
III. The Impact of Article 9 Changes on Bankruptcy

A. The Relationship Between Article 9 and the Bankruptcy Code State Law v. Bankruptcy Law

South Carolina's adoption of Article 9 of the Uniform Commercial Code (the "UCC"), implements some major revisions to the property rights given to secured creditors. In bankruptcy, property rights are usually governed by state law. Thus, by changing the property rights of the participants in a bankruptcy, the revisions to Article 9 may impact the dynamics of bankruptcy.

Generally speaking, the Bankruptcy Reform Act of 1978 (Title 11 of the United States Code of Laws, as amended, hereinafter the "Bankruptcy Code") creates a bankruptcy estate. In Chapter 7 of the Bankruptcy Code, the party declaring bankruptcy (hereinafter the "Bankrupt") must turn over his remaining assets to the Chapter 7 Trustee to be sold and distributed to the unsecured creditors under a system of priority established by Section 507. In Chapter 13, a Trustee is appointed to collect from the debtor a stream of payments based upon the debtor's ability to pay and based upon the hypothetical liquidation of the debtor's available assets. The Chapter 13 Trustee then distributes the fund collected each month from the debtor to the unsecured creditors pursuant to a plan that is confirmed and complies with Section 1325 of the Bankruptcy Code. In Chapter 11, the debtor becomes a "debtor-in-possession" or "DIP" with many of the powers of a Trustee so that he may engage in a formal negotiation with the debtor's creditors to formulate a plan of reorganization that meets the requirements of Section 1123 and 1129 of the Bankruptcy Code. Under Section 541 of the Bankruptcy Code, the Trustee steps into the shoes of the debtor and is possessed with the property rights of the debtor.

Generally speaking, the Revised Article 9 has been referred to as an "Anti-Bankruptcy Act" because it favors security interests over judgment lien creditors. See Wagner, G., *The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy*, AMERICAN BANKRUPTCY INSTITUTE LAW REVIEW, Volume 9, Number 1 (Spring 2001). However, this author, like others, believes that:

Revised Article 9 is both good news and bad news for trustee and general creditors of a trouble debtor. In many ways, secured creditors are given more comprehensive protections and more ways to "bankruptcy proof" their transactions. However, trustees will find many creditors erring in the transition to the new law and revised Article 9 gives the trustee some surprising ways to use the Bankruptcy Code to benefit both secured creditors and the estate.

Ahern, Anti-Trustee Act or Full Employment Program? Fifteen Things Trustees Need to Know about Revised Article 9, p. 43, NABTALK, Volume 17, Number 3, (Summer 2001).

III.A.2. Impact on the Avoidance Powers of the Trustee

Under Section 544 of the Bankruptcy Code, the Trustee has the rights of a judgment lien creditor under state law, upon the date of the bankruptcy petition. Thus, to the extent that the Revised Article 9 gives secured creditors rights over lien creditors, it favors these creditors over the Trustee by: (1) allowing security interests in more types of collateral; (2) allowing different types of perfection methods as to different types of collateral to be effective against the Trustee, but not other secured lenders; and (3) increasing the extent of automatic perfection provisions as to related collateral.

III.A.2.1. Allowing Security Interests in More Types of Collateral

Revised Article 9 expands the basic categories of collateral subject to perfection of security interests to include: accounts, agricultural liens, as-extracted collateral, chattel paper (including electronic chattel paper), commercial tort claims, deposit accounts, documents, general intangibles, goods (including consumer goods, fixtures, equipment, inventory), instruments (including promissory notes), investment property, letter of credit rights, manufactured homes, and proceeds. The definitions for each of these categories is as follows (for convenience, when quoting from Revised Article 9, the official comment or the South Carolina Reporter's Comments, these quotations will be italicized):

- (2) *'Account' except as used in 'account for', means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State, governmental unit of a State, or person licensed or authorized to operate the game by a State or governmental unit of a State. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.*

- (5) *'Agricultural lien' means an interest, other than a security interest, in farm products:*
 - (A) *which secures payment or performance of an obligation for:*

-
- (i) *goods or services furnished in connection with a debtor's farming operation; or*
 - (ii) *rent on real property leased by a debtor in connection with its farming operation;*
 - (B) *which is created by statute in favor of a person that:*
 - (i) *in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or*
 - (ii) *leased real property to a debtor in connection with the debtor's farming operation; and*
 - (C) *whose effectiveness does not depend on the person's possession of the personal property.*

 - (6) *'As-extracted collateral' means:*
 - (A) *oil, gas, or other minerals that are subject to a security interest that:*
 - (i) *is created by a debtor having an interest in the minerals before extraction; and*
 - (ii) *attaches to the minerals as extracted; or*
 - (B) *accounts arising out of the sale at the wellhead or minehead of oil, gas, or other minerals in which the debtor had an interest before extraction.*

 - (11) *'Chattel paper' means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this item, 'monetary obligation' means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does not include:*
 - (i) *charters or other contracts involving the use of hire of a vessel; or*
 - (ii) *records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.**If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.*

 - (13) *'Commercial tort claim' means a claim arising in tort with respect to which:*
 - (A) *the claimant is an organization; or*
 - (B) *the claimant is an individual and the claim:*
 - (i) *arose in the course of the claimant's business or profession; and*
 - (ii) *does not include damages arising out of personal injury to or the death of an individual.*

-
- (23) *'Consumer goods' means goods that are used or bought for use primarily for personal, family, or household purposes.*
- (29) *'Deposit account' means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.*
- (31) *'Electronic chattel paper' means chattel paper evidenced by a record or records consisting of information stored in an electronic medium.*
- (33) *'Equipment' means goods other than inventory, farm products, or consumer goods.*
- (34) *'Farm products' means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:*
(A) *crops grown, growing, or to be grown, including:*
 (i) *crops produced on trees, vines, and bushes; and*
 (ii) *aquatic goods produced in aquacultural operations;*
(B) *livestock, born or unborn, including aquatic goods produced in aquacultural operations;*
(C) *supplies used or produced in a farming operation; or*
(D) *products of crops or livestock in their unmanufactured states.*
- (41) *'Fixtures' means goods that have become so related to particular real property that an interest in them arises under real property law.*
- (42) *'General intangible' means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.*
- (44) *'Goods' means all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes. The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with*

the goods. The term does not include a computer program embedded in goods that consist solely of the medium in which the program is embedded. The term also does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction.

- (46) *'Health-care-insurance receivable' means an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided.*
- (47) *'Instrument' means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.*
- (48) *'Inventory' means goods, other than farm products, which:*
- (A) *are leased by a person as lessor;*
 - (B) *are held by a person for sale or lease or to be furnished under a contract of service;*
 - (C) *are furnished by a person under a contract of service; or*
 - (D) *consist of raw materials, work in process, or materials used or consumed in a business.*
- (49) *'Investment property' means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.*
- (51) *'Letter-of-credit right' means a right to payment or performance under a letter of credit, whether or not the beneficiary has demanded or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit.*
- (53) *'Manufactured home' means a structure, transportable in one or more sections, which, in the traveling mode, is eight body feet or more in width or forty body feet or more in length, or, when erected on site, is three hundred twenty or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-conditioning, and electrical systems contained*

therein. The term includes any structure that meets all of the requirements of this item except the size requirements and with respect to which the manufacturer voluntarily files a certification required by the United States Secretary of Housing and Urban Development and complies with the standards established under Title 42 of the United States Code.

