

*Here's How and When to Do It*

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# ***ACTION GUIDE***

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June 2005

## **Taking Security Interests in Personal Property**

**Randy Rogers**



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CONTINUING EDUCATION OF THE BAR ■ CALIFORNIA  
Oakland, California

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## Scope of Guide

This Action Guide is written from the perspective of counsel for the secured party. It tells you what to do to perfect a security interest that will give your client priority over other creditors. It assists you in selecting the appropriate method of perfection and takes you through the steps to perfect a security interest in the particular type of collateral that secures your client's loan, from computer software to fixtures. It also covers searches, preparation of a security agreement, continuation statements, and amendments. This Action Guide addresses practices under revised Article 9 of the Commercial Code that became effective on July 1, 2001. It assumes that revised Article 9 has been adopted in all states relevant to a particular transaction. If a debtor resides in or collateral is located in another state, it will be necessary to determine whether that state has adopted revised Article 9. If not, the laws of that state must be consulted, especially as to perfection and filing issues.

### PARTIES

The grantor of the security interest is referred to as the "debtor." The grantee is referred to as the "secured party."

## Revision Highlights

- ❑ Updated with the latest developments in the law pertaining to the taking of security interests in personal property. Also includes current versions of UCC forms.
- ❑ See step 4 about the Secretary of State's new "UCC Connect" service.

## Abbreviations

Secured Transactions	Secured Transactions in California Commercial Law Practice (2d ed Cal CEB 2001)
UCC	Uniform Commercial Code (official text adopted by the National Conference of Commissioners on Uniform State Laws)
UCC Committee Report	Report of the Uniform Commercial Code Committee of the Business Law Section of the State Bar of California Regarding Legal Opinions in Personal Property Secured Transactions, 44 Bus Law 791 (1989)
Secured Transactions	Secured Transactions in California Commercial Law Practice (2d ed Cal CEB 2001)

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# CONTENTS

ABOUT THE AUTHORS .....	xi
ACKNOWLEDGMENTS .....	xiii
CUTOFF DATES .....	xv
<b>When the Client Is Considering Granting Credit.....</b>	<b>1</b>
1. MAKE PRELIMINARY ANALYSIS OF CLIENT'S OBJECTIVES IN TAKING COLLATERAL.....	1
2. IDENTIFY THE COLLATERAL .....	2
3. REVIEW PRIORITY AND PERFECTION RULES .....	2
4. DETERMINE WHETHER THERE ARE PRIOR SECURITY INTERESTS.....	3
If Perfection Is by Filing Financing Statement (Form UCC-1) .....	4
If Perfection Is by a Public Filing of Document at an Office Other Than the Secretary of State.....	8
If Perfection Is by Obtaining Control .....	8
If Perfection Is by Taking Possession .....	8
5. CONSIDER FILING FINANCING STATEMENT AT OUTSET .....	9
6. SELECT APPROPRIATE PERFECTION METHOD.....	9
<b>When Perfecting by Filing Financing Statement.....</b>	<b>11</b>
7. IF YOU WILL PERFECT BY FILING A FINANCING STATEMENT, OBTAIN FORM UCC-1 .....	11
8. IF FILING A FINANCING STATEMENT, COMPLETE FORM UCC-1 .....	12
9. FILE FINANCING STATEMENT .....	17
<b>When Perfecting Interest in Negotiable Documents, Instruments, or Investment Property ....</b>	<b>20</b>
10. NEGOTIABLE DOCUMENTS.....	20
11. INSTRUMENTS.....	21
12. INVESTMENT PROPERTY.....	21
13. SECURITIES ISSUED BY A FEDERAL AGENCY OR INSTRUMENTALITY.....	23
<b>When Perfecting Interest in a Deposit Account .....</b>	<b>24</b>
14. DEPOSIT ACCOUNTS.....	24
<b>When Perfecting Interest in Intellectual Property .....</b>	<b>25</b>
15. TRADEMARKS.....	25
File Financing Statement .....	25
Record With Federal Government .....	26
16. PATENTS .....	28
File Financial Statement .....	28
Record With Federal Government .....	28
17. COPYRIGHTS .....	30
18. COMPUTER SOFTWARE.....	31
<b>When Perfecting Interest in Goods—Special Situations.....</b>	<b>32</b>
19. GOODS COVERED BY NONNEGOTIABLE DOCUMENTS .....	32
If Bailee Has Possession of Goods.....	32
If Bailee Does Not Have Possession of Goods.....	33
20. MOTOR VEHICLES.....	33
21. AIRCRAFT AND AIRCRAFT ENGINES OVER 750 HP .....	34

