B. Note by the Secretariat on article 9 of the Uniform Commercial Code of the United States of America (A/CN.9/132)*

CONTENTS

INTRODUCTION

1. By way of introduction to the discussion of the item "Security interests" held at the eighth session of the Commission, the Secretariat gave an oral report on article 9 of the Uniform Commercial Code of the United States of America. Several representatives requested the Secretariat to make that report available in a document.[1] This document is submitted in response to that request.

2. The Uniform Commercial Code (UCC) is a uniform law governing certain aspects of commercial law. It has been adopted by 49 of the 50 states. There are nine major subdivisions entitled "articles". Article 9 governs security interests in personal property (movables). It does not govern security interests in real estate except to the extent that it governs the conflict in priorities between security interests in fixtures, i.e. personal property, such as a furnace, which becomes attached to the real estate, and security interests in the real estate itself.[2]

3. Prior to the adoption of article 9 there was a wide variety of security interests in personal property available in one or more of the 50 states.[3] This variety is illustrated by UCC section 9-102 (2) which provides that article 9 applies "to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, or other lien or title retention contract and lease or consignment intended as security".

4. Each form of security interest had its own rules in respect of the formal requisites for validity, the secured party's rights against the debtor and third parties, the debtor's rights against the secured party, and the filing or registration requirements. The existence of so many separate forms of security interest had the result that half a dozen filing or registration systems covering security interests in personal property might be maintained within a single state, some of which were maintained on a local basis and some on a state-wide basis, each of which had to be checked to determine a debtor's status.

5. Despite the large number of security interests, there remained gaps in the structure. In many states a security interest could not effectively be taken in inventory, although there was a real need for such financing. In those states in which inventory financing was possible, it was often baffling as to how to maintain a technically valid security interest when financing a manufacturing process, where the property subject to the security interest, i.e. the "collateral", starts out as raw materials, becomes semi-finished goods and ends as finished goods.

6. This bewildering variety of security interests and

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* 28 February 1977.

[1] *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17* (A/10017), para. 62 (Yearbook..., 1975, part one, II, A).

[2] Sect. 9-313. See paras. 63-67, below.

[3] "State" law means the law of one of the 50 states. The law of the national Government is usually referred to as "federal" law.

legal rules greatly hindered the extension of credit on a national basis. On the insolvency of the debtor many creditors found that their security interests were unenforceable because they had not been created or perfected in accordance with the law of the state in which enforcement was sought.[4] Other creditors who were aware of the requirements of the local law found that the costs of adjusting their financing techniques to the exigencies of so many different systems of security interests greatly increased the cost of secured credit.

7. Article 9 was conceived and drafted to overcome these difficulties. Its purposes were:

To modernize the law of security interests;

To create a unified and coherent system of security interests within the state of enactment; and

To unify the law of security interests among the states and other political units of the United States.

There is general agreement in commercial and legal circles in the United States that it has solved these problems well. This is so even though complete uniformity among the states has not been achieved because of the adoption by some states of non-uniform provisions.

8. The major factor which distinguishes article 9 from the prior law is that one unified set of provisions based on functional considerations covers all forms of security interests in all kinds of personal property used as collateral. In particular the differences in the pre-UCC law between the rights and obligations of the parties where the creditor had title to the collateral (e.g. conditional sales contracts) and the rights and obligations of the parties where the debtor had title to the collateral have been eliminated. In substitution there is a distinction between "purchase money security interests" and security interests which are not for purchase money.[5] Article 9 also overcame the difficulties of using as collateral inventory and money claims not represented by an instrument. Its provisions govern the secured financing of industrialist, merchant, farmer and consumer alike.[6] This unified law of security interests was achieved by creating a new conceptual scheme, a scheme which often uses old ideas expressed in new language. Although the drafting of article 9 is detailed and has been said to be at times confusing, this conceptual scheme is not difficult.

9. Several versions of article 9 differing only in technical details have been promulgated. The discussion which follows is based on the current text, that of 1972.