- (61) *'Payment intangible' means a general intangible under which the account debtor's principal obligation is a monetary obligation.*
- (64) *'Proceeds', except as used in Section 36-9-609(b), means the following property:*
- (A) *whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;*
 - (B) *whatever is collected on, or distributed on account of, collateral;*
 - (C) *rights arising out of collateral;*
 - (D) *to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or*
 - (E) *to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.*
- (65) *'Promissory note' means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.*
- (75) *'Software' means a computer program and any supporting information provided in connection with a transaction relating to the program. The term does not include a computer program that is included in the definition of goods.*

Revised Article 9 maintained some of the definitions found previously. However, some of these definitions have been expanded dramatically. For example, accounts are greatly expanded. They are no longer just the right to payment for goods sold, leased or services rendered. An account now includes everything from the winnings in a government sponsored lottery to health-care-insurance receivables. Further, certain items that were considered general intangibles are now considered accounts. General intangibles now include two subcategories: Payment intangibles and software.

A comparison between the collateral under the old and Revised Article 9 is presented in the

following chart, prepared and presented in Ahern, L. "Workouts" Under Revised Article 9: A Review of Changes and Proposal for Study, AMERICAN BANKRUPTCY INSTITUTE LAW REVIEW, p. 176-177, Volume 9, Number 1 Spring 2001.

| Collateral | Former Article 9 | Revised Article 9 | Comment |
|--|---------------------|--------------------|--|
| Rights to payments for - Property disposed of other than by sale, lease or license -property licensed (e.g. fees & royalties from licenses of patents, copyrights, trademarks, software) - non-goods sold or leased - premium for issuance of insurance policy and surety bond premium - manufacturer's rebates - lottery winnings - provision of electricity | General Intangibles | Accounts | Purchasers of accounts must still file financing statements in order to defeat lien creditors and trustees in bankruptcy |
| credit card receivables | unclear | | |
| Payment stream under real estate contract | | | |
| Health Care Insurance Receivable | non-Article 9 | Account | Assignment to provider is automatically perfected |
| Payment Intangible (general intangible where obligation is money payment) | general intangible | new sub-categories | no UCC-1 must be filed by purchaser of payment intangibles or notes |
| promissory notes | instrument | | |
| software embedded in goods | unclear | goods | inventory, equipment or consumer |
| other software | unclear | general intangible | |

| | | | |
|---|--------------------------------|------------------------------|--|
| payments under letter of credit | proceeds of a letter of credit | letter of credit rights | perfect by control, not possession |
| deposit account | non-Article 9 | new categories of collateral | only non-consumer as original collateral; perfect by control |
| commercial tort claims | | | must arise from debtor's business, exist at time of security agreement and be specifically described |
| electronic chattel paper | | | perfect by "control" based on electronic identification method |
| supporting obligations (letters of credit, guaranties and other third-party enhancements) | unclear | | automatically perfected by perfection of underlying security |
| rights under lease or license of collateral | unclear | new types of proceeds | no longer limited to proceeds of sale, exchange, collection or other disposition of collateral |
| claims arising out of defects in or damage to collateral | unclear | | |

Thus, the secured creditor needs to make sure that the item it seeks to have as collateral is correctly identified. Further, while general descriptions are sufficient for financing statements, a more detailed description is going to be required of the collateral in the security agreement between the parties. *See Section II.A.4. below.*

II.A.2.2 Allowing for different types of perfection methods as to different types of collateral to be effective against the Trustee, but not other secured lenders.

The Trustee's rights are not impacted in some of the new types of collateral because the security interest in them can only be perfected by possession. However, the Trustee's rights can be impacted when a security interest in these new types of collateral "may be" perfected through filing or control. Section 312 provides as follows:

Section 36-9-312. Perfection of security interests in chattel paper, deposit accounts,

documents, goods covered by documents, instruments, investment property, letter-of-credit rights, and money; perfection by permissive filing; temporary perfection without filing or transfer of possession.

- (a) *A security interest in chattel paper, negotiable documents, instruments, or investment property may be perfected by filing.*
- (b) *Except as otherwise provided in Section 36-9-315(c) and (d) for proceeds:*
 - (1) *a security interest in a deposit account may be perfected only by control under Section 36-9-314;*
 - (2) *and except as otherwise provided in Section 36-9-308(d), a security interest in a letter-of-credit right may be perfected only by control under Section 36-9-314; and*
 - (3) *a security interest in money may be perfected only by the secured party's taking possession under Section 36-9-313.*
- (c) *While goods are in the possession of a bailee that has issued a negotiable document covering the goods:*
 - (1) *a security interest in the goods may be perfected by perfecting a security interest in the document; and*
 - (2) *a security interest perfected in the document has priority over any security interest that becomes perfected in the goods by another method during that time.*

Thus, a security interest in money can only be perfected through possession.

For deposit accounts and letter of credit rights, a security interest is created through control. Control is not synonymous with possession. A secured creditor may obtain control over a deposit account in another institution's possession. See Section 36-9-327 (control takes priority over the maintaining bank's interest). Control over a deposit account is defined by Section 36-9-104, as:

Section 36-9-104. Control of deposit account.

- (a) *A secured party has control of a deposit account if:*
 - (1) *the secured party is the bank with which the deposit account is maintained;*
 - (2) *the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or*
 - (3) *the secured party becomes the bank's customer with respect to the deposit*

account.

- (b) *A secured party that has satisfied subsection (a) has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.*

Thus, the code bifurcates control and possession, allowing secured creditors with control to be ahead of creditors with possession.

Similarly, control over a letter of credit right is defined as:

Section 36-9-107. Control of letter-of-credit right.

A secured party has control of a letter-of-credit right to the extent of any right to payment or performance by the issuer or any nominated person if the issuer or nominated person has consented to an assignment of proceeds of the letter of credit under Section 36-5-114(c) or otherwise applicable law or practice.

Thus, by having the issuer consent to an assignment, a secured party can gain control over the letter-of-credit right. This private agreement, without notice to anyone other than the parties involved, becomes a perfected security interest. Of note, the South Carolina's reporter's comments remind us that at present the reference to Section 36-5-114(c) may confuse the application of this section. Specifically, the reporter comments:

For a secured party to obtain control of a beneficiary's letter-of-credit right, Section 36-9-107 requires the beneficiary to assign the proceeds of the letter of credit to the secured party and for the issuer or the nominated party to consent to the assignment. In stating these requirements section 36-9-107 refers to consent under Section 36-5-114(c). This reference is misleading because it refers to a provision in the 1995 revision of Article 5 that has not been enacted in South Carolina. Section 5-114(c) of the 1995 revision states the requirements for an effective assignment of the proceeds of a letter of credit. Under that provision an assignment of the right to the proceeds of a letter of credit is not effective unless the issuer or nominated person consents to the assignment.

The failure of South Carolina to enact the 1995 revision of Article 5 raises a number of problems under Section 36-9-107. First, there is no section 36-5-114(c), the provision referenced in Section 36-9-107. The provision of the South Carolina Code addressing the assignment of proceeds of a letter of credit is Section 36-5-116. Second, and more significantly, Section 36-5-116 does not condition the effectiveness of an assignment of the proceeds of a letter of credit upon the issuer's or nominated party's consent to the assignment. These problems should not, however, affect the application of Section 36-9-107.

Perhaps in South Carolina, one can obtain a security interest in a letter-of-credit right without the consent of the entity extending the letter of credit.

For the following other types of collateral, the code creates a bifurcated system of perfection of security interests: chattel paper, negotiable documents, instruments or investment property. Previously, these types of negotiable documents could only be perfected through possession. Now, creditors can claim a security interest that defeats a bankruptcy trustee's lien rights in these types of collateral by filing a financing statement. For example, as it relates to investment property, Section 36-9-328 states:

- (1) *A security interest held by a secured party having control of investment property under Section 36-9-106 has priority over a security interest held by a secured party that does not have control of the investment property.*

The secured party having control has priority over the security party relying upon the filed financing statement. But, the secured party filing the financing statement has priority over the judgment lien creditor and the bankruptcy trustee.