22. BOATS, HOUSEBOATS, AND SHIPS.....	34
If Classified as an Undocumented Vessel.....	35
If Classified as a Documented Vessel.....	36
23. RAILROAD CARS, LOCOMOTIVES, AND OTHER ROLLING STOCK USED IN CONNECTION WITH INTERSTATE COMMERCE .....	36
24. MOBILEHOMES, MANUFACTURED HOMES, COMMERCIAL MODULARS, TRUCK CAMPERS, AND FLOATING HOMES .....	37
25. AGRICULTURAL COLLATERAL.....	38
26. AS-EXTRACTED COLLATERAL AND TIMBER TO BE CUT.....	39
<b>When Obtaining Purchase-Money Priority .....</b>	<b>40</b>
27. COLLATERAL OTHER THAN INVENTORY AND LIVESTOCK.....	40
28. INVENTORY AND LIVESTOCK .....	41
<b>When Perfecting and Obtaining Priority In Fixtures .....</b>	<b>42</b>
29. OBTAIN PRIORITY REGARDING FIXTURES UNDER REAL PROPERTY LAW.....	42
<b>When Preparing Written Security Agreement .....</b>	<b>44</b>
30. CONSIDER WRITTEN SECURITY AGREEMENT.....	44
31. DRAFT INTRODUCTORY PORTION OF SECURITY AGREEMENT .....	45
Describe Collateral .....	46
Describe Obligation.....	47
32. DRAFT DEBTOR'S REPRESENTATIONS AND WARRANTIES .....	48
33. DRAFT DEBTOR'S COVENANTS .....	49
34. DRAFT POWER OF ATTORNEY PROVISIONS.....	51
35. DRAFT DEFAULT AND REMEDY PROVISIONS .....	51
36. WHEN APPROPRIATE, DRAFT LEGAL OPINION REQUIREMENTS .....	52
37. DRAFT SIGNATURE PROVISIONS.....	53
<b>Before Granting Credit.....</b>	<b>54</b>
38. CONSIDER TAKING EXTRA PRECAUTIONS IF COLLATERAL CONSISTS OF CHATTEL PAPER, INSTRUMENTS, ACCOUNTS, OR GENERAL INTANGIBLES.....	54
Chattel Paper or Instruments .....	54
For Accounts and General Intangibles.....	54
39. DETERMINE THAT PARTIES MEET ALL REQUIREMENTS FOR SECURITY INTEREST TO ATTACH .....	55
40. REVIEW DEBTOR'S LEGAL OPINION.....	57
<b>When Consummating Transaction .....</b>	<b>57</b>
41. UPDATE SEARCH FOR PRIOR SECURITY INTEREST .....	57
42. UPDATE INSPECTION OF COLLATERAL .....	57
43. MONITOR EXECUTION AND DISTRIBUTION OF DOCUMENTS .....	57
<b>After Closing .....</b>	<b>58</b>
44. MONITOR STATUS OF COLLATERAL AND TAKE ACTION TO PROTECT SECURITY INTEREST.....	58
45. MONITOR STATUS AND ACTIVITIES OF DEBTOR AND TAKE ACTION TO PROTECT SECURITY INTEREST .....	59
46. FILE AMENDMENTS TO FINANCING STATEMENT.....	60
47. FILE CONTINUATION STATEMENT .....	62
48. RENOTICE TO COMPETING INVENTORY FINANCIERS .....	64
49. ANTICIPATE POSSIBLE DOCUMENT ASSIGNMENT BY SECURED PARTY.....	64
50. IF DEBTOR DEFAULTS, PURSUE REMEDIES .....	64