Substantive provisions of article 9

Security agreement

Creation of security interests

10. Since article 9 covers only consensual security interests and not those interests created by operation of law, there must be an express contract for the security interest to arise.[7] This contract is called a "security agreement". There are few formal requirements for a security agreement to be valid and enforceable against the debtor and third parties.[8]

11. The security agreement can be oral if the "secured party" has possession of the collateral.[9] An oral security agreement made valid by possession is the article 9 version of the pre-UCC pledge.[10]

12. If the secured party does not have possession of the collateral, the agreement must be in writing and signed by the debtor.[11] Under the UCC such a signature may be made by a stamp or mechanical means as well as by hand.[12] The signature need not be notarized or otherwise authenticated.

13. A written security agreement must contain a description of the collateral.[13] The "description . . . is sufficient whether or not it is specific if it reasonably identifies what is described".[14] This rule rejects the earlier "serial number" test by which the description had to be specific. Therefore, a security agreement may use as general a description of the collateral as "all the inventory", if that indeed is an accurate description of the collateral. Nevertheless, the parties will normally specifically identify any collateral which can be so identified.

Other terms in the security agreement

14. In addition to these minimal requirements for validity, in practice most security agreements contain many clauses relevant to the contract between the parties. With few exceptions article 9 grants the parties complete freedom to fashion the security agreement as they wish so long as the provisions do not violate a general standard of good faith.[15]

15. There are two contract clauses, the validity of which were previously in doubt, which are specifically permitted: a "future advances" clause and an "after-acquired property" clause.

16. Under a future advances clause a current security interest is created in order to secure the repayment of money which the creditor agrees to lend to the debtor at some time in the future. There was a vaguely articulated prejudice against such clauses in the pre-UCC

[4] For the concept of "perfection", see paras. 21-42, below.

[5] For the concept of "purchase money" and the consequences for the parties which arise out of this concept, see paras. 49-53, below.

[6] In addition to article 9, there are a number of other laws which are relevant to consumer transactions involving security interests.

[7] However, certain limited security interests which arise under article 2 (Sales) and article 4 (Bank collections) are also included without the need of an express contract. Sect. 9-203 (1).

[8] In order to have "priority" against the rights of most third parties, the security interest must be "perfected". For a discussion of perfection and of priorities, see paras. 21-62, below.

[9] Sect. 9-203 (1).

[10] Possession also serves to "perfect" the security interest. See paras. 23-25, below.

[11] Sect. 9-203 (1) (*a*).

[12] Sect. 1-201 (39).

[13] Sect. 9-203 (1) (*a*). "[I]n addition, when the security interest covers crops growing or to be grown or timber to be cut, [the security agreement must contain] a description of the land concerned".

[14] Sect. 9-110.

[15] Sect. 1-208 limits the use of a term providing that one party may accelerate payment or performance or require additional collateral "at will" or "when he deems himself insecure". Sect. 9-501 (3) lists the rules dealing with procedure on default which cannot be waived or varied by the parties. No agreement which affects the priorities of third parties is binding on the third party absent his agreement. Cf. sect. 9-316.

The general obligation to act in good faith is found in sect. 1-203.

ing statement currently on file. The difficulty of searching files at a distance has been reduced by the provision which requires the filing officer on request (and the payment of a fee) to issue a certificate showing whether there is on file on the date and hour stated therein any presently effective financing statement naming a particular debtor and, if there is, giving the date and hour of filing of each such statement and the names and addresses of each secured party.[34] In addition, in some states the filing officers will answer telephonic inquiries, although this is not required by article 9. There are also commercial organizations which will search the files for a client.

36. A filed financing statement is effective for a period of five years from the date of filing at which time it lapses.[35] Continuation statements can be filed to extend the effectiveness of the original statement.[36] There is no limit to the number of continuation statements which can be filed. If a continuation statement is filed prior to the lapse of the original financing statement, the date of priority is determined by the date of filing of the original financing statement.

Certificate of title

37. In most states, once motor vehicles and the like are sold for use, they must have a certificate of title on which can be noted any security interests in the vehicle. In those states in which such a requirement exists, the notation constitutes perfection.[37] For all other purposes the security interest in the motor vehicle is governed by article 9.

