Welcome to this podcast on Classification of Collateral I brought to you by CALI. I am Professor Jennifer S. Martin. This is the first of two podcasts that describe the process by which a creditor identifies collateral subject to a security interest under Article 9 of the Uniform Commercial Code. This podcast will focus primarily on descriptions of tangible personal property, including the descriptions used in a security agreement. Classifications of collateral constituting intangible property are left for another podcast.

Article 9 contains several rules that are dependent upon the classification of collateral, including rules for attachment of a security interest, the method of enforcement of a security interest once attached, perfection of a security interest, and the rights of third parties, including priority of competing creditors. These rules are many, but the best place to begin is the classification of collateral matters in the creation of the security interest.

Recall that according to § 9-203, a security interest becomes enforceable only if three elements are satisfied: (i) value has been given; (ii) the debtor has rights in the collateral or power to transfer rights in the collateral to a secured party; and (iii) one of the four alternative conditions are met. When the last of these three things occurs, the security interest attaches to the stated collateral and becomes enforceable as to that collateral. The most common of the four conditions is that the debtor has authenticated (signed) a security agreement that provides a description of the collateral.

What type of description of collateral will suffice in a security agreement? Section 9-108 provides guidance on what types of collateral descriptions in security agreements are sufficient. In general, a description of collateral is sufficient if it “reasonably identifies the collateral.” Section 9-108 gives examples of reasonable identification of collateral to include: specific listing; category; types of collateral defined in the Uniform Commercial Code; quantity; computation or allocation formulas or procedures; or any other method that is objectively determinable. The classification of collateral is made at the time of the attachment and does not change even if the debtor alters the use of the collateral later.

Let’s look at some examples of descriptions of collateral that are permissible under Article 9.

Example 1. Martin and Music City enter into a security agreement that described the collateral as a Yamaha clarinet. The description would be sufficient as it is a specific listing of the collateral.

Example 2. Martin and Music City entered into a security agreement that described the collateral as Martin’s musical instruments. This description would be sufficient as it is a description by category and would render the musical instruments owned by Martin at the time the security agreement is signed as the collateral.

Example 3. Artist and Friendly Finance entered into an agreement that described the collateral as a one-half interest in my painting titled *The First Flowers*. The description would be sufficient as a description including a specific listing and a computational or allocation formula involving the percentage interest in the painting.

When it comes to types of collateral defined in the Uniform Commercial Code, this can include tangible, intangible, and quasi-tangible personal property. Tangible personal property, the classification we are examining in this podcast, includes the Article 9 category goods, which has sub-classifications for inventory, farm products, consumer goods, and equipment, each of which is defined in § 9-102. Let’s take a look at each of these classifications of tangible collateral.

Inventory is most commonly goods that are held for sale or lease, but also goods that are leased by a person as the lessor, furnished under a contract for services or raw materials used or consumed in the business.

Example 4. Music City and First Bank entered into a security agreement that described the collateral as inventory. This description would be sufficient as it is a type of collateral defined in the Code. What might such a description of inventory include? The description would render the musical instruments held by Music City for sale in the store as collateral under the security agreement. The collateral description of inventory would also include any musical instruments leased by Music City, such as a violin leased to Student. The description of inventory would also include raw materials and materials used or consumed in a business, such as supplies Music City uses to prepare the instruments for sale or lease. Notably, inventory here would not include musical instruments in the possession of Music City for the purpose of repair as these are not instruments that Music City has a right to sell or lease.

Now, let’s take a look at farm products. Farm products are goods *other than standing timber* where the debtor is engaged in a farming operation and the goods are crops, livestock, supplies used in farming operations or products of crops or livestock in their unmanufactured state. Notice that standing timber is excluded. Section 9-102 does not define crops or livestock, but once the crops or livestock are subject to manufacturing, the collateral is no longer farm products. Notice also that this definition requires there be a “farming operation,” which means “raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation.”