51. IF DEBTOR FILES BANKRUPTCY, SEEK RELIEF FROM STAY TO ENFORCE COMMERCIAL CODE REMEDIES, OR SEEK REMEDIES UNDER BANKRUPTCY LAW .....	65
<b>After Debtor Pays Part of Debt.....</b>	<b>65</b>
52. FILE FOR PARTIAL RELEASE OF COLLATERAL .....	65
<b>After Debt Has Been Paid and All Secured Obligations Satisfied.....</b>	<b>65</b>
53. FURNISH TERMINATION STATEMENT.....	65
<b>Appendixes .....</b>	<b>67</b>
A. UCC CATEGORIES OF COLLATERAL .....	67
B. UCC SEARCHES DONE BEFORE JULY 1, 2006.....	74
C. UNIFORM COMMERCIAL CODE FINANCING STATEMENT (FORM UCC-1) AND ADDENDUM (FORM UCC-1AD).....	75
D. UNIFORM COMMERCIAL CODE FINANCING STATEMENT AMENDMENT (FORM UCC-3) .....	79
E. UNIFORM COMMERCIAL CODE INFORMATION REQUEST (FORM UCC-11) .....	81
<b>Tables .....</b>	<b>85</b>
TABLE OF STATUTES, REGULATIONS, AND RULES.....	85
TABLE OF CASES .....	89

## About the Authors



**Randy Rogers**

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Randy Rogers is a partner in the San Francisco office of Winston & Strawn. He represents lenders and borrowers in secured and unsecured lending transactions, loan workouts and debt restructurings, and bankruptcy cases and related litigation. Mr. Rogers is a member of the American College of Bankruptcy and the Commercial Financial Services Committee of the Business Law Section of the American Bar Association, and has served on the Agribusiness and Uniform Commercial Code Committees of the California State Bar. He graduated from the University of California, Santa Cruz, in 1977, and received his J.D. from the University of California, Hastings College of the Law, in 1980. He served as an Adjunct Professor of Law at the University of San Francisco Law School (1983). Mr. Rogers is a member of the Board of Editors of *Collier on Bankruptcy* (15th ed Matthew Bender 2000) and is a contributing author to that publication, as well as to the *Collier Bankruptcy Practice Guide* (Matthew Bender 2000) and the *Collier Bankruptcy Manual* (Matthew Bender 2000). He is the author of the *Collier Farm Bankruptcy Guide* (Matthew Bender 1997).



**Sandra L. Shippey**

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**Sandra L. Shippey**, who served as a consultant for this Action Guide, is a partner in the law firm of Procopio, Cory, Hargreaves & Savitch LLP in San Diego. Her practice emphasizes secured and unsecured personal property and real estate financing transactions, equipment leasing transactions, loan workouts, and debt restructurings. Ms. Shippey currently serves as the Co-Chair of the Uniform Commercial Code Committee of the Business Law Section of the State Bar of California. Ms. Shippey was admitted to practice law in Colorado in 1982, and in California in 1991. She graduated from the University of Colorado with a B.A., with distinction, in 1978, and from Boston University with a J.D., magna cum laude, in 1982. Prior to joining Procopio, Ms. Shippey was, among other things, Operations Counsel for General Electric Capital Corporation and an associate with Mayer, Brown & Platt. She is a member of the board of directors of the San Diego Christian Foundation, Inc. and a member of the board of trustees of Southwestern Christian Schools, Inc.

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## Cutoff Dates

We completed legal editing of this Action Guide at the end of March 2005.

We reviewed California and federal statute citations for amendments and repeals through these cutoffs:

California statutes for amendments and repeals through Stats 2004, ch 953 (end).

Federal statutes for amendments and repeals through 118 Stat 4020.

We try to add significant statutory and judicial developments, subsequent histories of cases, and other matters such as new forms and regulations after legal editing is done, but you should not assume that all developments after the listed cutoff dates have been included.