In addition to this bifurcated system of perfection, the code also allows for the continuation of automatic security interests as collateral moves from consumer goods to fixtures. In a most obvious and blatant attempt to limit the trustee's avoidance powers, Section 36-9-334(e) states

- (e) *A perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if:*
 - (1) *the debtor has an interest of record in the real property or is in possession of the real property and the security interest:*
 - (A) *is perfected by a fixture filing before the interest of the encumbrancer or owner is of record; and*
 - (B) *has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner;*
 - (2) *before the goods become fixtures, the security interest is perfected by any method permitted by this chapter and the fixtures are readily removable:*
 - (A) *factory or office machines;*
 - (B) *equipment that is not primarily used or leased for use in the operation of the real property; or*
 - (C) *replacements of domestic appliances that are consumer goods;*
 - (3) *the conflicting interest is a lien on the real property obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this chapter; or*
 - (4) *the security interest is:*

-
- (A) *created in a manufactured home in a manufactured-home transaction; and*
 - (B) *perfected pursuant to a statute described in Section 36-9-311(a)(2).*

Thus, in many instances, the lack of a recorded security interest does not matter. The secured party still retains his security interest over the bankruptcy trustee. The South Carolina Reporter's Comments state:

Under Section 36-9-334(e)(3) a security interest in a fixture perfected "by any method permitted by this article" is entitled to priority over a subsequent lien obtained in a legal or equitable proceeding. The principal function of this provision is to protect a fixture financier who fails to make a fixture filing from having its security interest avoided by the trustee under Section 544(a) of the Bankruptcy Code if the debtor files bankruptcy.

Thus, the trustee may have difficulty with the sale of assets free and clear of liens and encumbrances in situations where the interest is unknown until after the sale. For example, many utility companies in South Carolina finance the purchase and installation of new heating and air conditioning units. The units can be quite expensive. The recent trend among these utility companies is to execute a fixture filing that provides them with priority in foreclosure sales and bankruptcies. Under revised article 9, the fixture filing may still be needed to take priority in a foreclosure setting, but because of the continuation of the security interest, the automatic perfection given to purchase money security interests may take priority over the trustee's right to sell the property free and clear.

II.A.2.3 Increasing the extent of automatic perfection provisions as it relates to related collateral;

The perfection of security interests and the automatic perfection of security interests is dealt with in Section II.B of this discussion. However, one aspect of this discussion is not presented therein. Specifically, the Revised Article 9 expands the scope of the concept of proceeds. Proceeds are defined in Revised Article 9 in Section 36-9-101(64):

- (64) *'Proceeds', except as used in Section 36-9-609(b), means the following property:*
 - (A) *whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;*
 - (B) *whatever is collected on, or distributed on account of, collateral;*
 - (C) *rights arising out of collateral;*
 - (D) *to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or*
 - (E) *to the extent of the value of collateral and to the extent payable to the debtor*

or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

The attachment of the security interest in proceeds is automatic and the desire to have a security interest in proceeds does not even need to be made explicit in the security agreement. See Section 36-9-203; -315. Further, the process of identifying proceeds have been adopted in the Revised Article 9. Former tracing techniques such as the lowest intermediate balance rule for identifying proceeds in an account are now part of the Revised Article 9 scheme for the continuation of the security interest in proceeds. In addition, goods that become commingled, no longer lose their identity. Instead, the entire resulting product or mass become proceeds and perfection of the security interest in the original collateral will continue in the entire product or mass. See Section 36-9-315(b)(1), (c)-(e), 9-336(c)-(d).

Further, in addition to the broad list of items that are included in the definition of proceeds, one author has commented:

To wrap up this already-broad list, Revised Article 9 adds to the definition of proceeds “rights arising out of the collateral.” See UCC §9-102(a)(64)(C). By including such new terms as “collections” and “distributions”, section 9-102(a)(64) sweeps in rent payments under personal property leases, payments on instruments and payments on investment property. Revised Article 9 closes the definitional circle by defining “collateral” also to include proceeds. UCC §9-102(a)(12). Taken together, these provision make it clear that there will be little in the way of cash that will not be proceeds and will therefore need to be addressed as collateral of the properly documented secured creditor, under the Bankruptcy Code.

Ahern, L. “*Workouts*” Under Revised Article 9: A Review of Changes and Proposal for Study, AMERICAN BANKRUPTCY INSTITUTE LAW REVIEW, Volume 9, Number 1 Spring 2001.

The only limitation on the concept of proceeds is the limit on the number of days that the security interest continues to be perfected. Revised Article 9, extends the period of automatic perfection from ten (10) days to twenty (20) days. During this twenty day period, perfection of the security interest in the proceeds is automatic. Specifically, Section 36-9-315(c), (d) and (e) provide:

- (c) *A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.*
- (d) *A perfected security interest in proceeds becomes unperfected on the twenty-first day*

after the security interest attaches to the proceeds unless:

- (1) the following conditions are satisfied:*
 - (A) a filed financing statement covers the original collateral;*
 - (B) the proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and*
 - (C) the proceeds are not acquired with cash proceeds;*
 - (2) the proceeds are identifiable cash proceeds; or*
 - (3) the security interest in the proceeds is perfected other than under subsection (c) when the security interest attaches to the proceeds or within twenty days thereafter.*
- (e) If a filed financing statement covers the original collateral, a security interest in proceeds which remains perfected under subsection (d)(1) becomes unperfected at the later of:*
- (1) when the effectiveness of the filed financing statement lapses under Section 36-9-515 or is terminated under Section 36-9-513; or*
 - (2) the twenty-first day after the security interest attaches to the proceeds.*

Thus, the security interest could be lost after 20 days of the conversion into proceeds. However, if perfection of the security interest in the original collateral was accomplished through a financing statement, so long as the proceeds were not cash proceeds, it is possible for the secured creditor to extend the perfection of the security interest. In the seminar materials that discuss descriptions to be included in financing statements, a description of an “all assets” type financing statement is included. This “all assets” financing statement would cover both the original collateral and the proceeds of the original collateral.

III.B. The Perfection of Security Interests and Creditor Status

The creation, attachment and perfection of security interests under the revised Article 9 provides for the (1) an increased ability to perfect security interests by filing financing statements, (2) an increased level of automatic perfection of security interests in related items, (3) an increased level of automatic perfection of security interests in other collateral, (4) gives priority for determining the lien status of property to other statutes; (5) increases the ability to perfect security interests in property in the possession of others such as a bailee, (6) an entity in possession of certificated stocks or goods, (7) the secured creditor; (8) the perfection of security interests in accounts through control; (9) automatic perfection of proceeds; and (10) the continuation of perfection through a change in governing laws.

III.B.1. Increased ability to perfect by filing financing statements.

Section 9-310 sets forth the perfection method for the different types of collateral. Basically, a financing statement is required to be filed to perfect a security interest, unless it meets one of the exceptions. Section 9-310, with its official and South Carolina comments, states:

Section 36-9-310. When filing required to perfect security interest or agricultural lien; security interests and agricultural liens to which filing provisions do not apply.