Statutes and treaties of the United States

38. The federal government has by statute or treaty created special régimes for security interests in particular kinds of goods in which there is a special national or international interest. Some of these régimes are only for the recognition of security interests created in other countries,[38] some provide only for a means of perfection and leave other aspects of the law governing the security interest to the individual states,[39] while in a few cases a complete régime has been created.[40] In all these cases article 9, as state law, gives way to any conflicting provisions in the federal law.

Automatic perfection

39. There are a number of situations in which a security interest is considered perfected even though the collateral is in the possession of the debtor and no financing statement has been filed. In each case the total cost of perfecting, including the time of the personnel in filling out the forms and sending them to the appropriate office, was considered disproportionate to the loss of legal security suffered by third persons who may act in ignorance of the security interest. The most common situation envisaged is that in which the debtor has given a purchase money security interest in goods, other than motor vehicles or fixtures, which were purchased for his own personal, family or household purpose.[41] However, only two other situations, which are closely related to one another, are of commercial significance.[42]

40. To the extent that a securty interest in *negotiable* documents[43] arises for new value[44] given under a written security agreement, it is automatically perfected for a period of 21 days from the time it attaches.[45] This kind of interest can arise when a lender advances the funds necessary for the debtor to pay a draft which is accompanied by a negotiable document. Even if the lender does not take possession of the document, he can have a perfected security interest in the document for a period of 21 days. After this period of 21 days, the continuation of perfection would depend on filing a financing statement or taking possession of the document.[46]

41. Similarly, where the secured party has advanced funds and taken possession of a negotiable document as collateral, the document can be released to the debtor and the security interest will remain perfected for 21 days if the document is released in order for the debtor to sell or make necessary preliminary arrangements to dispose of the goods.[47]

42. In both these cases, which are sometimes referred to as "trust receipt transactions", the debtor needs possession of the negotiable documents for the purpose of reselling the goods, thereby raising the funds to reimburse the secured party, or for the purpose of "loading, unloading, sorting, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange".[48] Article 9, and the federal bankruptcy law, allow for the perfection to continue for 21 days even though the debtor has possession of the documents and there is no filing. However, anyone who purchases the documents or the goods represented by the documents

[34] Sect. 9-407 (2). For the procedure by which a potential lender of future credit can verify the current amount owed by the debtor and the specific items of property given by him as collateral, see sect. 9-208 and the official comments thereto.

[35] Sect. 9-403 (2).

[36] *Ibid.*

[37] Sect. 9-302 (3) (*b*). Motor vehicles held as inventory by a used or new car dealer are subject to the normal system of perfection by filing a financing statement.

[38] E.g., Convention on the International Recognition of Rights in Aircraft, Geneva, 19 June 1948, 310 UNTS 151.

[39] E.g., 49 USCA sec. 20c (railroad rolling stock); 49 USCA sec. 1403 (aircraft).

[40] E.g., 46 USCA secs. 911-984 (Federal Ship Mortgage Act).

[41] Although a purchase money security interest in goods, other than motor vehicles or fixtures which were purchased for his own personal, family or household purposes is automatically perfected and will have priority against other creditors and in bankruptcy, a buyer of the collateral will take free of the security interest, even though it was perfected, "if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods". Sect. 9-307 (2).

The concept of a "purchase money security interest" is discussed more fully at paras. 49-56 below.

[42] The list of security interests which are automatically perfected with neither a filing nor possession is given in sect. 9-302 (1) (*b*), (*c*), (*d*), (*e*), (*f*) and (*g*).

[43] For the concept of a negotiable document, see note 27 above.

[44] "New value" is not defined but in general it is to be distinguished from "old value", i.e. antecedent debt. See sect. 9-108, official comment No. 2.

[45] Sect. 9-304 (4).

[46] Sect. 9-304 (6).

[47] Sect. 9-304 (5).

[48] *Ibid.*

from the debtor in good faith has priority over the secured party in the documents or the goods.[49] In other words, such a perfected security interest is of value in case of conflict with other creditors but not in case of conflict with a good faith purchaser.[50]

PRIORITIES

43. A secured party will wish to perfect his security interest in order to establish his priority against third parties in the distribution of the debtor's assets in case of the debtor's insolvency. The security party may need to assert his security interest in particular collateral against four major classes of third parties:

Holders of liens which are not security interests;

other secured parties;

Purchasers of the collateral;

Trustee in bankruptcy.

