

Perfection of security interest in personal property

A secured party provides constructive public notice of its interest in personal property or fixtures by perfecting its security interest. Perfection affords the secured party a claim to the collateral that is superior to someone that obtains a lien through the judicial process subsequent to perfection (a "lien creditor"). Perfection also protects the security interest from avoidance by the bankruptcy trustee or debtor-in-possession, just as recording of a mortgage or deed of trust on real property protects the consensual lien on real property against avoidance in bankruptcy. See [Commentary.Avoiding liens in bankruptcy](#). Some forms of perfection also protect the secured party's interest in collateral, including proceeds of the disposition of collateral, against the competing claims of *some* other creditors and purchasers.

The method of perfection depends upon the type of collateral, but in all cases requires at least the attachment of a security interest. [U.C.C. 9-308\(a\)](#). Attachment is discussed in [Commentary.Enforceability of consensual lien in personal property and fixtures](#). For some types of collateral one method of perfection is mandatory and for other types of collateral more than one method of perfection is permissible. The methods of perfection are: (1) automatic perfection (i.e. nothing beyond attachment of the security interest is required); (2) filing a financing statement (not to be confused with a "financial statement" prepared by an accountant to report relevant financial facts about an entity); (3) possession of the collateral; (4) control of the collateral; or, (5) compliance with state certificate-of-title legislation covering automobiles, trailers, mobile homes, boats, farm tractors, and the like, or compliance with a pre-empting statute, regulation, or treaty of the United States.

We consider one important type of transaction for which perfection is automatic: the purchase-money security interest in consumer goods. There are thousands if not millions of such transactions annually. Note that this is but one of thirteen types of security interests in which perfection is automatic. See [U.C.C. 9-309](#). We also consider a variety of issues relating to the filing of a financing statement (content of the financing statement, location of filing, necessity to amend or refile) and summarily consider perfection through possession, control, or compliance with certificate-of-title legislation.

Remember that failure to perfect a security interest does not render the security interest unenforceable against the debtor. However, failure to perfect a security interest risks avoidance of the security interest in bankruptcy or subordination to the claims of third parties. See [Commentary.Enforceability of consensual security against third parties](#).

Enforceability of consensual lien against third parties

In [Commentary.Enforceability of consensual lien in personal property and fixtures](#) and [Commentary.Enforceability of consensual lien on real property](#), both of which deal with the enforceability of consensual liens against a debtor, we do not mention recording, perfection, public notice, or the like. The consensual secured creditor need do nothing beyond meeting the requirements discussed in those commentaries to foreclose the debtor's rights in the collateral if the debtor defaults. A debtor may not defeat the attempt of the holder of a consensual lien to foreclose on collateral with the plea that a deed of trust has not been recorded or a security

interest has not been perfected. Public notice protects the interests of third parties, those who are external to the consensual secured transaction. Public notice is not a protection for the debtor.

For this reason, your instructor may have chosen, as we do, to delay consideration of recording and perfection, and the consequences for the secured party of failure to take these steps, until after having fully considered the rights of the secured party against the debtor. But the consequences will be severe: the secured party's unrecorded lien may be subordinate to other parties claiming an interest in the same property or, in bankruptcy, the secured party's unrecorded lien may be eliminated entirely. Thus, it is critical for the secured party to take steps necessary to protect its interest in the debtor's property against third parties at the same time it takes the steps necessary to ensure that it can, upon default, foreclose the debtor's interest in the property.

For the time being, you know enough about recording a mortgage from your first year Property course to understand the concept of the secured party giving public notice of its interest in property.

Enforceability of consensual lien in personal property and fixtures

[U.C.C. 9-203\(b\)](#) states three requirements for a security interest in personal property and fixtures to be enforceable by a secured party against a debtor: (1) the debtor and the secured party must have authenticated a security agreement that contains a description of the collateral or the collateral must be in the possession or control of the secured party pursuant to a security agreement between the debtor and the secured party; (2) the secured party must give value to the debtor; and, (3) the debtor must have rights in or power to transfer rights in the collateral that is the subject of the security agreement. Once the security interest becomes enforceable against the debtor it is said to attach to the collateral (unless the agreement of the parties explicitly postpones the time of attachment). [U.C.C. 9-203\(a\)](#).