Example 5. Farmer and Second Bank enter into a security agreement that described the collateral as farm products. This description would be sufficient as it is a type of collateral defined in the Code. Presuming Farmer is engaged in a farming operation, the description would render as collateral under the security agreement items such as the corn growing on the farm, the pigs and cattle at the farm and even supplies like the fertilizer used on the crops. The term farm products would not include standing timber on the farm, or the corn once canned (a manufacturing process). Farm products would not include the Farmer’s tractor or harvester as those items don’t fit in the definition. Farm products would also include aquatic goods, such as farmed salmon.

Now, let’s take a look at consumer goods. Under § 9-102, consumer goods are goods that are used or bought “primarily for personal, family or household purposes.” However, under § 9-108, a secured lender cannot use the category consumer goods to identify collateral in a consumer transaction but must spell out the specific collateral.

Example 6. Williams, an individual, entered into a contract with Furniture Co. for the purchase of a bedroom set on credit, and signed a security agreement that described the collateral using the category “consumer goods.” This description would not be sufficient even though it is a type of collateral defined in the Code. This is because in a consumer transaction a description of the category “consumer goods" is insufficient. While a secured creditor cannot use the category of consumer goods as a description, the category has significance in other aspects of lending. The description “bedroom set” would be sufficient here.

Note that the collateral should be described from the point of view of the debtor. For example, if a bank took a security interest in the bedroom sets that Furniture Co. sells to individuals, the security agreement should describe the collateral as inventory because it is the inventory in the hands of the debtor Furniture Co. even though it is consumer goods in the hands of purchasers.

The last category of goods is equipment, which is the Article 9 category used to describe any goods that are not inventory, farm products or consumer goods.

Example 7. Music City and First Bank entered into a security agreement that described the collateral as equipment. This description would be sufficient as it is a type of collateral defined in the Code. The description would render the tools used by Music City to repair instruments as collateral under the security agreement, so long as they were owned by Music City at the time of attachment. The description of equipment would also include sound recording equipment in a sound studio operated by Music City.

Example 8. Veterinarian and Second Bank entered into a security agreement that described the collateral as equipment. The collateral would include an x-ray machine, examination table, animal crates and surgical tools used by Veterinarian. The description would not include pet food and treats sold by Veterinarian (inventory), dog biscuits given to dogs by Assistant (which would be supplies used in the business and therefore, inventory) or Veterinarian’s dog Snoopy (which would be consumer goods).

Before we conclude this first podcast on classification of collateral, here are three rules of the road that sometimes trouble students that are worth noting. First, after-acquired property is not included as collateral unless the agreement so provides, except in the case of inventory and accounts which most often includes after-acquired property. As such, the collateral only includes what is owned by the debtor at the time of the security agreement, unless otherwise indicated. Second, collateral is classified at the time the security interest attaches, even if the collateral is later used for a different purpose. The dog food sold by Veterinarian would be inventory, even if she takes a bag home for Snoopy. Finally, a description of a collateral in a security agreement is insufficient if it is supergeneric, including descriptions of “all the debtor’s assets” or “all the debtor’s personal property.” A description of “all inventory” or “all equipment,” though, is fine.

Example 9. Recall Example 7. A description of equipment in a security agreement between Music City and First Bank would only render the tools used by Music City to repair instruments as collateral if they were owned by Music City at the time of attachment. If Music City acquired additional tools at a later time, a definition of the equipment would not render the new tools subject to the security agreement unless there was an after acquired property clause in the security agreement.

Example 10. Karla purchased a sofa for her home and signed a security agreement with Friendly Finance. The security agreement with Friendly Finance described its collateral as equipment. The sofa would be consumer goods in this case, and the security agreement with a description of equipment would not be sufficient to render the sofa as collateral. This would be true even if Karla later brought the sofa to her office for client meetings. While the sofa might later become equipment, the characterization of the sofa in terms of Article 9 category is determined at the time the security interest attaches.

At this point, you should be able to describe how a secured creditor goes about describing the collateral in the security agreement, including by specific listing, category and type of collateral defined in the Code. You should also be able to describe and identify the tangible property definitions for goods: inventory, farm products, consumer goods and equipment.

I hope you’ve enjoyed this podcast on Classification of Collateral I.

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