Holders of liens

44. In general, liens arising by operation of law or through the execution of a judgement or the like have priority over all security interests which are unperfected at the time the lien is created.[51] Conversely, perfected security interests have priority over all liens created subsequent to the date of perfection.

45. The one major exception to this rule is that if the lien is possessory and it arose from the furnishing of services or materials with respect to goods subject to a security interest in the ordinary course of the lien holder's business, the lien normally has priority over a perfected security interest.[52] The most common situation in which such a possessory lien arises is when an automobile or other goods subject to a perfected security interest is taken to a dealer for repair. The dealer has a possessory lien for the value of the repairs done to the automobile. This possessory lien would normally take priority over the prior perfected security interest in the automobile. However, if the dealer returned the automobile to the debtor, he would lose his possessory lien and therefore his priority.

Other secured parties

46. In a contest for priority between two unperfected security interests in the same collateral, the first security interest to have attached to the goods prevails.[53]

47. In a contest for priority between a perfected and an unperfected security interest, the perfected security interest prevails even though it was created later in time and even though at the time of creation or perfection the perfected secured party knew of the earlier created unperfected security interest.[54]

48. In general, in a contest for priority between two perfected security interests, the first security interest to have been perfected prevails.[55]

49. The major exception to this latter rule arises when the subsequent security interest is a "purchase money security interest". A security interest is a purchase money security interest if either: (i) the seller of the collateral has taken or retained a security interest in the collateral to secure all or a part of its price (similar to the pre-UCC conditional sale) or (ii) a bank or other financing institution has financed the acquisition of the collateral and has taken a security interest in the collateral to secure repayment.[56]

50. Unlike the situation under the pre-UCC law of conditional sales, the fact that a security interest is a purchase money security interest gives the secured party no rights against the debtor which other secured parties do not have. In particular, he may not retake "his" goods if the debtor is in default in repayment of the obligation unless the debtor does not object to such a retaking.[57]

51. However, a purchase money security interest can take priority over an earlier perfected security interest which is not a purchase money security interest if the proper procedure is followed.[58]

52. *Example*: A has a security interest in all D's equipment "now owned or to be acquired during the life of this security agreement" to secure a loan of $1,000. A's security agreement was perfected on 1 February. On 1 March D purchases a new machine tool for $10,000 from B. He pays B $1,000 cash and arranges to pay the remaining $9,000 over the next three years. To secure the $9,000 obligation, he gives B a security interest in the machine. Although A has a perfected security interest in the machine tool by virtue of the pre-existing after-acquired property clause, the priority of which dates from 1 February, B has priority over A by virtue of his purchase money security interest if he perfects his security interest by the time D receives possession of the machine or within 10 days thereafter.[59]

53. If the purchase money security interest is with respect to inventory, the purchase money secured party must give notification in writing to any person who has filed a financing statement with respect to inventory in order to have priority over that person.[60] The reason for this special rule is that a secured party who has taken inventory as collateral expects there to be a turnover in the specific items of inventory with all new purchases to become part of the collateral in replacement of that which has been sold in the ordinary course of business. If this is not to be the case he should be so notified in time to protect his interests.

54. It should be noticed that where the security in-

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[49] Sects. 9-307 (1) and 9-309.

[50] Even in the case of unauthorized sale, the secured party will have a continuing perfected security interest in the proceeds. See paras. 68-71, below.

[51] Sect. 9-301 (1) (*b*) and (3).

[52] Sect. 9-310.

[53] Sect. 9-312 (5) (*b*). As to the time when a security interest attaches, sect. 9-203 (2).

[54] Sect. 9-301 (1) (*a*).

[55] Sect. 9-312 (5) (*a*). In a technical sense this statement is not true where a financing statement has been filed prior to the making of the security agreement. As noted in para. 29 above, in such a case the date of priority is the date of filing, even though the security interest is not perfected until it comes into existence.