- (a) *Except as otherwise provided in subsection (b) and Section 36-9-312(b), a financing statement must be filed to perfect all security interests and agricultural liens.*
- (b) *The filing of a financing statement is not necessary to perfect a security interest:*
 - (1) *that is perfected under Section 36-9-308(d), (e), (f), or (g);*
 - (2) *that is perfected under Section 36-9-309 when it attaches;*
 - (3) *in property subject to a statute, regulation, or treaty described in Section 36-9-311(a);*
 - (4) *in goods in possession of a bailee which is perfected under Section 36-9-312(d)(1) or (2);*
 - (5) *in certificated securities, documents, goods, or instruments which is perfected without filing or possession under Section 36-9-312(e), (f), or (g);*
 - (6) *in collateral in the secured party's possession under Section 36-9-313;*
 - (7) *in a certificated security which is perfected by delivery of the security certificate to the secured party under Section 36-9-313;*
 - (8) *in deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights which is perfected by control under Section 36-9-314;*
 - (9) *in proceeds which is perfected under Section 36-9-315; or*
 - (10) *that is perfected under Section 36-9-316.*
- (c) *If a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.*

Official Comment

1. *Source. Former Section 9-302(1), (2).*
2. *General Rule. Subsection (a) establishes a central Article 9 principle: Filing a financing statement is necessary for perfection of security interests and agricultural liens. However, filing is not necessary to perfect a security interest that is perfected by another permissible method, see subsection (b), nor does filing ordinarily perfect a security interest in a deposit*

account, letter-of-credit right, or money. See Section 9-312(b). Part 5 of the Article deals with the office in which to file, mechanics of filing, and operations of the filing office.

3. *Exemptions from Filing. Subsection (b) lists the security interests for which filing is not required as a condition of perfection, because they are perfected automatically upon attachment (subsections (b)(2) and (b)(9)) or upon the occurrence of another event (subsections (b)(1), (b)(5), and (b)(9)), because they are perfected under the law of another jurisdiction (subsection (b)(10)), or because they are perfected by another method, such as by the secured party's taking possession or control (subsections (b)(3), (b)(4), (b)(5), (b)(6), (b)(7), and (b)(8)).*
4. *Assignments of Perfected Security Interests. Subsection (c) concerns assignment of a perfected security interest or agricultural lien. It provides that no filing is necessary in connection with an assignment by a secured party to an assignee in order to maintain perfection as against creditors of and transferees from the original debtor.*

Example 1: Buyer buys goods from Seller, who retains a security interest in them. After Seller perfects the security interest by filing, Seller assigns the perfected security interest to X. The security interest, in X's hands and without further steps on X's part, continues perfected against Buyer's transferees and creditors.

Example 2: Dealer creates a security interest in specific equipment in favor of Lender. After Lender perfects the security interest in the equipment by filing, Lender assigns the chattel paper (which includes the perfected security interest in Dealer's equipment) to X. The security interest in the equipment, in X's hands and without further steps on X's part, continues perfected against Dealer's transferees and creditors. However, regardless of whether Lender made the assignment to secure Lender's obligation to X or whether the assignment was an outright sale of the chattel paper, the assignment creates a security interest in the chattel paper in favor of X. Accordingly, X must take whatever steps may be required for perfection in order to be protected against Lender's transferees and creditors with respect to the chattel paper.

Subsection (c) applies not only to an assignment of a security interest perfected by filing but also to an assignment of a security interest perfected by a method other than by filing, such as by control or by possession. Although subsection (c) addresses explicitly only the absence of an additional filing requirement, the same result normally will follow in the case of an assignment of a security interest perfected by a method other than by filing. For example, as long as possession of collateral is maintained by an assignee or by the assignor or another person on behalf of the assignee, no further perfection steps need be taken on account of the assignment to continue perfection as against creditors and transferees of the original debtor. Of course, additional action may be required for perfection of the assignee's interest as against creditors and transferees of the assignor.

Similarly, subsection (c) applies to the assignment of a security interest perfected by compliance with a statute, regulation, or treaty under Section 9-311(b), such as a certificate-of-title statute. Unless the statute expressly provides to the contrary, the security interest will remain perfected against creditors of and transferees from the original debtor, even if the assignee takes no action to cause the certificate of title to reflect the assignment or to cause its name to appear on the certificate of title. See PEB Commentary No. 12, which discusses this issue under former Section 9-302(3). Compliance with the statute is "equivalent to filing" under Section 9-311(b).

South Carolina Reporter's Comment

Section 36-9-310 states the general rule that a financing statement must be filed to perfect a security interest or agricultural lien and enumerates and references the exception to that rule.

Cross References

1. *Perfection of a security interest in supporting obligations by perfecting in the underlying collateral. Section 36-9-308(d).*
2. *Perfection of a security interest in a security interest, mortgage, or other lien securing a right to payment by perfecting in the right to payment. Section 36-9-308(e).*
3. *Perfection of a security interest upon securities entitlements or commodity contracts by perfecting in the securities account or commodity account in which the entitlements or contracts are titled. Section 36-9-308(f) and (g).*
4. *Automatic perfection of security interests upon attachment. Sections 36-9-309 and 36-9-312(e)-(h).*
5. *Perfection of security interest by complying with statutes, regulations, or treaties of the United States or certificate of title statutes. Section 36-9-311.*
6. *Perfection of security interests by possession or delivery. Section 36-9-313 and 36-9-312(b)(1), (c) and (d).*
7. *Perfection of security interests by control. Sections 36-9-314 and 36-9-312(b)(1) and (2).*
8. *Attachment and perfection of security interests in proceeds. Section 36-9-315.*

III.B.2. Automatic Perfection for Certain Related Collateral

The first exception mentioned in 36-9-310 relates to what one could refer to as related interests. In today's complex financing arrangements, financial institutions often demand what are referred to as credit enhancements. Basically, if the obligor's word is insufficient to provide the necessary security for an obligation, the financial institution may require, a guarantee, a mortgage, the hypothecation of assets, etc. Section 36-9-308 provides that if you perfect your security interest in one type of collateral, you automatically perfect your security interest in certain related collateral. Specifically, 9-308 provides for the automatic perfection of security interests under the following circumstances:

-
- (d) *Perfection of a security interest in collateral also perfects a security interest in a supporting obligation for the collateral.*

In times where credit enhancements are frequent characteristics of financing, this subsection provides that perfection of a security interest in a transaction perfects the security interest in all of the mechanisms used for the credit enhancement. To illustrate what is meant by a supporting obligation, the Official Reporter's Comments state:

Supporting Obligations. Subsection (d) is new. It provides for automatic perfection of a security interest in a supporting obligation for collateral if the security interest in the collateral is perfected. This is unlikely to effect any change in the law prior to adoption of this Article.

Example 2: Buyer is obligated to pay Debtor for goods sold. Buyer's president guarantees the obligation. Debtor creates a security interest in the right to payment (account) in favor of Lender. Under Section 9-203(f), the security interest attaches to Debtor's rights under the guarantee (supporting obligation). Under subsection (d), perfection of the security interest in the account constitutes perfection of the security interest in Debtor's rights under the guarantee.

Similarly, subsection (e) deals with related interests to the right to payment. This subsection states:

- (e) *Perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right.*

If you have a right to a payment, and that payment is collateralized, by perfecting the security interest in the right to payment, you have also perfected a security interest in the underlying collateral. Again, the Official Comment explains:

Rights to Payment Secured by Lien. Subsection (e) is new. It deals with the situation in which a security interest is created in a right to payment that is secured by a security interest, mortgage, or other lien.

Example 3: Owner gives to Mortgagee a mortgage on Blackacre to secure a loan. Owner's obligation to pay is evidenced by a promissory note. In need of working capital, Mortgagee borrows from Financer and creates a security interest in the note in favor of Financer. Section 9-203(g) adopts the traditional view that the mortgage follows the note; i.e., the transferee of the note acquires the mortgage, as well. This subsection adopts a similar principle: perfection of a security interest in the right to payment constitutes perfection of a security interest in the mortgage securing it.

An important consequence of the rules in Section 9-203(g) and subsection (e) is that, by acquiring a perfected security interest in a mortgage (or other secured) note, the secured party acquires a security interest in the mortgage (or other lien) that is senior to the rights of a person who becomes a lien creditor of the mortgagee (Article 9 debtor). See Section 9-317(a)(2). This result helps prevent the separation of the mortgage (or other lien) from the note.

