Welcome to this podcast on Classification of Collateral II brought to you by CALI. I am Professor Jennifer S. Martin. This is the second of two podcasts that describe the process by which a secured creditor identifies collateral subject to a security interest under Article 9 of the Uniform Commercial Code. This podcast will focus primarily on descriptions of intangible personal property, including the descriptions used in a security agreement. Classifications of collateral constituting tangible property, that is, goods, are left to 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, the perfection of a security interest, and the rights of third parties, including priority of competing creditors. These rules are many and are often related to industry practices, but the best place to begin is how the classification of collateral matters in the creation of the security interest. One of the methods of describing collateral expressly recognized as sufficient under § 9-108 is to identify the collateral in a security agreement by using the types of collateral defined in the Uniform Commercial Code. The podcast Classification of Collateral I discusses Article 9 categories for tangible personal property. Article 9, though, also includes the following specific intangible collateral categories under § 9-102 that may be used to describe collateral: accounts, chattel paper, commercial tort claims, deposit accounts, documents, instruments, investment property, general intangibles, and letter of credit rights. Many of these categories even have subcategories! For instance, instruments might be negotiable or nonnegotiable, and accounts includes health care insurance receivables as well as accounts receivable. While the term “intangible” is not defined in Article 9, each of these categories are defined in the Code, most often in § 9-102 or § 1-201.

One common type of intangible personal property is property that represents a right to payment (sometimes referred to as receivables). To the extent that some of these payment rights have physical documentation, such as evidence by paper, they are sometimes referred to as quasi-intangibles (but this is not a defined term under Article 9). Money is another example of a quasi-intangible. Receivables fall into several Article 9 categories: accounts, chattel paper, instruments, and payment intangibles. These can be tricky to identify at times. Let’s look at each of them in turn.

The classification of “account” means a right to payment of a monetary obligation, including accounts for property that has been sold, leased, licensed, signed, or otherwise disposed of and includes the right to payment of a monetary obligation, and includes amounts incurred for property, services, insurance, credit card charges, or even lottery winnings. The classification of “account” specifically excludes other payment categories, as well as deposit accounts. Let’s look at some examples.

Example 1. Dentist and Second Bank entered into a security agreement that described the collateral as accounts. Dentist provides dental services to Pamela, a patient, who provides her dental insurance card to Dentist. In this case, the right to Pamela’s monetary obligation would be an account of Dentist. Moreover, the definition of accounts specifically includes healthcare insurance receivables. Here, Dentist expects payment under the insurance policy upon presentation by Pamela of the insurance card. Accounts would also include any amount owed in the name of individual patients, such as Pamela, arising from services rendered by Dentist but not yet paid for, such as amounts not covered by insurance.

Recall that the definition of accounts does not include deposit accounts. When used as a category of collateral under Article 9, “deposit account” simply means a demand, time, savings, passbook, or similar account maintained at a bank but does not include investment property or other accounts.

Example 2. Music City and First Bank entered into a security agreement that described the collateral as deposit accounts held at First Bank. In this case, the reference to the deposit accounts would include the checking and savings accounts held at First Bank. But a description of the collateral as the “accounts” of Music City would not include the deposit accounts, but would include accounts owed and not yet paid by students for music lessons.

The classification of instruments means a negotiable instrument under Article 3 or any other writing that evidences a right to payment of a monetary obligation, such as a check or promissory note, but does not include a writing that is itself a security agreement or lease. An instrument is identified most often as being the type of writing normally transferred by delivery with an indorsement or assignment. Instruments do not include investment property and writings associated with credit cards.

Example 3. Dentist borrowed $15,000 from Benjamin, her brother, when she began her dental practice, signing a promissory note. Benjamin, needing money himself, borrowed $10,000 from Speedy Finance, and the parties entered into a security agreement that described the collateral as instruments. In this case, the reference to instruments would include the promissory note given to Benjamin from Dentist, whether or not the promissory note is negotiable under Article 3.