[56] Sect. 9-107.

[57] In fact, in one special case involving consumer goods the rights of the secured party to retain the collateral in satisfaction of the obligation are more restricted if the security interest is a purchase money security interest than if it is not. Compare para. (1) of sect. 9-505 with para. (2) of that section. See also para. 72, below.

[58] Sect. 9-312 (3) and (4).

[59] Sect. 9-312 (4).

[60] Sect. 9-312 (3).

terests have been perfected by filing, the rule giving priority to the first to file taken in conjunction with the notice filing system could lead to a situation where a debtor could find it difficult to use some of his goods as collateral for a loan.

55. *Example*: A files a financing statement on 1 February in anticipation of the lending of money to D in the future. The financing statement describes the collateral as "all inventory now owned or to be acquired". The anticipated loans are not made. On 1 July D goes to B to arrange to borrow money and offers to put up his inventory as collateral. B checks the financing statements on file under D's name and finds the statements filed by A. B knows that if A ever advances credit to D taking inventory as collateral, A will have priority over B even if B had previously advanced credit to D. In such a situation B may refuse to lend to D so long as there is the possibility that A could take priority over him by virtue of a later advance of funds.

56. Article 9 provides two means by which this result can be avoided. As described above, if B makes a purchase money advance to D and follows the prescribed procedure, he will have a priority over A. Secondly, section 9-404 allows the debtor (D) to require the secured party (A) to terminate the financing statement "whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value", as is the case in the example given.

Purchasers

57. The general rule is that purchasers of the collateral purchase it subject to the security interest.[61] This general rule is, however, subject to several important exceptions.

58. If the security interest is *unperfected*, any purchaser takes free of the security interest if "he gives value and receives delivery of the collateral without knowledge of the security interest".[62]

59. If a security interest in negotiable instruments or documents (or the two combined, which in article 9 terminology is called "chattel paper") is perfected by filing a financing statement, by the automatic perfection rules of section 9-304 (4) and (5)[63] or as proceeds under section 9-306 (2) and (3),[64] i.e. if the security interest is perfected in any manner other than by the secured party taking possession, a good faith purchaser of the instruments, documents or chattel paper takes free of the security interest.[65]

60. The most important exception to the general rule is that even if a security interest in inventory is perfected, a buyer in ordinary course of business (other than a purchaser of farm products from a farmer) takes free of the security interest even though the buyer knows of the security interest.[66] The reason for this rule is that it must be anticipated that inventory used as collateral will be sold in the ordinary course of business. The secured party's only legitimate interest is that, if the obligation is not to be paid immediately, he must be assured that his security interest will attach to the proceeds of the sale[67] and, if he so stipulates in his security agreement by an after-acquired property clause, to the replacement inventory.

Trustee in bankruptcy

61. Bankruptcy is governed by the law of the federal government. In case of conflict with the law of any state, including the Uniform Commercial Code, the federal bankruptcy law prevails.

62. When a person goes into bankruptcy, a "trustee in bankruptcy" is appointed to take control of the debtor's assets, to conduct the debtor's business operations if their continuation appears warranted, and to pay the creditors. In general the trustee in bankruptcy takes the debtor's assets subject to any prior *perfected* security interests. However, an unperfected security interest is of no value in bankruptcy and the unperfected secured party has the same status in the distribution of the bankrupt's assets as would an unsecured creditor.

FIXTURES

63. A special difficulty was encountered in reconciling the conflicts between a security interest in personal property and a security interest in the real estate to which that personal property becomes attached. The law in the United States governing rights in real estate is quite different from that governing rights in personal property and it differs markedly among the 50 states. In particular there is substantial disagreement as to the circumstances under which personal property becomes so attached to the real estate that it is subject to existing interests in the real estate even though it does not become part of the real estate, i.e. that it becomes a "fixture". In 1972 it was considered that, as a consequence of these difficulties, the earlier versions of section 9-313 on the priority of security interests in fixtures were inadequate and the text was substantially revised.

