

Commercial Law I

January 21, 2003

Security Agreement Terms

- Description of collateral
- Read § 9-108
- The description of collateral must reasonably identify what is described
- There are several ways in which collateral may reasonably be described and several ways in which collateral may not be reasonably described

Security Agreement Terms

- One method of reasonable identification is by using generic categories of personal property types specified in the UCC—e.g. accounts, equipment, inventory
- Note that this specification does not work in all cases—e.g. commercial tort claims or in the case of consumer transactions

Security Agreement Terms

- The purpose behind these particular exclusions is to prevent debtors from unintentionally encumbering property
- Another general exclusion is for super-generic descriptions—e.g. “all debtor’s personal property”

Security Agreement Terms

- As a matter of legal drafting and document craftsmanship, you must know the rules for proper creation of a description of collateral
- One of the tasks of any attorney representing a secured lender is to make sure that the security agreement is enforceable

Security Agreement Terms

- An enforceable security interest can not be created by a security agreement that contains an inadequate description of collateral
- Note particularly § 9-203(b)(3)(A)
- The debtor must have authenticated a security agreement that provides a *description of the collateral*

Security Agreement Terms

- Counsel for a debtor similarly should be concerned about the sufficiency of the collateral
- Debtor's counsel often is asked to give a legal opinion to the lender confirming that the security interest is enforceable

Security Agreement Terms

- A legal opinion may not be given confirming the enforceability of a security interest if the security interest is created by a security agreement with an inadequate description of collateral
- Thus, one step in the important legal opinion process is to review the description and compare it to the legal requirements

Security Agreement Terms

- Note that a lawyer can make this determination simply by examining documents and comparing the document to the legal requirements in the UCC
- Contrast this judgment with a determination of whether a debtor has rights in the collateral

Security Agreement Terms

- Typically, a lawyer is not in a position to determine whether or not a debtor has rights in collateral
- As a matter of opinion practice, the lawyer will make an assumption that the debtor has rights in the collateral
- The lawyer is not in the business of giving "title" opinions

Security Agreement Terms

- Sometimes a loan agreement or a security agreement will contain a representation and warranty that the debtor owns its property
- Should this representation prove to be false, an "event of default" will exist that entitles the lender to accelerate the maturity of the loan

Security Agreement Terms

- Similar to the question of rights in collateral, the documents may not reveal whether value has been given
- Typically, the lawyer giving a legal opinion will assume that value has been given, although there may be room for a legal judgment here

Security Agreement Terms

- Note that the term *value* is defined in § 1-201(44)
- NB: We will be using old Article 1 starting on page 1053 of the statutory supplement
- *Value* is a broad term that extends beyond merely funding a loan
- *Value* includes a commitment to lend

Security Agreement Terms

- Although a lawyer may not be in a position to know whether or not a loan actually has been funded, the lawyer should be in a position to examine a document, such as a loan agreement, and see whether or not the loan agreement contains a commitment by the lender to fund

Security Agreement Terms

- If a loan agreement contains a commitment to fund a loan, then the lawyer can make the judgment that value has been given
- In such a case, the lawyer might need to assume that the lender had properly authorized, executed and delivered the loan agreement that contained the commitment to lend

Security Agreement Terms

- We must **contrast** the *description of collateral* required by § 9-203(b)(3)(A) and evaluated for sufficiency in § 9-108 **with** the *indication of collateral* required by § 9-504 for financing statements
- Collateral is sufficiently indicated **either** by a sufficient description of collateral **or** by a more generic description such as *all assets*

Security Agreement Terms

- We evaluate the sufficiency of the form of financing statement as part of assessing whether a security interest is *perfected* but not as part of assessing whether a security interest is enforceable

Security Agreement Terms

- Beyond getting the basic description of collateral right, there are two other central aspects to the description of collateral
- Does the collateral description cover *after acquired collateral*?
- Does the collateral description cover *proceeds* of collateral?

Security Agreement Terms

- We need to be careful to distinguish here between best drafting practices and the minimum requirements of the law
- The best drafting practice is always to include a specific reference to after acquired collateral and always to include a specific reference to proceeds

Security Agreement Terms

- The general rule is: failure to include an after acquired collateral clause in a security agreement means that after acquired collateral is not covered
- However, the scope of the collateral coverage is a matter of contract interpretation and, at least in the case of accounts and inventory, some courts have not required specific mention of after acquired collateral in order to find coverage.
- See *In re Filtercorp*, Text 34, and § 9-108, Comment 3

Security Agreement Terms

- You need to compare § 9-108, Comment 3, with § 9-204(a)
- §9-204(a) states that a security agreement may create or provide for a security interest in after acquired collateral
- Note the limitations on the reach of an after acquired property clause: consumer goods limited and commercial tort claims excluded
- Can you figure out why the exception for accessions?

Security Agreement Terms

- The UCC rule for proceeds is specific: attachment of a security interest in collateral gives the secured party the right to proceeds--§ 9-203(f)
- Notwithstanding this rule, the drafting practice is to include a specific reference to proceeds in the description of collateral

Security Agreement Terms

- Notwithstanding the inclusion of proceeds in the scope of collateral (whether by contract or law), the interest in proceeds may not continue forever
- In many cases, the right to proceeds will not continue
- Note that the security interest attaches to *identifiable* proceeds of collateral

Security Agreement Terms

- Even if the proceeds are identifiable so that the enforceable security interest may continue in proceeds, *perfection* of the security interest in proceeds may not continue unless an additional step is taken

Security Agreement Terms

- A security agreement also may provide that it secures future advances made by a creditor to a debtor--§ 9-204(c)
- The general rule is that failure to mention the coverage of future advances means that future advances are not covered—but this will be a matter of contract interpretation

Security Agreement Terms

- Do not confuse the requirement to mention after acquired property and future advances in a security agreement with the requirements of a financing statement
- It is not necessary to mention either future advances or after acquired property in a financing statement--§ 9-502, Comment 2