# Taking Security Interests in Personal Property

by Randy Rogers

## When the Client Is Considering Granting Credit

### STEP 1. MAKE PRELIMINARY ANALYSIS OF CLIENT'S OBJECTIVES IN TAKING COLLATERAL

#### 1. COLLATERAL

##### DEFINED NOTE

“Collateral” is property subject to a security interest. [Com C §9102\(a\)\(12\)](#).

Tailor your approach differently if the collateral is of only peripheral, as opposed to crucial, significance in the transaction.

#### 1. If Collateral Is Crucial

If you represent an asset-based lender, *e.g.*, one whose credit decision centers on maintaining a first-priority security interest in inventory or other assets of a certain quality and amount, you should take a more rigorous approach to a wide range of issues, such as obtaining:

- Priority over other secured parties (see [steps 3–4](#), below); and
- Rigorous covenants in the security agreement concerning inventory and other assets. See [step 28](#), below.

#### 2. If Collateral Is Less Important

If your client is basically satisfied with the general credit of the debtor, but is taking collateral as an added protection, you can concentrate on:

- Taking the steps required to perfect the security interest (see [steps 6–29](#), below);
- Preparing the security agreement (see [steps 30–37](#), below); and
- Taking the steps required for the security interest to attach. See [step 39](#), below.

#### 2. RECOGNIZE STEPS NECESSARY TO ATTACH AND PERFECT SECURITY INTERESTS

In either case you will need to:

#### 3. Attach

Make sure the security interest is enforceable, *i.e.*, that the security interest attaches (see [step 39](#), below); and

#### 4. Perfect

Understand the steps required to perfect the security interest so that you can:

- Determine whether there are prior security interests (see [steps 3–4](#), below);
- Select the appropriate method of perfection (see [step 6](#), below); and

- Complete the steps to perfect the security interest as soon as possible so that you establish priority of your client's interest. See [step 5](#), below.
- 5. Try to Meet Precautionary Deadline**
- *If possible*, perfect the security interest within **10 days** to avoid an argument that the transfer is an avoidable preference or an unperfected security interest under the Bankruptcy Code. See [11 USC §§544, 547\(b\)](#) (trustee can avoid certain security interests).

## STEP 2. IDENTIFY THE COLLATERAL

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### 3. DETERMINE WHAT COLLATERAL TO TAKE

Ideally, the secured party should take sufficient collateral that can be sold for an amount reasonably anticipated to discharge the debt in the event of a default.

### 6. Items to Include

The collateral package should identify:

- The principal assets targeted as collateral (*e.g.*, inventory, accounts, and items of equipment);
- All related assets, *e.g.*, trademarks when the collateral includes a significant amount of branded inventory; and
- If the collateral is a going business, intangibles such as:
  - Patents;
  - Licenses (including software licenses);
  - Trademarks and trade names;
  - Goodwill; and
  - Business records.

### NOTE

If the collateral is accounts, consider also taking a security interest in the debtor's bank accounts, into which the proceeds of the accounts will be deposited.

### 4. CATEGORIZE COLLATERAL UNDER THE UCC

Once you have identified the collateral, determine which Commercial Code category applies to it. For a description of these categories, see [Appendix A](#).

## STEP 3. REVIEW PRIORITY AND PERFECTION RULES

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### 5. GENERAL PRIORITY RULE

Generally, when two secured parties each claim a security interest in the same collateral, priority is given to the secured party who perfects first by either ([Com C §9322\(a\)](#)):

### 7. Financing Statement

Filing a financing statement ([Form UCC-1](#)), as long as this method is available to perfect a security interest in the particular collateral; or

### 8. Other Methods

Perfecting its security interest by another method, such as obtaining possession or control of the collateral.

**Further Research:** See *Secured Transactions in California Commercial Law Practice*, chap 4 (2d ed Cal CEB 2001), referred to throughout this Action Guide as Secured Transactions.

**NOTE** →

Act quickly, because in most situations the first to perfect its security interest will obtain priority.

**6. WHEN GENERAL RULE DOES NOT APPLY**

Ascertain whether any exceptions to this general priority rule apply in your case, *e.g.* (note that the following is by no means an exhaustive list):

**9. Purchase Money**

If certain requirements are met, a purchase money creditor may obtain a security interest in property sold or financed by the creditor that will have priority over a prior perfected security interest. [Com C §9324](#); *Secured Transactions* §§4.10–4.19. See also [steps 27–28](#), below.