64. Even under the 1972 definition of a "fixture", i.e. goods which "become so related to particular real estate that an interest in them arises under real estate law" but which are not "ordinary building materials incorporated into an improvement on land",[68] the ultimate question of which goods are fixtures is left to the non-uniform provisions of the real estate law of each of the states. Goods which are in some manner related to particular real estate but which are not fixtures either (i) remain as ordinary goods, in which case the normal rules governing security interests in personal property are applicable, or (ii) become a part of the real estate in which case none of the rules governing security interests in personal property is applicable.

65. A security interest in fixtures is perfected by filing a financing statement containing all of the information required of any other financing statement plus "a description of the real estate".[69] The financing statement must be filed "in the office where a mortgage on the real estate would be filed or recorded",[70] which in some states would be the same office in which financing

[61] Sect. 9-306 (2).
[62] Sect. 9-301 (1) (*c*).
[63] See paras. 40-42, above.
[64] See paras. 68-71, below.
[65] Sects. 9-308 and 9-309.
[66] Sect. 9-307 (1).
[67] See para. 68, below.
[68] Sect. 9-313 (1) (*a*) and (2).
[69] Sect. 9-402 (5).
[70] Sect. 9-401 (1) and 9-313 (1) (*b*).

statements perfecting security interests in other personal property would be filed but in other states would not.

66. The two main rules in respect of priorities between a security interest in a fixture and an interest in the real estate are that, subject to certain technical requirements

> A security interest in fixtures, whether for purchase money or not, has priority over subsequent real estate interests only if a financing statement is filed before the subsequent real estate interest is of record;[71]
>
> A purchase money security interest in fixtures has priority over pre-existing real estate interests, including real estate mortgages and other security interests in the real estate, if a financing statement is filed either before or within 10 days after the goods become fixtures.[72]

67. The official comments to section 9-313 explain that the priority of purchase money security interests in fixtures over pre-existing real estate mortgages and other such interests, which was a change in the law in most of the United States, was intended to make available the "short-term credit necessary for the modernization of real estate by the installation of new fixtures [, such as furnaces, air-conditioning equipment and the like, which] in the long run could not [but] help real estate lenders".[73]

PROCEEDS

68. "Proceeds" includes whatever is received upon the sale, exchange or other disposition of collateral.[74] In some cases, such as inventory, sale is not only authorized by the secured party, it is desired, because it is only by such sale that the debtor can acquire the money to repay the debt owed. In other cases the disposition may be unauthorized or even involuntary, as in the case of the destruction of the collateral by fire where the insurance proceeds become "proceeds" under article 9.[75]

69. Whatever the nature of the disposition and whatever the nature of the proceeds which result, the general rule is that, unless otherwise agreed, a security agreement automatically gives the secured party a security interest in any identifiable proceeds.[76] Moreover, the general rule is that if the security interest in the original collateral was perfected, the security interest in the proceeds is also perfected.[77]

70. The security interest in the proceeds attaches to all proceeds which can still be identified. This is true whether the proceeds are other goods taken in exchange, accounts or notes receivable, checks which have not been deposited or cash which has not been commingled. Once the proceeds have taken the form of cash or of bank or other deposit accounts in which the proceeds have been commingled with other funds, a perfected security interest continues in the cash or deposit account limited to an amount not greater than the amount of any cash proceeds received by the debtor within 10 days before the institution of the insolvency proceedings less certain deductions.[78]

71. When the collateral disposed of is inventory, a continuing security interest in the proceeds and an after-acquired property clause by which incoming inventory is made subject to the security agreement serve much the same purpose. In both cases the total value of the collateral to secure repayment of the obligation owed to the secured party remains approximately the same even though the individual items change.