Under this Article, attachment and perfection of a security interest in a secured right to payment do not of themselves affect the obligation to pay. For example, if the obligation is evidenced by a negotiable note, then Article 3 dictates the person whom the maker must pay to discharge the note and any lien securing it. See Section 3-602. If the right to payment is a payment intangible, then Section 9-406 determines whom the account debtor must pay.

Similarly, this Article does not determine who has the power to release a mortgage of record. That issue is determined by real-property law.

The concept in subsection (e) is to allow the credit enhancements associated with a right to payment to follow the perfection of the security interest in the right to payment. The importance of this exception is referred to in the South Carolina Reporter's Comments as follows:

The significance of Section 36-9-308(f) is that it constitutes a major exception to the provision in the Recording Act conditioning the effectiveness of a mortgage assignment against subsequent purchases and lien creditors upon the recording of the assignment. Section 30-7-60 S.C. Code Ann. (1976). If a mortgagee assigns mortgage note in transactions within the scope of Article 9, the assignee obtains a perfected security interest in the mortgage without recording the mortgage assignment. The scope of this exception to the Recording Act is broad because Article 9 applies not only to security interest in promissory notes taken to secure an obligation, but also to sales of promissory notes. Section 36-9-109(a)(3).

Thus, mortgage assignments in South Carolina may still be perfected, even though the assignment is not reflected in the recording statute.

Subsections (f) and (g) deal with related entitlements when a creditor perfects a security interest in a securities account or a commodity account. Specifically, these subsection state:

- (f) Perfection of a security interest in a securities account also perfects a security interest in the security entitlements carried in the securities account.*
- (g) Perfection of a security interest in a commodity account also perfects a security interest in the commodity contracts carried in the commodity account.*

III.B.3. No Financing Statement for Certain Items that are Automatically Perfected

Section 9-309 provides for the automatic perfection of a security interest in certain types of collateral. This Section, with the Official Comment and the South Carolina Report's Comments state:

Section 36-9-309. Security interest perfected upon attachment.

The following security interests are perfected when they attach:

- (1) a purchase-money security interest in consumer goods, except as otherwise provided in Section 36-9-311(b) with respect to consumer goods that are subject to a statute or treaty described in Section 36-9-311(a);*
- (2) an assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles;*
- (3) a sale of a payment intangible;*
- (4) a sale of a promissory note;*
- (5) a security interest created by the assignment of a health-care-insurance receivable to the provider of the health-care goods or services;*
- (6) a security interest arising under Section 36-2-401, 36-2-505, 36-2-711(3), or 36-2A-508(5), until the debtor obtains possession of the collateral;*
- (7) a security interest of a collecting bank arising under Section 36-4-210;*
- (8) a security interest of an issuer or nominated person arising under Section 36-5-118;*
- (9) a security interest arising in the delivery of a financial asset under Section 36-9-206(c);*
- (10) a security interest in investment property created by a broker or securities intermediary;*
- (11) a security interest in a commodity contract or a commodity account created by a commodity intermediary;*

-
- (12) *an assignment for the benefit of all creditors of the transferor and subsequent transfers by the assignee thereunder; and*
 - (13) *a security interest created by an assignment of a beneficial interest in a decedent's estate.*

Official Comment

1. *Source. Derived from former Sections 9-302(1), 9-115(4)(c), (d), 9-116.*

2. *Automatic Perfection. This Section contains the perfection-upon-attachment rules previously located in former Sections 9-302(1), 9-115(4)(c), (d), and 9-116. Rather than continue to state the rule by indirection, this Section explicitly provides for perfection upon attachment.*

3. *Purchase-Money Security Interest in Consumer Goods. Former Section 9-302(1)(d) has been revised and appears here as paragraph (1). No filing or other step is required to perfect a purchase-money security interest in consumer goods, other than goods, such as automobiles, that are subject to a statute or treaty described in Section 9-311(a). However, filing is required to perfect a non-purchase-money security interest in consumer goods and is necessary to prevent a buyer of consumer goods from taking free of a security interest under Section 9-320(b). A fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9-334.*

4. *Rights to Payment. Paragraph (2) expands upon former Section 9-302(1)(e) by affording automatic perfection to certain assignments of payment intangibles as well as accounts. The purpose of paragraph (2) is to save from ex post facto invalidation casual or isolated assignments-assignments which no one would think of filing. Any person who regularly takes assignments of any debtor's accounts or payment intangibles should file. In this connection Section 9-109(d)(4) through (7), which excludes certain transfers of accounts, chattel paper, payment intangibles, and promissory notes from this Article, should be consulted.*

Paragraphs (3) and (4), which are new, afford automatic perfection to sales of payment intangibles and promissory notes, respectively. They reflect the practice under former Article 9. Under that Article, filing a financing statement did not affect the rights of a buyer of payment intangibles or promissory notes, inasmuch as the former Article did not cover those sales. To the extent that the exception in paragraph (2) covers outright sales of payment intangibles, which automatically are perfected under paragraph (3), the exception is redundant.

5. *Health-Care-Insurance Receivables. Paragraph (5) extends automatic perfection to assignments of health-care-insurance receivables if the assignment is made to the health-care provider that provided the health-care goods or services. The primary effect is that, when an individual assigns a right to payment under an insurance policy to the person who provided health-care goods or*

services, the provider has no need to file a financing statement against the individual. The normal filing requirements apply to other assignments of health-care-insurance receivables covered by this Article, e.g., assignments from the health-care provider to a financier.

6. Investment Property. Paragraph (9) replaces the last clause of former Section 9-116(2), concerning security interests that arise in the delivery of a financial asset. Paragraphs (10) and (11) replace former Section 9-115(4)(c) and (d), concerning secured financing of securities and commodity firms and clearing corporations. The former Sections indicated that, with respect to certain security interests created by a securities intermediary or commodity intermediary, "[t]he filing of a financing statement . . . has no effect for purposes of perfection or priority with respect to that security interest." No change in meaning is intended by the deletion of the quoted phrase.

Secured financing arrangements for securities firms are currently implemented in various ways. In some circumstances, lenders may require that the transactions be structured as "hard pledges," where the securities are transferred on the books of a clearing corporation from the debtor's account to the lender's account or to a special pledge account for the lender where they cannot be disposed of without the specific consent of the lender. In other circumstances, lenders are content with so-called "agreement to pledge" or "agreement to deliver" arrangements, where the debtor retains the positions in its own account, but reflects on its books that the positions have been hypothecated and promises that the securities will be transferred to the secured party's account on demand.

The perfection and priority rules of this Article are designed to facilitate current secured financing arrangements for securities firms as well as to provide sufficient flexibility to accommodate new arrangements that develop in the future. Hard pledge arrangements are covered by the concept of control. See Sections 9-314, 9-106, 8-106. Non-control secured financing arrangements for securities firms are covered by the automatic perfection rule of paragraph (10). Before the 1994 revision of Articles 8 and 9, agreement to pledge arrangements could be implemented under a provision that a security interest in securities given for new value under a written security agreement was perfected without filing or possession for a period of 21 days. Although the security interests were temporary in legal theory, the financing arrangements could, in practice, be continued indefinitely by rolling over the loans at least every 21 days. Accordingly, a knowledgeable creditor of a securities firm realizes that the firm's securities may be subject to security interests that are not discoverable from any public records. The automatic-perfection rule of paragraph (10) makes it unnecessary to engage in the purely formal practice of rolling over these arrangements every 21 days.