**10. Proceeds**

The Commercial Code contains special rules to govern a conflict between two secured creditors over proceeds arising from a sale or other disposition of collateral. See [Com C §9322\(b\)–\(c\)](#); *Secured Transactions* §§4.27–4.30.

**11. Investment Property**

If a secured party has “control” over investment property, that secured party will have priority over a secured party that files a financing statement. See [step 12](#), below.

**Further Research:** See *Secured Transactions* §4.22.

**12. Producer’s Liens**

When a producer sells farm products to a processor—*e.g.*, a grower sells grapes to a winery—the producer has a lien on all farm products of the type sold by the producer and the lien is prior to most other liens, claims, or encumbrances against the processor. See [Food & A C §§55631–55653](#).

**13. Livestock Liens**

When a rancher sells livestock to a meat packer, the rancher has a lien on the livestock that is prior to most other liens, claims, or encumbrances of the processor. See [Food & A C §§55701–55704](#).

**7. AVOID OVERLOOKING “ATTACHMENT” REQUIREMENT**

Focus on perfection as early as possible; however, do not overlook the equally critical requirement that the security interest “attach,” because when conflicting security interests are not perfected, the first to *attach* has priority. See [Com C §9322\(a\)\(3\)](#). See also [step 39](#), below, on attachment.

**Further Research:** For a general discussion of the topic of this step, see *Secured Transactions*, chap 4.

**STEP 4. DETERMINE WHETHER THERE ARE PRIOR SECURITY INTERESTS**

**8. OBJECTIVE**

Learn *as early as possible* whether there are any prior security interests in the collateral.

**9. OPTIONS IF PRIOR SECURITY INTERESTS EXIST**

If there are prior security interests in the same collateral, your client can:

- As a condition of closing the transaction, require the debtor to terminate, release, or subordinate those prior interests;

**NOTE**

- Abort the transaction; or
- Decide that the prior security interests are immaterial.

If your client chooses to proceed with the transaction, the client may wish to enter into an intercreditor agreement or subordination agreement with the other secured party, setting forth their respective priorities and agreeing to an approach to the exercise of remedies, including foreclosure on collateral.

**Sample Form:** For a sample subordination agreement, see [Secured Transactions §4.76](#).

## 10. DETERMINE APPLICABLE METHODS OF SEARCH

To decide where to search for prior security interests, determine the applicable methods of perfecting a security interest in each category of proposed collateral. For methods of perfection, see [step 6](#), below.

### IF PERFECTION IS BY FILING FINANCING STATEMENT (FORM UCC-1)

## 11. CHOOSE METHOD OF SEARCH

To learn whether there is a previously filed financing statement, you can either:

- Conduct the search yourself, either online in states that permit it (e.g., UCC Connect through the California Secretary of State's office), or by filing a standard [UCC-11 Information Request](#) (see [Appendix E](#)) with the Secretary of State (see below); or
- Engage a firm to conduct a search for prior security interests. See below.

## 12. WHERE TO SEARCH

- A search must be conducted in the office in which a financing statement must be filed to perfect a security interest in the particular type of collateral. See [step 9](#), below.
- For transactions concluded before July 1, 2006, a search may also need to be conducted in the jurisdiction in which a financing statement was required to be filed under the old version of Article 9 that expired on July 1, 2001.
- Generally, a tax and judgment lien search should also be conducted in the appropriate office for the applicable state.

## 13. CONSIDER ENGAGING SEARCH FIRM

To save time and attorney fees, you can hire a firm that, for a fee, will assist you and expedite searches and filings. Some firms that provide these services are:

- CLAS Information Services  
2020 Hurley Way, #350  
Sacramento, CA 95825  
(800) 952-5696  
[www.clasinfo.com](http://www.clasinfo.com)
- CT Corporation  
1350 Treat Blvd., Suite 100  
Walnut Creek, CA 94597