**Perfection of Security Interests**

Welcome to this podcast on Perfection of Security Interests brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is how a secured creditor 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 § 9-310 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 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?

Of course, a secured creditor creates a security interest in collateral in order to entitle the creditor to possession of the collateral in the event that the debtor fails to pay. But, 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. Basically, one of the creditors will get to be first. Being first means the secured creditor has the right to payment from the sale of the collateral before claims of others. This can be especially important because oftentimes a creditor that does not have first priority, sometimes called a junior creditor, will not get paid in full because there is not sufficient collateral to satisfy all creditor claims.

In order to have these priority battles, though, we need a system that will help us to determine who is first. In general, the basic rules operate such that the first secured creditor to file or *perfect* its security interest 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. You might think of perfection as designating the secured creditor as first in line to the collateral. A secured creditor that is not perfected will be behind the secured creditor that is perfected. Of course, if two secured creditors perfect their security interest then a first in time system will permit one of them to be first in line. The idea behind the system of perfection is that it is fair to give priority to the creditor that files or perfects first due to the concept of notice. It is worth noting, though, that this is not a pro rata system whereby all creditors share according to the amount of their claim or one that gives any type of preference based on status, such as taxes or child-support.

The typical methods of perfection are: filing, possession, control, automatic perfection, and levy. While there are exceptions and rules as to the proper filing location, most secured creditors will file a *financing statement* with the office of the relevant Secretary of State in order to perfect their security interest. So, for purposes of this podcast, we will focus primarily on filing. A filing of a financing statement gives notice to other parties who might want to take an interest in the collateral, so long as they know to search the records. Notice that the correct term is financing statement not financial statement. Sometimes students make a mistake and use the incorrect term, but don’t do this now that you’ve been alerted to it. A financial statement is an accounting document and has no relationship to Article 9. Sometimes you will see reference to an initial financing statement or even a UCC-1, which is the form number. These latter references are correct and can be used.

Because the secured creditor can perfect in multiple ways, in order for a creditor to protect itself prior to lending, it will have to search the relevant filing records, and also look to see who has possession of the collateral. Most states now have online search registries that allow creditors to search for their debtor so long as the searching creditor has the correct name. A searching creditor that fails to take both actions of searching and verifying possession of the collateral may find themselves losing priority to another secured creditor. Recall that this is because possession is a form of perfection, so the creditor with possession may have been first to perfect. Similarly, a purchaser who is buying goods outside the ordinary course of business should do a UCC search. An example of this might be if a new lawyer purchased office equipment and furniture from a lawyer who is retiring. The prudent new lawyer would search the UCC records before the purchase to make sure that a secured creditor did not have an interest in the office equipment and furniture.

So, what needs to be in a financing statement? The financing statement is in a simple one page format and does not require any signature. A secured party is authorized to file an initial financing statement under § 9-509 if the debtor has signed a security agreement or if a security interest arises as to proceeds, but sometimes a debtor that signed a credit application will authorize filing a financing statement at an earlier point in time. Sometimes creditors will file before making a loan or taking a security interest because it expects to make the loan and wants to ensure that it is first in line without having to check the records again.

The filer must include on the financing statement the name of the debtor, the name of the secured creditor, an indication of the collateral, the mailing address of the secured creditor, the mailing address of the debtor, and an indication of whether the debtor is an individual or organization. A filing that includes these items should be accepted by the state filing officer, even though some of the information might be incorrect. However, the totality of the information included must not be seriously misleading in order to be enforceable.

The most important information on the financing statement is the debtor’s name because the records are searched using the debtor’s name only. So, it is very important to get this correct. The most common situations are that with respect to registered organizations and individuals. With respect to registered organizations, § 9-503 directs that the financing statement use only the name listed on the public organic record for the organization, such as the name listed on a corporation’s articles of incorporation. Do not include any trade name as only the name on the public organic record will suffice.

As to individuals, the drafters provided two alternatives for debtor names under § 9-503. Alternative A directs that a filer should use the name of the debtor listed on an unexpired driver’s license of the state where the filing is to occur and otherwise to use the surname and first personal name of the debtor if there is no driver’s license. Alternative B directs that a filer should use the individual name of the debtor, the surname and first personal name of the debtor or the name listed on the unexpired driver’s license of the state where the filing is to occur.

For all this to occur, the filer must file in the correct system and the searcher must search the correct system. There are many filing systems covering UCC, real property, state certificates of title, federal filing, and even insurance and banks, so the searcher and filer must choose the right system in order for the proper communication to occur. The multiplicity of filing systems sometimes leads to uncertainty about where a creditor will want to file or even if it should file in multiple locations. For instance, the UCC filing system exists in each of the fifty states, so a searcher would have to know which state to search in. There are also real estate and fixture filing systems in some 3000 counties across the country, so a secured party will want to know if the transaction potentially involves fixtures. Certificate of title laws have their own filing systems covering motor vehicles and often motor homes and boats in each of the fifty states, so this type of collateral typically requires a special filing. Some states, such as Florida, have separate systems for alcoholic beverage license filing. Patent, trademark, and copyright filings are in Washington, whereas ship mortgage filing is with the Coast Guard and aircraft filing is in Oklahoma City such that filing in the standard UCC records would be insufficient.

At this point, you should be able to describe the basic process of perfecting a security interest, including the requirements for filing a financing statement. You should also be able to describe why a secured creditor and searcher must use the correct system in order to protect their interest in collateral.

I hope you’ve enjoyed this podcast on Perfection of Security Interests.

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