In some circumstances, a clearing corporation may be the debtor in a secured financing arrangement. For example, a clearing corporation that settles delivery-versus-payment transactions among its participants on a net, same-day basis relies on timely payments from all participants with

net obligations due to the system. If a participant that is a net debtor were to default on its payment obligation, the clearing corporation would not receive some of the funds needed to settle with participants that are net creditors to the system. To complete end-of-day settlement after a payment default by a participant, a clearing corporation that settles on a net, same-day basis may need to draw on credit lines and pledge securities of the defaulting participant or other securities pledged by participants in the clearing corporation to secure such drawings. The clearing corporation may be the top-tier securities intermediary for the securities pledged, so that it would not be practical for the lender to obtain control. Even where the clearing corporation holds some types of securities through other intermediaries, however, the clearing corporation is unlikely to be able to complete the arrangements necessary to convey "control" over the securities to be pledged in time to complete settlement in a timely manner. However, the term "securities intermediary" is defined in Section 8-102(a)(14) to include clearing corporations. Thus, the perfection rule of paragraph (10) applies to security interests in investment property granted by clearing corporations.

7. Beneficial Interests in Trusts. Under former Section 9-302(1)(c), filing was not required to perfect a security interest created by an assignment of a beneficial interest in a trust. Because beneficial interests in trusts are now used as collateral with greater frequency in commercial transactions, under this Article filing is required to perfect a security interest in a beneficial interest.

8. Assignments for Benefit of Creditors. No filing or other action is required to perfect an assignment for the benefit of creditors. These assignments are not financing transactions, and the debtor ordinarily will not be engaging in further credit transactions.

South Carolina Reporter's Comment

Section 36-9-309 enumerates the security interests that are automatically perfected when they attach. Under this provision security interests that were automatically perfected under former Section 36-9-302(1)(c)-(g), continue to be perfected automatically. Section 36-9-309, however, expands the scope of automatic perfection. Security interests resulting from sales of payment intangibles and promissory notes are perfected on attachment as are security interests created by assignments of health-care insurance receivables to providers of health care goods or services. In addition, some security interests that arise from transactions in investment properties are automatically perfected.

Thus, Section 309, creates an automatic perfection of the security interest in many items. The following chart provides a list of the items that Section 309 provides for:

| Type of Property | Automatic Perfection Upon Attachment | Comments |
|-------------------------|---|-----------------|
|-------------------------|---|-----------------|

| | | |
|---|--|---|
| Purchase money security interest in consumer goods other than titled collateral | "Consumer goods" Section 36-9-102(a)(23) | Automatic Perfection (but be careful with goods that also may become fixtures) |
| Sale of payment intangible | "Payment intangible" Section 36-9-102(a)(61) | This is a new category. |
| Sale of promissory notes | "Promissory note" Section 36-9-102(a)(65) | |
| Security assignment of health-care insurance receivable to health-care provider | "Health-care-insurance receivable" Section 36-9-102(a)(46) | Be careful of anti-assignment statute. |
| Security interests of sellers and lessors of goods prior to debtor receiving possession | <i>Under Section 36-2-401, 36-2-505, 36-2-711(3), or 36-2A-508(5), these interest are automatically perfected.</i> | The following are automatically perfected: a seller's reservation of title in goods shipped or delivered to a buyer under Section 36-2-401; a seller's reservation of a security interest in a documentary sale under Section 36-2-404; a buyer's security interest in goods under Section 36-2-711(3) that arise when a buyer rightfully rejects or justifiably revokes acceptance under Section 36-2-711(3); and a lessee's security interest under Section 36-2A-508(5) that arise when the lessee rightfully rejects or on which the lessee justifiably revokes acceptance. |

| | | |
|---|---|--|
| Security interests in investment property created by broker or securities intermediary | See attachment of investment property Section 36-9-206; "Investment property" Section 36-9-102(a)(49) "Securities intermediary" Section 36-8-102(a)(14) | |
| Security interests in commodity contract or commodity account created by a commodity intermediary | "Commodity account" Section 36-9-102(a)(14) "Commodity contract" Section 36-9-102(a)(15) "Commodity intermediary" Section 36-9-102(a)(17) | |
| Assignments for the benefit of all creditors of the transferor | Neither a receiver nor a trustee need file in order to perfect their interest | |

Thus, for these categories of assets, filing is not necessary for the perfection of the security interest.

III.B.4. Property subject to a statute, regulation, or treaty described in Section 36-9-311(a);

Section 36-9-311 gives priority for determining the lien status of property to other statutes or treaties. Specifically, Section 36-9-311 provides that financing statements do not have to be filed if a security interest is perfected through another statute. This Section states as follows:

Section 36-9-311. Perfection of security interests in property subject to certain statutes, regulations, and treaties.

- (a) *Except as otherwise provided in subsection (d), the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to:*
 - (1) *a statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt Section 36-9-310(a);*
 - (2) *Chapter 19 of Title 56 (Protection of title to and interests in motor vehicles) and Chapter 23 of Title 50 (Filing of watercraft and outboard motors) but during any period in which collateral is inventory held for sale by a person who is in the business of selling goods of that kind, the filing provisions of this chapter (Part 5) apply to a security interest in that collateral created by*

-
- him as debtor; or*
- (3) *a certificate-of-title statute of another jurisdiction which provides for a security interest to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the property.*
- (b) *Compliance with the requirements of a statute, regulation, or treaty described in subsection (a) for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this chapter. Except as otherwise provided in subsection (d) and Sections 36-9-313 and 36-9-316(d) and (e) for goods covered by a certificate of title, a security interest in property subject to a statute, regulation, or treaty described in subsection (a) may be perfected only by compliance with those requirements, and a security interest so perfected remains perfected notwithstanding a change in the use or transfer of possession of the collateral.*
- (c) *Except as otherwise provided in subsection (d) and Section 36-9-316(d) and (e), duration and renewal of perfection of a security interest perfected by compliance with the requirements prescribed by a statute, regulation, or treaty described in subsection (a) are governed by the statute, regulation, or treaty. In other respects, the security interest is subject to this chapter.*
- (d) *During any period in which collateral subject to a statute specified in subsection (a)(2) is inventory held for sale or lease by a person or leased by that person as lessor and that person is in the business of selling goods of that kind, this section does not apply to a security interest in that collateral created by that person.*

As the South Carolina Reporter's Comments suggest, Section 36-9-311 subordinates Article 9's perfection rules to other statutes establishing the priority of the security interest held in certain types of collateral. Specifically, the South Carolina Reporter's Comments are as follows:

Section 36-9-311(a)(1) provides that statutes, regulations, or treaties of the United States which impose requirements for the priority of a security interest over a lien creditor preempt the perfection rules of Article 9. In addition, this sections 36-9-311(a)(2) and (3) provide that state certificate of title statutes govern the perfection of security interests in covered goods. With two exceptions, Section 36-9-311(b) provides that a security interest subject to a statute, regulation, or treaty described in subsection (a) can be perfected only by complying with the requirements of the statute, regulation, or treaty. The first exception to this rule applies when goods covered by a certificate of title statute entered this state subject to a security interest perfected under the law of another state. Section 36-9-311(b), 36-9-313(b), and 36-9-316(d) and (e) provide that the secured party can perfect in this state by taking possession of the goods. The second exception applies when

goods covered by a certificate of title statute are inventory held for sale or lease by a person in the business of selling or leasing goods of that kind. Section 36-9-311(d)

South Carolina has two certificate of title statutes that control the perfection of security interests. Section 56-19-610 to 722, S.C. Code Ann. (1976 and Supp. 1999) govern the perfection of security interests in motor vehicles. Section 50-23-140, S.C. Code Ann. (Supp. 1999) governs the perfection of security interests on watercraft and outboard motors.

Article 9 envisions that a state certificate of title statute that provides that perfection occurs when the appropriate state authority receives an application for a certificate of title which discloses the security interest, rather than when the authority issues the certificate. See Section 36-9-311, Official Comment 5. The South Carolina certificate of title statutes conform to this exception. See Sections 56-19-230 and 50-23-140(c) S.C. Code Ann. (1976 and Supp. 1999).