PROCEDURE ON DEBTOR'S DEFAULT

72. The procedure to be used on the debtor's default is designed to achieve the dual goal of assuring to the largest degree possible that the secured party will be paid the money owed him and that the debtor will suffer the least possible loss of property in the process. As one consequence of this policy, the secured party has lost the unilateral right he had under the typical pre-UCC conditional sales (i.e. title retention) statute to take and keep "his" goods. After default the secured party may propose to retain the collateral in full discharge of the obligation. However, if the debtor objects, as he would if the collateral could be sold for more than the outstanding claim, the collateral must be sold.[79] Moreover, any surplus from the sale of the collateral must be turned over to the debtor.[80]

73. Prior to the UCC the taking of possession of the collateral and the foreclosure sale were often the function of government officials, usually the sheriff. Experience showed that this was not the best system, either for the secured party or for the debtor. It was slow, it was administratively expensive, and the price received for the collateral was usually only a small fraction of its value. The debtor's right for a specified period of time to repurchase the collateral at the price paid at the foreclosure sale plus expenses was not a guarantee against a low sales price. In fact the existence of such a right of redemption lessened the value of the goods to the purchaser at the foreclosure sale, thereby causing the sales price to drop even lower.

74. Article 9 operates on the theory that on balance it is better for all parties if the foreclosure sale is as much like a commercial sale as possible. Therefore, "unless otherwise agreed a secured party has on default the right to take possession of the collateral . . . without judicial process if this can be done without breach of the peace or [the secured party] may proceed by [judicial] action".[81] Once the secured party has possession of the

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[71] Sect. 9-313 (4) (*b*).

[72] Sect. 9-313 (4) (*a*). This rule does not apply where the conflicting real estate interest is a construction mortgage which was recorded before the goods became fixtures if the goods became fixtures before the completion of construction (sect. 9-313 (4) (*b*)).

[73] Sect. 9-313, official comment No. 8.

[74] Sect. 9-306 (1).

[75] This last point was not clear under the pre-1972 versions of article 9. Sect. 9-306 (1) now reads in part, "Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement".

[76] Sect. 9-306 (2).

[77] Sect. 9-306 (3). The statement in the text is subject to a number of technical, but important, exceptions which are set out in sect. 9-306 (3).

[78] Sect. 9-306 (4). Some question has been raised as to whether the provision will be enforced in bankruptcy proceedings, but the issue has not as yet been faced in a clear manner.

[79] Sect. 9-505. For a more restrictive rule where the security interest is a purchase money security interest in goods purchased for personal, family or household purposes, see sect. 9-505 (1).

[80] Sect. 9-504 (2).

[81] Sect. 9-503.

collateral after default he "may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing".[82]

75. "Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable."[83]

76. Experience with article 9 during the 10 to 20 years it has been in force has shown that when the debtor is himself a merchant, there is little reason to fear the potentialities for abuse by the secured party inherent in these default procedures. Merchant-debtors know the market for the collateral and they can either sell the collateral themselves at the best possible price and apply the proceeds to the obligation or they can advise the secured party of possibilities of sale. If the secured party does not follow such advice and receives a lower price for the collateral than he might otherwise have obtained, a court might later conclude that disposition was not effected "in a commercially reasonable manner".[84]

77. There are special rules within article 9 to protect consumer debtors who are less able to protect themselves against overreaching secured parties.[85] Moreover, in recent years there have been a number of new statutes and regulations, especially by the federal government, designed to protect consumers and some of these new rules affect default proceedings under article 9.

FOREIGN TRANSACTIONS

Recognition of foreign-created security interests

78. If a security interest is created in one state and the collateral is subsequently removed to a second state, the secured party will wish to enforce his security interest in the second state. Even within the United States prior to the widespread enactment of the UCC this caused serious problems because there were security devices in use in some states which did not have corresponding régimes in other states. At times the result was that the original security interest was lost if the collateral was removed from the state of origin with or without the consent of the secured party.

79. This is no longer the case under article 9. If a security interest was validly created under the provisions of article 9 in one state, there is no question but that it will be recognized as having been validly created under the identical provisions of article 9 in any other state to which the collateral may have been removed. Furthermore, it would be unusual for a security interest to have been validly created under the law of a foreign country but not to be valid according to the criteria of article 9, at least if the security agreement was in written form.[86]

80. The rights and obligations of the debtor and the secured party and the priorities between the secured party and third parties are those specified in article 9 in the state of enforcement rather than those specified under the law of the state where the security interest was created.[87] Security interests created in other states of the United States, except for Louisiana, are enforced as they were created now that all states other than Louisiana have enacted the UCC. Although security interests created in foreign countries are enforced under a régime different from the régime of creation, there is an assurance that the foreign-created security interest will be enforced. Moreover, since article 9 permits the parties to determine the majority of the provisions in the security agreement, the terms of the foreign-created security agreement would govern the transaction except as those provisions contravened the few specific prohibitions in article 9. However, the system of priorities may be different than it was in the country in which the security interest was created.