A "security agreement" between the debtor and the secured party is a defined term ([U.C.C. 9-102\(a\)\(73\)](#)) that requires further reference both to the definition of "security interest" ([U.C.C. 1-201\(37\)](#)) and to the definition of "agreement" ([1-201\(3\)](#)). Notice that the definition of agreement includes oral bargains as well as bargains that arise from circumstances such as usage of the trade, course of dealing, or course of performance. Thus, a security agreement may be oral. However, because of the danger that a party might fabricate a claim of a security interest, the drafters have required some additional evidence of the existence of a security agreement as a condition to its enforceability. See [Official Comment 3 to U.C.C. 9-203](#). To determine the nature of the additional evidence required, one needs to know if the security interest will be possessory or non-possessory, or, in the case of some types of collateral, whether the secured party has control over the collateral.

A security interest is non-possessory if the secured party does not have possession of the collateral. Many consensual secured transactions involving personal property or fixtures are non-possessory. The debtor whose equipment, or inventory, or car, or furniture is collateral needs to use and therefore retain possession of the collateral. For other kinds of collateral, such as accounts or general intangibles, there is nothing physical to possess. A non-possessory security agreement will be enforceable only if it is evidenced by recorded language,

authenticated by the debtor, that reflects an agreement by the debtor to grant a security interest and sufficiently describes the collateral. [U.C.C. 9-203\(b\)\(3\)\(A\)](#). Authentication of recorded language means the debtor's signature, use of a symbol, or other action that confirms the debtor's identity and indicates the debtor's assent to or adoption of the recorded language. See [U.C.C. 9-102\(a\)\(7\)](#)("authenticate") and [U.C.C. 9-102\(a\)\(69\)](#)("record"). The concept of an authenticated record, replacing the old Article 9 concept of a signed writing, accomodates electronic technology and commerce. An authenticated record of the security agreement must describe the collateral in the manner stated in [U.C.C. 9-108](#). That section expands considerably on the more terse definition of sufficient description found in former Article 9 (former U.C.C. 9-110), a definition that had engendered much litigation concerning the sufficiency of description of collateral in a security agreement. The authenticated record need not be a single document. No doubt, as under former Article 9, we shall continue to see controversies about whether several authenticated records taken together will be sufficient to indicate the debtor's agreement to a security interest. See, e.g., [Komas v. Future Systems Inc.](#)

A security interest is possessory if the secured party has possession of the collateral. For example, a [pawn shop](#) may hold a ring as collateral for repayment of a loan, or a bank may hold grain to secure repayment of a loan to a farmer by holding a [negotiable warehouse receipt](#) issued by a storage facility in which the grain is stored. For all collateral other than certificated securities, if the security interest is possessory, the security agreement can be enforceable in the absence of an authenticated record if the secured party has possession pursuant to the agreement between the parties. Possession by the secured party is thought to be sufficient confirming evidencing of the existence of the security agreement. [U.C.C. 9-203\(b\)\(3\)\(B\)](#).

If the collateral consists of deposit accounts, investment property, letter-of-credit rights, or electronic chattel paper, the security agreement will also be enforceable if the secured party has control over such collateral pursuant to the debtor's security agreement, even if the security agreement is oral. [U.C.C. 9-203\(b\)\(3\)\(D\)](#). Control over these types of collateral is defined in [U.C.C. 9-104](#), [9-105](#), [9-106](#), and [9-107](#). If the collateral consists of a certificated security in registered form, the security agreement will be enforceable if the security has been delivered to the secured party pursuant to the debtor's security agreement. [U.C.C. 9-203\(b\)\(3\)\(C\)](#).

In some cases, such as a corporate merger, a person not originally a party to a security agreement (e.g. an acquiring company) may become bound as debtor to a security agreement entered by another person (e.g. an acquired company). See [U.C.C. 9-203\(d\), \(e\)](#).

There are a few types of security interests governed at least in part by Article 9 that are enforceable even in the absence of an agreement of the parties, i.e. they are non-consensual. See [U.C.C. 9-203\(c\)](#). For example, under U.C.C. Article 2, a buyer of goods entitled to revoke acceptance of those goods (i.e. return the goods to the seller and cancel the contract) has a security interest in the goods in the buyer's possession to secure repayment of any portion of the purchase price already paid. U.C.C. 2-711(3). As long as the buyer retains possession of the goods, no agreement is necessary to make this security interest enforceable against the debtor. [U.C.C. 9-110\(1\)](#). In this example, what is the debt? Who is the debtor?

Under [U.C.C. 9-203\(b\)](#), a security agreement is enforceable against the debtor only if, in addition to the requirement of a security agreement evidenced by recorded language, possession, or control, the secured party gives value to the debtor and the debtor has rights in or the power to transfer rights in the collateral.

In U.C.C. 9-203(b)(1), the drafters of the Commercial Code express the requirement of value in the passive voice, a style of writing that good writers discourage. When one thinks about a secured transaction, however, it is clear that a security interest is unenforceable unless the secured party furnishes value. In most cases the secured party advances or promises to advance funds to or sells property on credit to the person who becomes obligated to pay, but the transaction could call for the secured party to advance value to a third party. In either case we have value under [U.C.C. 1-201\(44\)\(d\)](#).

