**Proceeds and Related Concepts**

Welcome to this podcast on Proceeds and Related Concepts brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is the transformation of collateral subject to a security interest, in particular whether a security interest exists in proceeds, products, offspring, accessions, and the like. This topic primarily requires a careful reading of UCC § 9-315 and a basic understanding of how a secured party attaches its security interest in the first place.

Recall that § 9-203 lists three formalities for creating a security interest enforceable against the debtor: first, value given by the creditor; second, the debtor having rights in the collateral; and third, an authenticated security agreement or other validating device such as possession of the collateral. We might imagine that the creation of the security interest attaches a sort of invisible string between the debtor’s obligation to pay the creditor and the collateral. But issues can arise with respect to exactly what the collateral is. What happens if the collateral to which the string is attached is sold? What if the collateral to which the string is attached is combined with other goods belonging to the debtor? What if the collateral is animals which produce offspring?

Of course, a debtor and creditor will often provide for these transformations in a security agreement by express language. However, secured creditors are not always able or do not always provide for such changes expressly. As such, there are rules of the road for these value tracing concepts, the most important of which is that of § 9-315 with respect to proceeds.

So what does it mean when we use the term proceeds? Well, § 9-102 provides some guidance on that. Proceeds means whatever is acquired upon the sale, lease, license, exchange, or other disposition of the collateral. Basically, the intention is to broadly cast proceeds as anything that somehow is acquired upon, collected upon, or arising out of the collateral. For instance, if I grant a security interest to a creditor in my book on Secured Transactions, but later sell the book and receive $50, the $50 would be proceeds of the collateral. If I take the $50 and purchase a book on Contracts, the book on Contracts also would be considered proceeds of the book on Secured Transactions, so long as the secured creditor can trace the money used to purchase the book. It is proceeds because it was acquired upon the sale of the collateral, the book on Secured Transactions. We might imagine that the collateral has been transformed into the new book on Contracts.

What does this mean for the secured creditor in terms of its security interest? After all, it seems that their collateral has now been sold to someone else. Several rules of the road are helpful here. First, a security interest continues in collateral notwithstanding sale, lease, license, exchange or other disposition, unless authorized by the secured party or subject to one of the exceptions in other parts of Article 9. Meaning that the creditor’s security interest in my book on Secured Transactions continues in the book even though it has been sold. Basically the invisible string that represents a security interest is still attached to that book. I guess that the buyer should be careful to inquire before buying my book. An exception to this would be if the creditor agreed to permit me to sell the Secured Transactions book free of its security interest. Second, a security interest also attaches to any *identifiable* proceeds of the collateral. If the proceeds are not goods, such as money, the secured party can identify the proceeds by a method of tracing permitted under other law outside of Article 9.

Notice that in our hypothetical, the $50 cash while I had it was identifiable proceeds of the Secured Transactions book, so long as we could still find the $50. The Contracts book was also identifiable proceeds. The creditor’s security interest would attach to the Contracts book as identifiable proceeds of the collateral. All of this depends, of course, on the ability of the creditor to identify proceeds of the collateral. Of course, the secured creditor can only get paid once, but might have more than one piece of collateral.

You might ask, what about the $50 cash that I used to purchase the Contracts book. Is there still a security interest attached to it? The simple answer is no. The taker of the money receives it free of the security interest of the creditor. This is the rule of § 9-332, which provides that a transferee of money takes the money free of a security interest unless acting in collusion with the debtor in violating the rights of the secured party. So, when I use the $50 that was proceeds of the sale of the Secured Transactions book to purchase the Contracts book, the seller of the book is a transferee of money and takes free of the security interest.

A few more rules are worth mentioning. In the event that collateral (including proceeds) is commingled with other property such that it loses its identity as a separate product, the creditor’s security interest will attach to the product or mass under § 9-336. An example of this might be where the creditor has a security interest in copper sheeting, but the copper sheeting is used by the debtor to manufacture copper oven ware. The identity of the copper sheeting is lost when it was united with other goods to become the new product. There is no continuing interest in the copper sheeting as such, but a security interest would attach to the product, here the oven ware.

Of course, there are more issues than just proceeds and commingling, including products and offspring of the collateral. Arguably, products and offspring would be considered proceeds without need for specific reference in a written security agreement, even though parties often do specify. Products mean something that the collateral produces, such as oranges from an orange tree or eggs from chickens. Although the broad definition of proceeds might cover products, most secured creditors avoid any confusion by specifically reciting products as part of the collateral in the security agreement where applicable. Similarly, you might sometimes hear the term offspring used with regard to animals, such as a foal of a racehorse. But, if the racehorse is collateral, does that mean the foal is as well? Sometimes the answer to this question will depend on type of offspring and whether it increases the collateral of the secured creditor. Because the creditor might argue that the foal is proceeds of the collateral, the debtor may insist on an exclusion in the security agreement to the extent that the foal of the racehorse might be particularly valuable itself.

Proceeds, products and offspring can be compared with other types of collateral more related to after-acquired property, including replacements, additions, and substitutions. These latter types of collateral changes require specific reference in a security agreement for the security interest to attach to them. For instance, if the saddle for the racehorse is part of the collateral, the debtor might find that after some time the saddle is old and no longer useful. If the debtor purchases a replacement saddle, it would not be covered by the creditor’s security agreement unless the security agreement so provides. This type of transaction is not proceeds because the new saddle was not acquired from a sale or other disposition of the old saddle. The debtor had to spend new money in order to acquire the new saddle.

Before we conclude, another related issue that comes up from time to time is that of accessions. An accession is simply goods that are physically united with other goods in such a manner that the identity of the original goods is *not lost*. We might imagine with our copper sheeting that the identity of the goods as copper sheeting is lost when it is transformed into oven ware. Such a loss of identity does not always occur, though. What if the debtor purchases on credit a new motor for a tractor that is subject to a security interest of another creditor? Well, it would seem that the motor is united with the tractor, but arguably the identity of the motor is not lost. It is still a motor and could be removed. We would call the motor an accession. Under § 9-335, a creditor can take a security interest in an accession (here, the motor), with such security interest continuing in collateral after it is united with the other goods (here, the tractor). But, the creditor would need to specifically list accessions as collateral in the security agreement. An exception to this is with respect to accessions made to collateral subject to a certificate of title statute, such as a car. In these cases, a security interest in the whole car is sufficient to cover a security interest taken in an accession of say tires and will have priority over a security interest in the accession (again the tires).

At this point, you should be able to identify and describe proceeds, products, offspring, commingling and accessions, including the extent to which a creditor’s security interest attaches to these types of collateral without further action. You should also be able to distinguish those situations where new property of the debtor is not proceeds, often because the new property was not derived from the collateral.

I hope you’ve enjoyed this podcast on Proceeds and Related Concepts.

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