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Secured Transitions: Getting It Right With UCC Filings

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Revised Article 9 of the Uniform Commercial Code (“UCC”), as adopted in each state, sets forth the methodology for perfecting lien securing lenders interests in particular pieces of collateral. It is critical to understand the search and filing process of the public records for a state or county’s lien search system so that a lender can perfect attached liens, identify perfected liens and make informed lending decisions. It should be recognized that UCC financing statements are not legal documents in and of themselves, but act as public notices which refer to an agreement between a lender and a borrower and allow a specific lien to be perfected and given a priority against other creditors.

Attachment and Perfection Together

Article 9 of the UCC provides minimum requirements for perfecting a secured interest in collateral property. Generally, the first secured party to file a UCC financing statement attains lien priority. However, prior to filing the financing statement, the security interest must “attach” to the collateral property. A security interest attaches to collateral property when the following occurs: value is given in exchange for the property; it is established that the debtor has rights in the property; and in most instances a security agreement has been entered into between the lender and the debtor wherein the collateral is described. In certain instances, the security agreement will have to describe the land upon which the collateral is situated.

There is no particular form that a security agreement must take. The necessary language can be contained in a promissory note, mortgage, deed of trust, pledge agreement or loan agreement, but it must explicitly grant a security interest to the secured party. There must be some indication of intent to grant the security interest. Security agreements are not required for attachment where the collateral involves deposit accounts, electronic chattel paper, investment property, or letters of credit which the secured party already has control over. However, it is considered a best practice to enter into some form of security agreement and/or control agreement and file a UCC financing statement notwithstanding the type of collateral.

Security agreements must provide a reasonable identification of the collateral property. Very generic descriptions, such as “all assets” or “all personal property” may not be sufficient for attaching a secured interest. A sufficient description would list the collateral by categories such as “all equipment, inventory, and accounts.”

A sufficient description should also include after-acquired property. Such property is collateral in which the debtor has no rights at the time of the transaction, but subsequently acquires rights to, like equipment purchased years after the transaction is completed. There must be an affirmative statement



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within the security agreement creating a secured interest in the after-acquired property. Language such as, “property now owned or hereafter acquired,” is typically used to effect attachment. It is a best practice to include this affirmative language in the UCC financing statement as well.

It is also considered a best practice to have the description of collateral found within the security agreement match the description on the UCC financing statement and to include proceeds associated with collateral in the description. Proceeds can be any property acquired upon sale, lease, exchange or other disposition of collateral, insurance payouts from loss or destruction of collateral, and anything collected or distributed on account of collateral.

Once a secured interest attaches to collateral property, that secured interest needs to be perfected to establish the lien priority. There are three general methods of perfecting a security interest: filing of a UCC financing statement (most common method); effecting possession of the collateral property; effecting control over the collateral property. In some cases, the attachment of a security interest automatically acts to perfect the security interest. Once a security interest is perfected, that security interest prevails over judgment creditors and bankruptcy trustees. It is best practice in all instances to file a UCC financing statement to reflect the security interest.

Get the Name Right

Personal property is generally not affixed to real estate and in many instances can be intangible. For these reasons, it is imperative that the names of the various parties in a UCC financing statement are accurate. A state or county’s lien search system’s capacity to detect a UCC filing is based solely on searching a debtor’s name. Inaccurate naming of a debtor on a filing can distort public records. With respect to entity debtors, such as corporations and limited liability companies the name to use is the exact depiction of the name of the entity as found in the public record at the time the entity was formed, as amended. This is known as the “Public Organic Record” as defined under the UCC. A party filing a UCC financing statement must be sure to spell the entity exactly as the entity’s name appears in its organizational documents and as filed in the office where the entity was registered, typically the secretary of state’s office. Use of precise punctuation and abbreviation is also necessary to ensure an accurate UCC filing. An entity’s “filed” certificate of formation or articles of incorporation will provide the accurate rendering of its name.

Issues with Individuals

Since there is no official index or organic public records for individuals, it is recommended that parties filing UCC financing statements use the name on a debtor’s unexpired driver’s license. Issues arise when: the debtor does not have a driver’s license; the format of a driver’s license does not distinguish among surname, first name and middle name; or the debtor has legally changed his or her name. States that adopted the 2010 amendments to the UCC give two options to utilize when

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determining how to identify an individual debtor's name. The first option is to use the debtor's name as it appears on an unexpired driver's license, known as "Alternative A" and "only if" that name appears on a financing statement. The second option, also known as the "safe harbor" option, and known as "Alternative B", provides more flexibility whereby the debtor's first name and surname can be used regardless of whether he or she has an unexpired license. Notwithstanding the availability of the Alternative B "safe harbor" option, most states have chosen to exclusively use the Alternative A option. If there is uncertainty concerning an individual debtor's name, it is considered a best practice to file multiple UCC financing statements using variations of the debtor's name, but include the exact name of the debtor appearing on the unexpired driver's license.

Where to File?

A security agreement can cover real estate, fixtures, or personal property and each of these categories have their own particularities as to how and where a secured interest can be perfected. Article 9 of the UCC only pertains to filing liens on fixtures and personal property. It provides for two filing options based on the type of property being used as security.

Fixtures

UCC financing statements covering fixtures must be filed in the recording office of the county where the real estate that the fixtures are connected to are situated. A fixture filing can also be done in conjunction with recording of a mortgage or deed of trust on the real estate. It should be noted that a UCC financing statement covering fixtures does not have to be filed if there is language within the recorded mortgage creating a secured interest in the fixtures under the UCC. Notwithstanding, it is considered a best practice to file a fixture UCC financing statement in addition to the filing of a mortgage or deed of trust.

Personal Property

UCC financing statements covering personal property must be filed in the central filing office of the state in which the debtor resides, typically the secretary of state's office. If the debtor is an entity, the state of residence is the state where the entity was formed or organized. If there is uncertainty concerning the debtor's place of residence, it is considered a best practice to file financing statements in multiple states.

Perfection by Pre-Filing

Secured parties have the option of pre-filing UCC financing statements prior to their security interests attaching to the collateral. This may enable secured party to get a senior lien position or prevent an intervening lien in the collateral, but it can only be done if the debtor grants written consent for pre-filing. The debtor's authorization must evidence an intent to grant a future security interest in



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the collateral. If the transaction does not end up occurring, the pre-filed financing statement must be terminated.

Ensuring Perfected Liens

To the extent there is confusion on where to file a UCC financing statement and against whom, it is always best to file multiple statements in multiple jurisdictions and/or against multiple variations of a debtor's name. It is also important to follow state or local filing requirements.

UCC financing statements are effective 5 years from the filing date. A lapse will occur unless a continuation statement is filed prior to the lapse. Thus, lien expiration dates need to be monitored. A continuation statement can be filed within a 6-month period prior to the expiration of the 5 year period which will extend the effective date of the original statement for an additional 5 years.

Conclusion

In order to maintain valid perfected security interests, it is essential to make sure that attachment and perfection have been effected in connection with the grant of a security interest. It is necessary to file perfected liens under the correct name pursuant to Article 9.

Termination dates must be monitored carefully, and continuation statements need to be filed within the 6-month period before the expiration of financing statements 5-year life. Pre-filing a UCC financing statement with borrower consent is a best practice to obtain a first in time filing race to obtain perfection and to prevent an intervening lien. Though the UCC as adopted in each state follows the model law, states or local offices may adopt specific local requirements that a filer needs to be aware of when filing UCC's.

For more information navigating the nuances of secured transactions and protecting liens, please contact Thomas L. Hofstetter at tlh@spsk.com or at (973) 769-4065.