Article 9 further envisions that when certificate of title legislation perfection will not relate back to a point in time earlier than the date upon which the State officials received the application. See Section 36-9-311, Official Comment 5. The current South Carolina certificate of title statutes do not conform to this expectation. Under section 56-19-630 S.C. Code Ann. (1976) the perfection of a security interest in a motor vehicle relates back to the date on which the security interest was created if delivery of the application to the Department of Highways and Public Transportation is completed within ten days after the creation of the security interest. Under section 50-23-140(c) S.C. Code Ann. (Supp. 1999) the perfection of a security interest in a watercraft or an outboard motor relates back to the date the security interest was created if delivery of the application is completed within twenty days after the creation of the security interest. The relation-back for the perfection of non-purchase-money security interests and a twenty day relation back period measured from the date on which the debtor receives delivery of the collateral for purchase-money security interests. See Section 36-9-317(e)

Thus, while some questions remain concerning the “relation-back” provisions of the South Carolina’s certificate of title laws, these laws clearly provide for the method of perfecting a security interest in property that is described therein.

III.B.5. Goods in possession of a bailee

Generally, a secured creditor does not file a financing statement for goods that are in the possession of a bailee. Section 36-9-312(c) and (d) provides:

- (c) *While goods are in the possession of a bailee that has issued a negotiable document covering the goods:*
 - (1) *a security interest in the goods may be perfected by perfecting a*

-
- security interest in the document; and*
- (2) *a security interest perfected in the document has priority over any security interest that becomes perfected in the goods by another method during that time.*
 - (d) *While goods are in the possession of a bailee that has issued a nonnegotiable document covering the goods, a security interest in the goods may be perfected by:*
 - (1) *issuance of a document in the name of the secured party;*
 - (2) *the bailee's receipt of notification of the secured party's interest; or*
 - (3) *filing as to the goods.*

Thus, if the bailee issues a negotiable documents, such as a warehouseman's receipt, then the security interest is perfected in the negotiable document. Conversely, if the bailee does not issue a negotiable document, then the secured creditor can perfect its security interest by placing the bailee on notice or by filing a financing statement. Nevertheless, caution should be taken if the secured creditor decides to perfect by just noticing the bailee. Specifically, if the secured party allows the debtor to sell or prepare the collateral for sale while in the possession of the bailee, other provisions of the code may limit the automatic perfection to only twenty days. See 36-9-312(f) below.

III.B.6. Certified securities, documents, goods, or instruments which is perfected without filing or possession under Section 36-9-312(e), (f), or (g);

For a twenty day period, a security interest in certificated securities, documents, goods and instruments are automatically perfected. Section 36-9-312 (e), (f), (g) and (h) provide:

- (e) *A security interest in certificated securities, negotiable documents, or instruments is perfected without filing or the taking of possession for a period of twenty days from the time it attaches to the extent that it arises for new value given under an authenticated security agreement.*
- (f) *A perfected security interest in a negotiable document or goods in possession of a bailee, other than one that has issued a negotiable document for the goods, remains perfected for twenty days without filing if the secured party makes available to the debtor the goods or documents representing the goods for the purpose of:*
 - (1) *ultimate sale or exchange; or*
 - (2) *loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange.*

-
- (g) *A perfected security interest in a certificated security or instrument remains perfected for twenty days without filing if the secured party delivers the security certificate or instrument to the debtor for the purpose of:*
- (1) *ultimate sale or exchange; or*
 - (2) *presentation, collection, enforcement, renewal, or registration of transfer.*
- (h) *After the twenty-day period specified in subsection (e), (f), or (g) expires, perfection depends upon compliance with this chapter.*

As stated in the Official Comments, these sections pertain to transactions that are to occur quickly. The Comments state:

There are a variety of legitimate reasons-many of them are described in subsection (f) and (g)-why certain types of collateral must be released temporarily to a debtor. No useful purpose would be served by cluttering the files with records of such exceedingly short term transactions.

Thus, these sections allow for automatic perfection, but only for a brief period of time.

III.B.7. Collateral in the secured party's possession under Section 36-9-313;

Section 36-9-313 retains previous article 9's provisions for perfection of a security interests through possession by the secured creditor. Section 36-9-313 provides:

Section 36-9-313. When possession by or delivery to secured party perfects security interest without filing.

- (a) *Except as otherwise provided in subsection (b), a secured party may perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral. A secured party may perfect a security interest in certificated securities by taking delivery of the certificated securities under Section 36-8-301.*
- (b) *With respect to goods covered by a certificate of title issued by this State, a secured party may perfect a security interest in the goods by taking possession of the goods only in the circumstances described in Section 36-9-316(d).*
- (c) *With respect to collateral other than certificated securities and goods covered by a document, a secured party takes possession of collateral in the possession of a person other than the debtor, the secured party, or a lessee of the collateral from the debtor in the ordinary course of the debtor's business, when:*

-
- (1) *the person in possession authenticates a record acknowledging that it holds possession of the collateral for the secured party's benefit; or*
 - (2) *the person takes possession of the collateral after having authenticated a record acknowledging that it will hold possession of collateral for the secured party's benefit.*
- (d) *If perfection of a security interest depends upon possession of the collateral by a secured party, perfection occurs no earlier than the time the secured party takes possession and continues only while the secured party retains possession.*
- (e) *A security interest in a certificated security in registered form is perfected by delivery when delivery of the certificated security occurs under Section 36-8-301 and remains perfected by delivery until the debtor obtains possession of the security certificate.*
- (f) *A person in possession of collateral is not required to acknowledge that it holds possession for a secured party's benefit.*
- (g) *If a person acknowledges that it holds possession for the secured party's benefit:*
 - (1) *the acknowledgment is effective under subsection (c) or Section 36-8-301(a), even if the acknowledgment violates the rights of a debtor; and*
 - (2) *unless the person otherwise agrees or law other than this chapter otherwise provides, the person does not owe any duty to the secured party and is not required to confirm the acknowledgment to another person.*
- (h) *A secured party having possession of collateral does not relinquish possession by delivering the collateral to a person other than the debtor or a lessee of the collateral from the debtor in the ordinary course of the debtor's business if the person was instructed before the delivery or is instructed contemporaneously with the delivery:*
 - (1) *to hold possession of the collateral for the secured party's benefit; or*
 - (2) *to redeliver the collateral to the secured party.*
- (i) *A secured party does not relinquish possession, even if a delivery under subsection (h) violates the rights of a debtor. A person to which collateral is delivered under subsection (h) does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this chapter otherwise provides.*

Section 36-9-313 permits a security interest to be perfected by taking possession of goods, instruments, negotiable documents, money, or tangible chattel paper. Other categories of collateral

cannot be perfected through possession, including accounts, commercial tort claims, deposit accounts, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction.

Revised Article 9 does not define possession. However, from the subsections dealing with possession, the Official Comments to the Revised Article 9 states:

In determining whether a particular person has possession, the principles of agency apply. For example, if the collateral clearly is in possession of an agent of the secured party for the purposes of possessing on behalf of the secured party, and if the agent is not also an agent of the debtor, the secured party has taken actual possession without the need to rely on a third-party acknowledgment. See subsection (c) and Comments 4 and 8. However, if the agent is an agent of both the secured party and the debtor, prudence might suggest that the secured party obtain the agent's acknowledgment in order to ensure perfection by possession. The debtor cannot qualify as an agent for the secured party for purposes of the secured party's taking possession. And, under appropriate circumstances, a court may determine that a third person in possession is so closely connected to or controlled by the debtor that the debtor has retained effective possession, even though the third person may have agreed to take possession on behalf of the secured party. If so, the third person's taking possession would not constitute the secured party's taking possession and would not be sufficient for perfection.

Thus, some questions relating to possession may still crop up from time to time.

