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A COMPARISON OF A SECURITY AGREEMENT UNDER THE FORMER ARTICLE 9 AND THE NEW ARTICLE 9

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The following annotated Security Agreement is presented as a *sample* for purposes of understanding the operation of the new Article 9 by looking at how it may affect the preparation of a security agreement. The security agreement is intended to provide a different way of thinking about the new Article 9 and to assist persons studying the new Article 9. The Security Agreement is *not* intended as a model form.

The Security Agreement is based on the final draft[1] of Article 9.[2] The Drafting Committee[3] has completed its substantive work. The American Law Institute approved Article 9 at its annual meeting in May 1998 and the National Conference of Commissioners on Uniform State Laws gave its final approval at its meeting in July 1998. Article 9 has now been submitted to the States for adoption. It has been adopted in about a dozen states and is pending in approximately twenty-five additional jurisdictions. It is expected to be introduced in all or most of the balance of the states in time for it to be effective on the suggested uniform effective date of July 1, 2001.

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1 Copies of the final draft may be purchased from the sponsors: NCCUSL, 312.915.0195; and ALI, 800.253.6397, x 7000 or online: http://www.ali.org/ali/com_ucc.htm. The final draft is also available for purchase from the ABA (800.285.2221) and commercial publishers. Copies of the drafts prior to the final draft may be obtained at no cost at: http://www.law.upenn.edu/library/ulc/ulc.htm.

2 This security agreement (in updated form) and other materials discussing the new Article 9 will be distributed from time-to-time. A request for copies or inclusion on the distribution list for these materials can be sent to Steven O. Weise; Heller Ehrman White & McAuliffe LLP; 601 So. Figueroa Street, 40th Fl.; Los Angeles, California 90017-5758; 213.244.7831; FAX: 213.614.1868; sweise@hewm.com. The author was the ABA Advisor to the Drafting Committee.

3 The Chair of the Drafting Committee was Bill Burke (wburke@shearman.com). The Reporters were Steve Harris (sharris@kentlaw.edu) and Chuck Mooney (cmooney@oyez.law.upenn.edu).

SECURITY AGREEMENT

THIS SECURITY AGREEMENT ("Security Agreement") is made the ~~30th~~ 1st day of ~~June~~ July, 2001,[1] between Vending Machine Manufacturing Co., a Delaware Corporation ("Debtor") and Finance Company, an Illinois Corporation ("Secured Party"), ~~as Agent for the lenders listed on Exhibit A~~.[2]

This Security Agreement is entered into with respect to:

(i) a loan (the "Loan") to be made by Secured Party to Debtor[3] pursuant to a Loan Agreement (the "Loan Agreement") dated the same date as this Security Agreement;

(ii) the sale by Debtor and the purchase by Secured Party of Accounts[4];

(iii) the sale by Debtor and the purchase by Secured Party of Chattel Paper[5];

(iv) the sale by Debtor and the purchase by Secured Party of Payment Intangibles[6]; and

(iv) the sale by Debtor and the purchase by Secured Party of Promissory Notes[7].

1. *The Drafting Committee has completed its work and obtained ALI and NCCUSL approval in 1998. This Security Agreement, for discussion purposes, assumes that the new Article 9 becomes effective in the relevant jurisdiction on July 1, 2001, as contemplated by the new Article 9. All statutory references in this document refer to the final Draft of Article 9. Note that in many instances different rules will apply in consumer transactions. See § 9-102(a)(26).*

2. *The "secured party" includes a "representative" of the "secured party." § 9-102(a)(72)(E). A financing statement may name a representative of the secured party without indicating that capacity. §§ 9-502(a)(2), 9-503(d). This rule should also apply to the security agreement if the obligations described cover those held by all participants.*

3. *Note that if the "debtor" is a guarantor securing its obligations under a guaranty the guarantor will have the rights of a debtor for the collateral that it supplies and also as an "obligor" if the primary obligor has also supplied collateral. §§ 9-102(28) and 59) and 9-602. Either way it cannot waive its rights to the extent a debtor cannot waive its rights. § 9-602.*

4. *Article 9 continues to apply to the sale of accounts. § 9-109(a)(3). Note the expanded definition of "accounts," described below. § 9-102(a)(2).*

5. *Article 9 continues to apply to the sale of chattel paper. § 9-109(a)(3). The definition of "chattel paper" now includes transactions involving a combination of goods and software, to a limited extent. § 9-102(a)(11).*

6. *Article 9 applies to the sale of "payment intangibles." § 9-109(a)(3). The definition is discussed below. Sales of payment intangibles are automatically perfected under § 9-309(a)(3). These changes are designed to facilitate securitization transactions without interfering with the sale of loan participations.*