The classification of chattel paper can sometimes be confusing because it is a record or records that include both a monetary obligation and a security interest in goods.

Example 4. Retailer sells appliances to buyers on credit who pay over time, with each buyer signing an installment sales contract that includes both a promise to pay the purchase price of the appliance and grants Retailer a security interest in the appliance. Second Bank loaned Retailer $10,000, and the parties entered into a security agreement that described the collateral as Retailer’s chattel paper. In this case, the reference to chattel paper would include the installment sales contracts of Retailer arising from the sale of appliances to buyers who pay over time because the installment sales contracts evidence both a monetary obligation to the Retailer and a security interest arising from the sale of specific goods, the appliances. Note that chattel paper is better collateral than accounts. In the event of default, an account merely gives the creditor a right to recover the money owed. But with chattel paper, the creditor also has the right to enforce the security interest.

The last category of payment intangible is some other general intangible where the principal obligation is a monetary obligation, but it doesn’t fall into the other payment categories we’ve discussed here.

Example 5. Bank lends Equipco $250,000, taking a security interest in Equipco’s payment intangibles. Equipco leases an x-ray machine to Dentist, with Dentist paying monthly for the machine (which would be equipment). The payment intangible here would include the payments of Dentist under the equipment lease for the x-ray machine.

Of course, not all intangibles are related to payments. Categories of intangibles unrelated to a right to payment under Article 9 include commercial tort claims, documents, investment property, letter of credit rights, general intangibles, and even money (which, of course, is a medium of exchange of a domestic or foreign government). Let’s look at some of these categories to make sure that you can identify them.

A commercial tort claim is simply a tort claim where the claimant is an organization or the claimant is an individual and the claim arose in the claimant’s business or profession but did not involve a personal injury claim. It’s important to note, though, that under § 9-108, a description in a security agreement using the category “commercial tort claim” is insufficient to describe collateral. The description must be more specific.

Example 6. Dentist has a tort claim against Competitor for business interference. Dentist’s claim would be a commercial tort claim. If Dentist wants to use the claim as collateral for a loan, Bank cannot use the Article 9 description by category but would instead describe the claim more particularly, perhaps as “claim against Competitor for business interference.”

Investment property means a security, whether certificated or uncertificated, and includes securities in accounts.

Example 7. Martin grants a security interest to Bank in her securities. The category securities would include both her certificated stock in Willamette Valley Vineyards and her securities account at Fidelity.

The category documents refers to documents of title and receipts under Article 7 of the UCC and would include warehouse receipts covering goods stored at a warehouse.

The category of letter of credit rights represents a right to payment of a beneficiary under a letter of credit issued by a bank. Letters of credit are sometimes used to ensure that sellers of goods are paid for their sales of goods, particularly in international transactions.

Before we finish, let’s look at the final category of intangibles, general intangibles. Sometimes students have trouble with this category. Importantly, general intangibles exclude the other intangibles and goods but include “things in action,” payment intangibles, and software. Basically, general intangibles acts as a catch-all for any remaining types of intangible personal property not already covered by other categories. “Things in action” often represents contract rights, including rights that arise under a license of intellectual property.

Example 8. Dentist grants Bank a security interest in a number of Article 9 categories, including general intangibles. General intangibles would include Dentist’s trade name (intellectual property), any software used at the Dental office, Dentist’s right to payment of a loan given to Employee, a tax refund Dentist is expecting, and Dentist’s rights under a contract to purchase an x-ray machine not yet delivered.

Just a reminder before we finish. Remember that under § 9-108, a description of 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 accounts” or “all securities,” though, is fine because the description is by category of collateral.

At this point, you should be able to describe how a secured creditor goes about describing the collateral in the security agreement, particularly when using a type of collateral defined in the Code. You should be able to describe and identify the intangible and quasi-intangible property definitions: accounts, chattel paper, commercial tort claims, deposit accounts, instruments, documents, investment property, general intangibles, letter of credit rights, and money.

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

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