III.B.8. Deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights which is perfected by control under Section 36-9-314;

As previously discussed, perfection of a security interest in certain categories of collateral may be achieved through control. Specifically, Section 36-9-314 provides:

Section 36-9-314. Perfection by control.

- (a) *A security interest in investment property, deposit accounts, letter-of-credit rights, or electronic chattel paper may be perfected by control of the collateral under Section 36-9-104, 36-9-105, 36-9-106, or 36-9-107.*
- (b) *A security interest in deposit accounts, electronic chattel paper, or letter-of-credit rights is perfected by control under Section 36-9-104, 36-9-105, or 36-9-107 when the secured party obtains control and remains perfected by control only while the*

secured party retains control.

- (c) *A security interest in investment property is perfected by control under Section 36-9-106 from the time the secured party obtains control and remains perfected by control until:*
- (1) *the secured party does not have control; and*
 - (2) *one of the following occurs:*
 - (A) *if the collateral is a certificated security, the debtor has or acquires possession of the security certificate;*
 - (B) *if the collateral is an uncertificated security, the issuer has registered or registers the debtor as the registered owner; or*
 - (C) *if the collateral is a security entitlement, the debtor is or becomes the entitlement holder.*

In fact, as suggested above, although a security interest in some of these categories may be achieved through the filing of a financing statement, it is preferable to perfect through control. Control takes priority over financing statements. The requirements for control of deposit accounts are contained within Section 36-9-104. For the priority of security interests in deposit accounts, see Section 36-9-327. For the requirements for control of electronic chattel paper, see Section 36-9-105. For the priority of chattel purchases, see Section 36-9-330. For the requirements for control of investment property, see Sections 36-9-106 and 36-8-106. For the priority of security interests in investment property, see Section 36-9-328. For the requirements for control of letter-of-credit right, see Section 36-9-107. For the priority of security interests in letter-of-credit rights, see Section 36-9-329.

III.B.9. Proceeds which are perfected under Section 36-9-315;

See Section III.A.3. above.

III.B.10. Perfected under Section 36-9-316.

Section 36-9-316 relates to the continuation of the perfection of security interests when the underlying governing law changes. Specifically, Section 36-9-316 states:

Section 36-9-316. Continued perfection of security interest following change in governing law.

- (a) *A security interest perfected pursuant to the law of the jurisdiction designated in Section 36-9-301(1) or 36-9-305(c) remains perfected until the earliest of:*
- (1) *the time perfection would have ceased under the law of that jurisdiction;*
 - (2) *the expiration of four months after a change of the debtor's location to*

-
- another jurisdiction; or*
- (3) *the expiration of one year after a transfer of collateral to a person that thereby becomes a debtor and is located in another jurisdiction.*
- (b) *If a security interest described in subsection (a) becomes perfected under the law of the other jurisdiction before the earliest time or event described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earliest time or event, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.*
- (c) *A possessory security interest in collateral, other than goods covered by a certificate of title and as-extracted collateral consisting of goods, remains continuously perfected if:*
- (1) *the collateral is located in one jurisdiction and subject to a security interest perfected under the law of that jurisdiction;*
- (2) *thereafter the collateral is brought into another jurisdiction; and*
- (3) *upon entry into the other jurisdiction, the security interest is perfected under the law of the other jurisdiction.*
- (d) *Except as otherwise provided in subsection (e), a security interest in goods covered by a certificate of title which is perfected by any method under the law of another jurisdiction when the goods become covered by a certificate of title from this State remains perfected until the security interest would have become unperfected under the law of the other jurisdiction had the goods not become so covered.*
- (e) *A security interest described in subsection (d) becomes unperfected as against a purchaser of the goods for value and is deemed never to have been perfected as against a purchaser of the goods for value if the applicable requirements for perfection under Section 36-9-311(b) or 36-9-313 are not satisfied before the earlier of:*
- (1) *the time the security interest would have become unperfected under the law of the other jurisdiction had the goods not become covered by a certificate of title from this State; or*
- (2) *the expiration of four months after the goods had become so covered.*
- (f) *A security interest in deposit accounts, letter-of-credit rights, or investment property which is perfected under the law of the bank's jurisdiction, the issuer's jurisdiction, a nominated person's jurisdiction, the securities intermediary's jurisdiction, or the commodity intermediary's jurisdiction, as applicable, remains perfected until the*

earlier of:

- (1) *the time the security interest would have become unperfected under the law of that jurisdiction; or*
- (2) *the expiration of four months after a change of the applicable jurisdiction to another jurisdiction.*

- (g) *If a security interest described in subsection (f) becomes perfected under the law of the other jurisdiction before the earlier of the time or the end of the period described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earlier of that time or the end of that period, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.*

This Section presents the revised four month rule. Under the old four month rule, if the location of the collateral moved from one jurisdiction to another, the secured creditor had four months to discover the change in location and file a new financing statement in the new location. Because the location of the financing statement is now where the debtor is located, the new four month rule discusses when the debtor changes jurisdiction and once again, the rule gives the secured creditor four (4) months to discover the change in location and file the appropriate financing statement in the new location.

III. C. Unresolved Bankruptcy Issues Arising out of the Revisions to Article 9

In his article on the Revised Article 9, Professor G. Ray Wagner makes the argument that the revisions to Article 9 which are detrimental to the bankruptcy trustee should be found to violate federal bankruptcy law and not apply in the bankruptcy setting. Wagner, G., *The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy*, AMERICAN BANKRUPTCY INSTITUTE LAW REVIEW, Volume 9, Number 1 (Spring 2001). This author does not see that happening but it would be entertaining to see someone make some of the arguments.

Some of the issues that will arise in the future may include:

1. In South Carolina, we have not yet adopted Article 5. As mentioned earlier, some sections of Revised Article 9 refer to Article 5. With that in mind, it will be interesting to find out how the transition rules are going to play in determining the perfection of security interests in certain collateral without the consent of all of the parties involved in the transactions.
2. Revised Article 9 provides for strict foreclosure under certain circumstances, thereby allowing the secured creditor to retain the collateral in exchange for

a full or partial satisfaction of the debt. These strict foreclosures and the ability to attack these transactions as preferences or fraudulent conveyances will likely be tested. See A. Coles-Bjerre, *Trusting the Process and Mistrusting the Results: A Structural Perspective on Article 9's Low-Price Foreclosure Rule*, AMERICAN BANKRUPTCY INSTITUTE LAW REVIEW, Volume 9, Number 1 (Spring 2001)

3. Revised Article 9 provides for the mandatory disposition of consumer goods when 60% of the cash price has been paid or 60% of the principal amount of the obligation has been paid. Again, preferences and fraudulent conveyance actions are a potential in these circumstances and also questions as to the reasonableness of the liquidation procedures.
4. Revised Article 9 allows for broad categories of definitions for financing statements and narrower objectively identifiable classifications of collateral for security agreements. Thus, Trustees are going to require that secured creditors provide them with copies of security agreements to determine whether the security interest attaches to a particular asset. Conflicts between the descriptions contained in financing statements and security agreements will likely arise and when they do, the courts will likely be required to sort out the problems and damages.
5. Revised Article 9, by deleting former Section 36-9-306(4), does away with some general principals relating to the tracing of proceeds into commingled bank accounts. In its place, Section 36-9-315 now deals with the secured creditors rights to proceeds by simply indicating that the filing of the bankruptcy does not affect a secured party's rights to proceeds. Thus, identification and tracing become important issues as it relates to the cash in the debtor's accounts and the remaining assets of the bankrupt. See Note, *Tracing Cash Proceeds in Insolvency Proceedings Under Revised Article 9*, AMERICAN BANKRUPTCY INSTITUTE LAW REVIEW, Volume 9, Number 1 (Spring 2001).

Of course, there will be many other issues, not predicted here. This list is only a brief, simple list to provide some food for thought.