Describes the collateral
  - Authenticated (signed) by debtor
  - You now have a security interest that is attached to the collateral
- File a UCC Financing Statement
  - UCC-1 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 value in having a security agreement if you do not perfect your position

• You must file a UCC Financing Statement (UCC-1)

• No perfection = Unsecured creditor

• Perfection = Secured creditor
THE SECURITY AGREEMENT

• Minimum requirements
  • Identification of parties
    • Debtor and secured party
  • Granting clause
    • The magic words “expressly grants security interest”
  • Collateral Description
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"). The security interest extends to all repossessions, 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 Agreement. 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.

• If we have a signed credit application, we have an authenticated security agreement and therefore have a security interest in the described collateral.
NO SECURITY AGREEMENT IN APPLICATION?

• What are your options?
  
  • Draft a security agreement
  
  • Remember minimum requirements
  
• Need an example?
  
  • *NACM’s Manual of Credit and Commercial Laws*, Volume II. Chapter 6 “Applicable Forms”
    
    • Includes Simple Security Agreement
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

NAME: Michelle Smith
446-250-9651
ucc@ncscredit.com

ADDRESS: P.O. Box 24101
Cleveland OH 44124

5. ALTERNATIVE DESIGNATION (if applicable): Lessor, lessor, lessor's agent

This FINANCING STATEMENT is to be filed (or recorded in the REAL ESTATE RECORD, attached affidavit, if applicable) at the office of the Recorder of the County where the real property is located.

6. Optional filer reference data covers the following collateral:

NCS No: UCC # 5123991 REJ # 350939

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

ORGANIZATION NAME
Roller Manor Plumbing & Heating Inc.

ADDITIONAL INFORMATION
1. TYPE OF ORGANIZATION Corporation
2. JURISDICTION OF ORGANIZATION AK
3. ORGANIZATIONAL ID, if any 118357

3. SECURED PARTY'S NAME (name of TOTAL ASSIGNEE or ASSIGNOR OF) - Insert only one secured party name (3a or 3b)

ORGANIZATION NAME
Ferguson Enterprises, Inc.

ADDITIONAL INFORMATION
1. TYPE OF ORGANIZATION Corporation
2. JURISDICTION OF ORGANIZATION AK
3. ORGANIZATIONAL ID, if any

4. This FINANCING STATEMENT covers the following collateral:
See Attached

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, 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 in NC, warehouses inventory in NC, SC and GA, and the principal owners live in NY. In what state should you file the UCC-1 financing statement?
UCC-1 FILING RULES

• As a general rule, you file in the state where the organization is registered

• 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 NEED A SIGNATURE?

• No - signature is not required
  • The debtor has already authenticated the security agreement authorizing the creditor to file the UCC-1
    • 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.

• Duration
  • Five (5) years after the date of filing
  • Lapses if not continued
  • Security agreement is still valid but no longer a secured creditor
UCC-1 CONTINUATION

- Must be filed within six (6) months prior to the expiration date
- Again, does **not** require customer signature
- Valid for another five (5) years
PRIORITY RULES

• “First to file, first in right”
  • First secured party to file a UCC financing statement (perfect their security interest) has priority over competing secured parties

  • Again, the key word is file – your security agreement is worthless until you have filed your UCC-1

• Major exception to the “first to file” rule
  • Purchase Money Security Interest (PMSI)
PURCHASE MONEY SECURITY INTEREST

- Definition
  - A security interest granted to a trade creditor in goods sold on credit terms to the customer for the purchase price of the goods
PURCHASE / MONEY – 2 PARTS

• “Purchase”
  • Security interest in the goods sold on credit terms for the purchase price

• “Money”
  • Security interest in the debtor’s proceeds (money) from the sale of the goods
  • Allows access to co-mingled funds not specifically identifiable by the creditor or courts
    • 2001 revision adopted by the states
PMSI – THE SUPERMAN OF FILINGS

• 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 security agreement:

  Applicant hereby grants Seller a **Purchase Money Security Interest** in all inventory, equipment, and materials distributed by Seller . . .
• 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 – COMMON PITFALLS

• Poor communication with the customer

• Not understanding the notification requirement

• Not researching if the customer has other secured creditors and knowing who they are
PMSI & YOUR CUSTOMER’S BANK

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

• 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
DEFAULT & ENFORCEMENT

• Collection rights
  • A secured creditor may exercise collection rights with respect to the collateral & demand payment

• Non Judicial Repossession
  • Keep the peace
  • Taking possession of the collateral without any court action
  • Recovery through stealth or without permission could be viewed as theft

• Judicial Foreclosure
  • Court ordered turnover of collateral
ISSUES WITH ENFORCEMENT FOR FERGUSON

- Where did the collateral go?
  - By the time our customer is in default, the collateral (material) is probably gone
  - The money (proceeds) are probably nonexistent
  - How can you repossess something that isn’t there?

- Identity of collateral
  - We sell a lot of commodities that are similar to other suppliers
  - Equipment can be easily identified with serial numbers, but that too is probably gone
SO WHERE’S THE VALUE?

- You’re a secured creditor in bankruptcy
- Gives your demand a little more strength
- It might make repossession easier
- It’s better than not having it
INSOLVENCY (BANKRUPTCY)

• Forget the UCC, you’re now subject to the US Bankruptcy 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
  • Repossession of any kind

• In the end, you are a secured creditor in bankruptcy hoping that you’re first in line and the trustee has assets to liquidate and distribute
DISTRIBUTIONS IN BANKRUPTCY

- Secured creditors
  - Claims are paid in order of priority
  - PMSI, in most cases, gives you superpriority status
  - Secured creditor’s claims are always paid before unsecured creditors

- Unsecured creditors
  - Tossed into one bucket and claims are paid on a prorated basis
  - Only paid if all unsecured creditor’s claims are paid in full
LESSONS I’VE LEARNED

• Repossession of collateral is unlikely

• Most customers have few assets to liquidate in BK

• Even secured creditor’s claims can go unpaid

• PMSI: My lesson learned
  • Not a tool to extend credit to customers who are not creditworthy
QUESTIONS