Perfection of foreign-created security interests

81. It would be possible to recognize the foreign act of perfection of the security interest to the same degree as is recognized the foreign act of creation. However, once the collateral has been brought to a second state, third parties who are interested in determining the status of those goods would look under the name of the debtor in the appropriate office in that state. They would not find the original financing statement there. On the other hand it would be excessively harsh on a secured party if the security interest was no longer perfected as soon as the collateral was removed from the state in which the security interest was originally perfected. No secured party can be expected to watch the collateral constantly to see that it has not been removed. Removal of the collateral is, of course, a more likely event between two states of the United States than it is between two countries.

82. Several different means have been used to overcome these difficulties. Long prior to the widespread enactment of the UCC some federal statutes were enacted providing for a nation-wide system of perfection for certain items of collateral of national or international interest.[88] Many, but not all, states require motor vehicles to have certificates of title on which all interests in the vehicle, including security interests, must be noted. So long as such a certificate of title is outstanding, the security interest noted thereon is perfected wherever the vehicle might go.

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[82] Sect. 9-504 (1).

[83] Sect. 9-504 (3).

[84] "The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner." Sect. 9-507 (2).

[85] Sect. 9-505.

[86] That a valid security interest created in another state is to be enforced is clear from sect. 9-103. It is unclear whether a foreign-created security interest would be enforced under article 9 if it was not valid where created. But see sect. 1-105 on the parties' right to choose the law applicable to the security agreement.

[87] Although this result is nowhere specifically stated, it would be surprising if under sect. 1-105 any law were applied other than that of the state where tangible collateral is located at the time the default proceedings are begun.

[88] See para. 38, above.

83. For other collateral in which a security interest has been perfected in one state, article 9 provides that the perfection remains valid for four months after the collateral has been removed to a second state.[89] If within that four-month period of time the secured party reperfects by taking possession of the collateral or filing a financing statement in the second state, the perfection continues to be valid in that state and the priority dates from the original act of perfection in the first state.

84. *Example*: Secured Party perfects a security interest in machines by filing in state X on 1 February. On 1 March Debtor takes the machinery to state Y. (It is not important whether this happened with or without the consent of Secured Party.) The security interest will automatically continue to be perfected in state Y until 1 July. If Secured Party reperfects by filing a financing statement in state Y before 1 July, the date of priority in state Y is 1 February, the date of the original perfection in state X. If Secured Party reperfects in state Y on 15 July, i.e., after the expiration of the four-month period, the date of priority in state Y is 15 July.

85. This system of perfecting in two different states is not necessary if the collateral was purchased in state X with the understanding that it would be taken to state Y within 30 days. If the seller delivers the goods in state Y, there is, of course, no difficulty; since the buyer acquires his rights in the goods in state Y, the security interest attaches in state Y and it must be perfected in state Y. However, if the seller delivers the goods in state X and the buyer is to take them to state Y, the security interest in the goods must be perfected in state X as well as in state Y if the secured party is to be fully protected. In order to avoid the necessity of two filings in such a situation, article 9 provides that the secured party can file in the state to which the goods are intended to be taken, i.e. state Y, and for a period of 30 days the security interest is perfected in state X.[90] If the collateral remains in state X for more than 30 days, the security interest must be reperfected in state X for the perfection to continue without lapse.

86. *Example*: Goods are sold and delivered to Debtor in state X on 1 June with the understanding that they will be taken to state Y during the month of June. A security interest in the goods (normally for the unpaid balance of the price) is perfected in state Y on 1 June. The goods are taken to state Y on 20 June. During the period 1 to 30 June the security interest is perfected in state X, even though no act of perfection takes place in state X. The security interest is also perfected in state Y and the date of priority is 1 June.

[89] Sect. 9-103 (1) (*d*).

[90] Sect. 9-103 (1) (*c*).