There are, however, somewhat less obvious but commercially important cases. Reconsider [Problem.Enforcement of Judgment.1](#). In that case, might Ms. Rodriguez agree to accept installment payments of the judgment if secured by a security interest in some of the equipment of Athletics, Inc? If so, would the value requirement be satisfied? See [U.C.C. 1-201\(44\)](#).

The value requirement reflects a general principle of secured debt: a lien (whether judicial, consensual, or statutory and whether on real or personal property, or on fixtures) is unenforceable absent an underlying obligation. This principle takes an unusual turn in bankruptcy, where a lien on property (*in rem* liability) will generally remain enforceable notwithstanding the discharge of the underlying obligation (*in personam* liability) in the amount of the discharged obligation, or the value of the collateral, whichever is less. See [Commentary.Consumer Chapter 7](#).

We explore the requirement of rights in collateral in [Central Production Credit Assoc. v. Hopkins](#) and [State Bank of Young America v. Wagener](#).

Enforceability of consensual lien on real property

Like the security interest in personal property, enforceable consensual security in real property requires: (1) agreement; (2) that the secured party give value to the debtor; and, (3) the debtor have rights in the real property in which the lien is granted. Unlike personal property security, these concepts may derive in part from common law rather than from statute. Moreover, vocabulary may differ from that used in Article 9. For example, in the real property context, one hears of the necessity for "an underlying obligation" rather than the language in [U.C.C. 9-203\(b\)\(1\)](#) referring to the giving of value.

Like the non-possessory security interest in personal property, a consensual lien on real property is unenforceable absent a prescribed writing. See, e.g., Cal. Civ. Code [2922](#), [1091](#), and [2948](#). There is no modern counterpart to the personal property possessory security interest in the context of real property security. Thus, a written agreement is required for the enforceability of all security interests in real property. Although one hears the expression "mortgagee in possession", such a mortgagee is one who has taken possession of real property after the debtor has defaulted, not at the inception of the transaction. Historically this was not always the case.

Early in the development of the use of real property as security, a debtor would convey title to (and sometimes surrender possession of) her real property to a lender on condition subsequent; upon repayment of the loan, the lender would be obligated to reconvey title, and surrender possession, to the debtor. Eventually, this structure was replaced by the non-possessory security device, a mortgage or deed of trust, in which the debtor retains possession of the property.

Other aspects of a real estate transaction may also be subject to a Statute of Frauds. For example, an agreement to retain a real estate broker or to purchase real property must be in writing. [Cal. Civ. Code 1624\(c\),\(d\)](#). And, in the case of a purchase of real property secured by the property being purchased, the underlying indebtedness of the purchaser is unenforceable absent a prescribed writing. [Cal. Civ. Code 1624\(f\)](#).

1624. Statute of frauds

The following contracts are invalid, unless they, or some note or memorandum thereof, are in writing and subscribed by the party to be charged or by the party's agent:

- (a) An agreement that by its terms is not to be performed within a year from the making thereof.
- (b) A special promise to answer for the debt, default, or miscarriage of another, except in the cases provided for in Section 2794.
- (c) An agreement for the leasing for a longer period than one year, or for the sale of real property, or of an interest therein; such an agreement, if made by an agent of the party sought to be charged, is invalid, unless the authority of the agent is in writing, subscribed by the party sought to be charged.
- (d) An agreement authorizing or employing an agent, broker, or any other person to purchase or sell real estate, or to lease real estate for a longer period than one year, or to procure, introduce, or find a purchaser or seller of real estate or a lessee or lessor of real estate where the lease is for a longer period than one year, for compensation or a commission.
- (e) An agreement which by its terms is not to be performed during the lifetime of the promisor.
- (f) An agreement by a purchaser of real property to pay an indebtedness secured by a mortgage or deed of trust upon the property purchased, unless assumption of the indebtedness by the purchaser is specifically provided for in the conveyance of the property.
- (g) A contract, promise, undertaking, or commitment to loan money or to grant or extend credit, in an amount greater than one hundred thousand dollars (\$ 100,000), not primarily for personal, family, or household purposes, made by a person engaged in the business of lending or arranging for the lending of money or extending credit. For purposes of this section, a contract, promise, undertaking or commitment to loan money secured solely by residential property consisting of one to four dwelling units shall be deemed to be for personal, family, or household purposes.

This section does not apply to leases subject to Division 10 (commencing with Section 10101) of the Commercial Code.