7. *Article 9 applies to the sale of "promissory notes." § 9-109(a)(3). The definition is discussed below. § 9-102(a)(65). Sales of promissory notes are automatically perfected under § 9-309(a)(4).*

Secured Party and Debtor agree as follows:

1. Definitions.

1.1 *"Collateral."* The Collateral shall consist of all of the ~~following~~ personal property[8] of Debtor, wherever located, and now owned or hereafter acquired[9] ,including:

(i) Accounts[, including health-care-insurance receivables][10] ~~all amounts owed to Debtor for the licensing of intellectual property rights;~~

(ii) Chattel paper[11]~~, including equipment leases and conditional sales agreements~~;

(iii) Inventory[12]~~, including property held for sale or lease and raw materials~~;

(iv) Equipment[13]~~, including property used in the Debtor's business, machinery and production machines~~;

(v) Instruments[, including Promissory Notes][14] ~~notes, negotiable instruments, and negotiable certificates of deposit~~;

8. *A financing statement may use a "supergeneric" description, such as "all my personal property." § 9-504(2). A security agreement may not. § 9-108(c). Article 9 provides a "safe-harbor" for describing collateral by an Article 9 category in a security agreement or in a financing statement. § 9-108(b)(3).*

9. *A security interest cannot apply to after-acquired commercial tort claims. § 9-204(b)(2).*

10. *"Accounts" include a wide variety of rights to payment arising out of the transfer of rights in tangible and intangible personal property, including credit card receivables and license fees. § 9-102(a)(2). Article 9 now covers security interests in rights under an insurance policy if the right is a "health-care-insurance receivable." §§ 9-102(a)(46) and 9-109(d)(8). A separate reference to "health-care-insurance receivables" is not necessary.*

11. *"Chattel paper" includes tangible and intangible chattel paper. § 9-102(a)(11), (31), and (78). This results in some special perfection and priority rules discussed below. The definition of "chattel paper" now includes transactions involving a combination of goods and software, to a limited extent. § 9-102(a)(11).*

12. *"Goods," and therefore inventory, includes software "embedded" in goods. § 9-102(a)(44) and (75).*

13. *"Equipment" no longer has its own definition, it is the residual category of goods (goods that are not inventory, farm products, or consumer goods). § 9-102(a)(2). "Goods," and therefore equipment, includes software embedded in the goods. § 9-102(a)(44) and (75).*

14. *"Instruments" continue to include non-Article 3 payment obligations that are "of a type that in ordinary course of business [are] transferred by delivery with any necessary indorsement or assignment." A reference to "instruments" includes "promissory notes." § 9-102(a)(47). A separate reference to "promissory notes" is not necessary. As noted above, Article 9 applies to the sale of promissory notes. § 9-109(a)(3). A "promissory note" is an "instrument"*

		that is not "order" paper or a certificate of deposit. § 9-102(a)(65).
(vi)	~~Securities~~ Investment Property;[15]	*15. "Investment property" is the terminology used to cover what used be securities. See new Article 8 and former § 9-107. A reference to "general intangibles" (§ 9-102(a)(42)) or "instruments" (§ 9-102(a)(47)) will not include "investment property."*
(vii)	Documents~~, including a documents of title, a warehouse receipt, and a bill of lading~~;	
(viii)	Deposit accounts;[16]	*16. Article 9 permits a security interest in a deposit account as original collateral. A reference to "general intangibles" will include "payment intangibles," but will not include a "deposit account." § 9-102(a)(42). There are special perfection rules, discussed below.*
(ix)	Debtor's claim for interference with contract against Big Soda Pop Company;[17]	*17. Article 9 covers a security interest in a tort claim if the claim is a "commercial tort claim." §§ 9-102(a)(13), 9-109(d)(12). The description of the collateral must refer to a specific tort claim and cannot describe the claim by "type." § 9-108(e)(1). The security interest can not cover after-acquired tort claims. § 9-204(b)(2). A reference to "general intangibles" will not include a "commercial tort claim." § 9-102(a)(42).*
(x)	Letter-of-credit rights,[18]	*18. Letter-of-credit rights are the right to payment under a letter of credit. § 9-102(a)(51). Article 5 controls the right to draw under a letter of credit. § 5-114. A reference to "general intangibles" will not include letter- of-credit rights. § 9-102(a)(42). There are special perfection rules discussed below.*
(xi)	General intangibles[, including payment intangibles][19] ~~licenses, intellectual property, and tax returns~~;	*19. A reference to "general intangibles" does not include some types of collateral that may sound like a "general intangible," such as commercial tort claims, deposit accounts, investment property, and letter-of-credit rights. The term does include payment intangibles and software. § 9-102(a)(42). A separate reference to those types of collateral is not necessary. A "payment intangible" is a general intangible where the account debtor's principal obligation is the payment of money. § 9-102(a)(61).*
(xii)	[Supporting obligations] ~~Rights ancillary to, or arising in any way in connection with, any of the foregoing, including~~	*20. "Supporting obligations" include guaranties and letter-of-credit rights that support payment of another obligation, such as an account or an instrument. § 9-102(a)(77). A security interest in an obligation automatically attaches to a*

