

PERFECTION OF PROCEEDS

Section 9-306 of the Uniform Commercial Code deals with the rights of a secured party to the proceeds when its collateral is sold or otherwise transferred by the debtor.

Section 1 of this Statute seeks to define the very term "proceeds" as follows:

"Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds except to the extent that it is payable to a person other than a party to the security agreement. Money, checks, deposit accounts and the like are "cash proceeds." All other proceeds are "non-cash proceeds."

The statute goes on to say that a security interest in collateral continues despite sale of the collateral, or its exchange or other disposition unless the disposition was authorized by the secured party in the security agreement or otherwise. For example, an automobile dealer ordinarily grants a security interest in all his inventory to a financial institution. It is understood, however, that in the ordinary course of business the dealer will sell cars to his customers, and any such sale will terminate the inventory security interest as to the vehicle sold. This leaves the buyer free to grant a security interest to his own financial institution and to make monthly payments if he can't pay cash for the automobile of his dreams.

Ordinarily, contracts between car dealers and their financial institutions, usually

called "floor planning agreements," provide that a dealer must apply that portion of the sale proceeds of the vehicle representing its wholesale cost to the floor planning creditor upon sale. The dealer's failure to do so is termed a "sale out of trust," and constitutes conversion.

UCC 9-306 further states that when a transfer is not authorized by the secured party, the security agreement continues in any identifiable proceeds received by the debtor. A security interest in "identifiable proceeds" seems a risky one, especially when the secured party is not aware of the transfer, and therefore has had no reason to identify the proceeds. As our readers already know, for a security interest to be effective against third parties, it has to be perfected. The security interest in identifiable proceeds is continuously perfected by law if the creditor's security interest in the original collateral was perfected, but this perfection in proceeds continues for only ten (10) days after the receipt of the proceeds by the account debtor, except under three circumstances:

1. A filed financing statement covers the original collateral and the proceeds are the type of collateral in which a security interest may be perfected by filing in the same office or offices where the original financing statement has been filed, and if the proceeds are acquired with cash proceeds, the description of the collateral in the financing statement indicates the type of property constituting the proceeds; or
2. The financing statement covers the original collateral and the proceeds are identifiable cash proceeds; or

3. The security interest in proceeds is perfected before the expiration of the ten (10) day period.

All of this is somewhat confusing without examples. Suppose your customer has financed the purchase of a commercial metal fabricating machine through you. The proper place to file a financing statement to perfect your security interest in your jurisdiction is, for purposes of our example, the county of the debtor's residence, and you have therefore filed with the county clerk of that county. You receive your

monthly payments as scheduled for a period of one year, but then learn to your surprise that your debtor has traded the metal fabricating machine that you had as collateral to a third party for a different, better fabricating machine, and that the transfer took place sixty days before you learned of it. Are you perfected?

Your security interest under the statute continues in the original metal fabricator in the hands of the third party and you could therefore repossess it from the person to whom your customer traded it. Your security interest also continues perfected in your customer's new fabricator since it is identifiable non-cash proceeds of your collateral and you have already filed in the proper place to perfect a security interest in said proceeds.

If instead of trading your fabricating machine for a better model, the debtor had simply sold it for cash and purchased a certificate of deposit which you can trace, you have a perfected security interest in the debtor's certificate of deposit.

Suppose, however, that in your jurisdiction the place for filing financing statements on equipment such as your fabricating machine and the place for filing on farm products is different -- say, for example, the local clerk's office versus the Secretary of State's office. If your customer trades his fabricating equipment for a barge load of corn -- which is not only identifiable non-cash proceeds but also a farm product -- unless you can file a new financing statement within ten days of the transfer, the perfection of your security interest in the proceeds will expire under the statute.

The questions involving perfection in the proceeds of collateral can become even more complicated than our examples, and may at time require a court of law to unravel, but this should give our readers an inkling of the issues and law involved. □

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