**Possession, Control, and Automatic Perfection**

Welcome to this podcast on Possession, Control, and Automatic Perfection brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is how a secured creditor that does not file a financing statement goes about perfecting its security interest in order to prevail against others who might claim the same collateral. This topic primarily requires a careful reading of UCC § 9-309 through § 9-314 and a basic understanding of how a secured party attaches its security interest in the first place.

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 who else might claim the collateral. What happens if another creditor wants to take a security interest in the same collateral? How does the secured creditor notify others of its security interest?

Sometimes, the debtor will give a security interest in the same collateral to more than one creditor. You can see that this creates a potential contest between the secured creditors over rights to the collateral in the event of default. We refer to these battles over collateral as involving a question of which creditor has *priority* to the collateral. In general, the basic rules operate such that the first secured creditor to *file or* *perfect* will have priority with respect to the collateral. This means that it is not enough to simply be a secured creditor, a creditor will want to be a perfected secured creditor. While creditors will often file a *financing statement* to perfect their security interest, § 9-310 makes it clear that filing is not necessary to perfect a security interest in cases where perfection can occur by possession, control, automatic perfection, or by some other method pursuant to another statute entirely, such as certificate of title laws. This means that a later creditor will have to do more than simply search the records of the filed financing statements in order to protect itself from earlier claims.

We will look at a number of these alternatives, but let’s look at possession first. Basically, while filing a financing statement gives notice to other claimants, possession of some types of collateral actually substitutes for the filing requirement because possession of the collateral itself provides notice. Section 9-313 provides that a secured creditor can perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral. For instance, if First Bank loans me $1000 and takes a security interest in a painting that I own titled Summer Landscape, First Bank could perfect its security interest by taking possession of Summer Landscape. It is important to note, though, that if the goods are covered by a certificate of title law, mere possession of the goods will not perfect a security interest in them. So, if the collateral was not Summer Landscape, but instead was my car, which is subject to the certificate of title laws of the State of Florida, First Bank could not perfect simply by taking possession of the car.

It should be noted that sometimes a third-party might have possession of the collateral. In such cases, the secured party can perfect if the person in possession authenticates a record acknowledging that it holds possession of the collateral for the secured party’s benefit; or the person takes possession after having authenticated a record acknowledging that it will hold possession of the collateral for the secured party’s benefit. For instance, if Summer Landscape was on display at Southern Museum, the Museum could sign a statement acknowledging that it holds possession of Summer Landscape for the benefit of First Bank.

So, when it comes to goods, possession is a true alternative to filing a financing statement. If the collateral is chattel paper, instruments, certificated securities, and negotiable documents, these types of collateral can also be perfected by either filing or possession. However, for purposes of priority, possession is a superior method of perfection of certificated securities, chattel paper, and instruments. When it comes to money, though, possession is the exclusive method of perfection. Not surprisingly, there is some collateral where perfection by possession is impossible due to the intangible nature of the collateral, such as accounts and general intangibles.

In addition to possession, Article 9 also permits perfection of security interests for deposit accounts and investment property by control of the secured party. Section 9-312(b) specifies that security interests in deposit accounts and letter of credit rights can *only* be perfected by control under § 9-314. When it comes to deposit accounts, generally a secured party takes control when it is the bank in which the account is maintained. As an alternative, where the secured creditor is not the bank in which the account is maintained, the bank can authenticate a record agreeing that it will comply with the secured party’s instructions with regard to the account. Finally, the secured party could just become the bank’s customer by putting the account in the name of the secured party. Perfection of deposit accounts by control sometimes comes up on the bar exam to illustrate that control, rather than filing, is the only method of perfection for deposit accounts.

Perfection of a security interest in investment property can be made by a filing or delivery of a certificated security, but control is a superior method of perfection. If the investment property is a certificated security, the secured party must have control of the certificate, meaning it must be delivered to the secured party and registered in the secured party’s name. If it is an un-certificated security, the secured party can perfect by control if it registers itself as the owner of the security on the records of the corporation. Most owners of investment property, though, do not actually have the certificates, but rather a securities intermediary buys and sells securities on their behalf. In such an instance, a secured party would control a securities entitlement by becoming the entitlement holder or getting the securities intermediary to agree that it will comply with the secured party’s instructions regarding the entitlement. For instance, I open a securities account at Traders and invest $100,000 in Apple stock. When I borrow money from Second Bank using the securities entitlement as collateral, Second Bank could perfect by becoming the customer of Traders or obtaining an agreement with Traders to follow Second Bank’s instructions regarding my account.

One last alternative to look at. As it turns out, there is also an exception to the filing requirement for most purchase-money security interests in consumer goods. A purchase money security interest is sometimes called a PMSI. PMSI’s are automatically perfected upon attachment of the security interest pursuant to § 9-309 if we have consumer goods. Section 9-103 directs that in order to have a PMSI, there must be a security interest created where an obligation was incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral, but only if the value is in fact so used. An example of the first would be if I purchase a refrigerator from Sears on credit and Sears takes a security interest in the refrigerator. As an example of the second, if my friend Scott lends me $1000 to purchase a new refrigerator, taking a security interest in the refrigerator, this would be a PMSI so long as I actually used the $1000 to purchase the refrigerator. If Scott was prudent, he would make sure that he gives me a check for $1000 made out to both myself and Sears. The PMSI’s of Sears or Scott in these hypotheticals would enjoy automatic perfection because the refrigerator would be consumer goods so long as I purchased it for personal, family, or household purposes. This means that no filing or possession would be required.

Of note, § 9-309 also provides automatic perfection to a number of other transactions, including, assignments of accounts; payment intangibles that are not a significant part of the assignor’s outstanding accounts or payment intangibles; sales of promissory notes and payment intangibles; assignment of health care insurance receivables to the provider of the healthcare goods or services; and certain security interests arising under Article 2, Article 4, and Article 5 of the UCC.

At this point, you should be able to describe the alternatives of perfecting a security interest by possession or control. You should also be up to describe when a security interest is automatically perfected because it is a PMSI in consumer goods.

I hope you’ve enjoyed this podcast on Possession, Control, and Automatic Perfection.

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