~~security agreements securing any of the foregoing, guaranties guarantying any of the foregoing, documents, notes, drafts representing any of the foregoing, the right to returned goods, warranty claims with respect to any of the foregoing, amounts owed in connection with the short-term use or licensing of any of the foregoing, government payments in connection with the purchase or agreement not to produce any of the foregoing;~~[20]

(xiii) ~~books and records pertaining to the foregoing and the equipment containing the books and records; and~~

(xiv) [to the extent not listed above as original collateral, proceeds and products of the foregoing]~~, including money, deposit accounts, goods, insurance proceeds and other tangible or intangible property received upon the sale or other disposition of the foregoing.~~[21]

related supporting obligation. § 9-203(f). A security agreement does not need a separate reference to "supporting obligations." The security interest in the supporting obligation is automatically perfected if the security interest in the underlying collateral is perfected. § 9-308(d). The same is true for a security interest in a security interest that secures an obligation that itself is collateral. §§ 9-203(g) and 9-308(e).

21. "Proceeds" is broadly defined in Revised Article 9 to include whatever is acquired upon the sale, lease, license, exchange or other disposition of collateral; rights arising out of collateral; and collections and distributions on collateral. § 9-102(a)(64). This is much broader than under former law. Article 9 looks to non-UCC law for the method of tracing. § 9-315(b)(2). It is expected that for money the courts will use the lowest intermediate balance rule. § 9-315, Official Comment 3. A security interest in collateral automatically attaches to proceeds (§ 9-203(f)), continues in collateral following its sale (§ 9-315(a)(1)), and initially remains perfected (§ 9-313(c) and (d)). A security agreement does not need a separate reference to "proceeds."

1.2 *"Obligations."* This Security Agreement secures the following:

(i) Debtor's obligations under the Loan, the Loan Agreement, and this Security Agreement;

(ii) all of Debtor's other present and future obligations to Secured Party;[22]

(iii) the repayment of (a) any amounts that Secured Party may advance or spend for the maintenance or preservation of the Collateral[23] and (b) any other expenditures that Secured Party may make under the provisions of this Security Agreement or for the benefit of Debtor;

(iv) all amounts owed under any modifications, renewals or extensions of any of the foregoing obligations;

(v) all other amounts now or in the future owed by Debtor to Secured Party~~, whether or not of the same kind or class as the other obligations owed by Debtor to Secured Party~~;[24] and

(vi) any of the foregoing that arises after the filing of a petition by or against Debtor under the Bankruptcy Code, even if the obligations due not accrue because of the automatic stay under Bankruptcy Code § 362 or otherwise.

This Security Agreement does not secure any obligation described above which is secured by a consensual lien on real property.[25]

1.3 UCC. Any term used in the Uniform Commercial Code ("UCC") and not defined in this Secu-

22. *A security agreement may secure future advances. § 9-204(c).*

23. *A security interest automatically secures expenses relating to the foreclosure sale, other than attorneys fees. The security interest secures attorneys fees if provided for by contract and permitted by applicable law. § 9-615(a)(1). The secured party is automatically entitled to attorneys fees incurred in enforcing collection from an account debtor or obligor on an instrument. § 9-607; see also Official Comment 10.*

24. *Article 9 rejects decisions that have held that "other indebtedness" must be of the same "kind" or "class" or be "related" to the original debt secured. § 9-204, Official Comment 5.*

25. *This is designed to avoid problems under state real property anti-deficienly laws, such as those that exist in California. See generally § 9-604.*

26. *Under the former Article 9 these is some risk in using terms defined under the UCC because of the relatively narrow scope of those terms. These include "accounts" and "proceeds." The expansion of the defintions of those terms (as*

rity Agreement has the meaning given to the term in the UCC.[26]

discussed above) considerably reduces the risk of incorporating defined terms by reference. Care should continue to be taken that an incorporated definition has the meaning the parties intend to give to that word.

2. Grant of Security Interest.

Debtor grants a security interest in the Collateral to Secured Party to secure the payment or performance of the Obligations.[27]

27. Article 9 still does not use the word "grant" for the creation of a security interest. §§ 9-102(a)(73), 9-203. It is likely that practice will continue to use the term "grant."

3. Perfection of Security Interests.

3.1 Filing of financing statement.

(i) Debtor ~~shall sign~~ authorizes Secured Party to file[28] a financing statement (the "Financing Statement") describing the Collateral.

28. The debtor does not have to sign the financing statement. § 9-502. Although former law probably permits electronic filings so long as the debtor has "signed" something along the way, this change will facilitate electronic filings. The secured party will need the debtor to authorize the secured party to file a financing statement (or ratify it later). The debtor's authentication of the security agreement "authorizes" the secured party to file a financing statement covering the collateral described in the security agreement. § 9-509(b)(1). The sample affirmative statement to the left is not necessary.

(ii) Debtor authorizes Secured Party to file a financing statement (the "Financing Statement") describing any agricultural liens or other statutory liens held by Secured Party.[29]

29. An "agricultural lien" is a lien created by statute, involving agriculture and not dependent on possession. § 9-102(a)(5). It is not a "security interest." Non-UCC law will continue to govern the creation and attachment of agriculture liens and thus govern their enforceability between the holder of the lien and the debtor. A "secured party" includes the holder of an agricultural lien. §§ 9-102(a)(72)(B), 9-109(a)(2). Perfection will occur under Article 9. §§ 9-308(b). Non-UCC law will govern the creation and perfection of other statutory liens. § 9-109(d)(2).

(iii) Secured Party shall receive prior to the Closing an official report from the Secretary of State of each Collateral State, ~~and the~~ Chief Executive Office State, and the Debtor State[30] (each as defined below) (the "SOS Reports") indicating that Se-

30. As defined below in the security agreement, the "Debtor State" is the state of the debtor's incorporation. Under new Article 9 a secured party will file a financing statement for all types of collateral in the state of the debtor's "location." § 9-301(1). For debtors formed by a filing with a state, the debtor's "location" is the state of its organization. § 9-307(e). However, the secured party will need to continue to search in the applicable states under old Article 9 for five years after the effective date of revised Article 9 (i.e. until

cured Party's security interest is prior to all other security interests or other interests reflected in the report.

July 1, 2006) because financing statements filed under old Article 9 remain effective until their natural lapse date, but not for more than five years after the effective date of Revised Article 9. § 9-705(c).

3.2 Possession.

(i) Debtor shall have possession of the Collateral, except where expressly otherwise provided in this Security Agreement or where Secured Party chooses to perfect its security interest by possession <u>in addition to the filing of a financing statement</u>.[31]

31. For a security interest perfected by possession, the location of the collateral governs the perfection of the security interest. § 9-301(2). A security interest in an instrument may be perfected by filing. § 9-312(a). A security interest in an instrument (and other tangible property) may also be perfected by possession. § 9-313(a). Perfection by possession may confer better protection against the claim of another purchaser (including a secured party). Possession of an instrument will eliminate the risk of a holder in due course defeating the rights of the secured party that perfects only by filing. § 9-331(a). In addition, a security interest in an instrument perfected by possession generally will prevail over one perfected only by filing. § 9-330(d). There are similar rules for chattel paper. § 9-330. A security interest arising upon the sale of a promissory note is automatically perfected. § 9-309(4).

(ii) Where Collateral is in the possession of a third party, Debtor will join with Secured Party in notifying the third party of Secured Party's security interest <u>and obtaining an acknowledgment from the third party that it is holding the Collateral for the benefit of Secured Party</u>.[32]

32. If a third party has possession of the collateral, perfection occurs when the third party "acknowledges" that it holds the collateral for the secured party's benefit. § 9-313(c)(1) and (2). A lessee of collateral in the ordinary course of the debtor's business may not qualify as a third party in possession. The acknowledgment requirement changes former law which requires only that the third party receive notice of the security interest.

3.3 <u>*Control.* Debtor will cooperate with Secured Party in obtaining control[33] with respect to Collateral consisting of:</u>

33. Article 9 borrows the concept of using control as a perfection device for investment property under former law for use in several circumstances under the new Article 9. See former §§ 8-106 and 9-115.

(i) <u>Deposit Accounts;[34] and</u>

34. A security interest in deposit account may be perfected only by "control." § 9-312(b). "Control" occurs automatically when the depositary institution with respect to the deposit account is the secured party. For third parties, it occurs either (i) when the depositary institution has agreed with the secured party that the depositary will follow directions from the secured party without further consent from the debtor, or (ii) the secured party becomes the bank's

customer (§ 4-104(a)(5)) with respect to the deposit account. § 9-104. The existence of control does not of itself prevent the debtor from transferring funds from the account. See § 9-104(b). A transferee of money that does not act in "collusion" with the debtor will take the funds free of any security interest in the funds. § 9-332.

(ii) Investment Property;[35]

35. A security interest in investment property may be perfected by filing or control. §§ 9-312(a), 9-313(e), 9-314(a). Generally, "control" of a security entitlement exists when (i) a securities intermediary has agreed with the secured party that the intermediary will follow directions from the secured party without further consent from the debtor, or (ii) the secured party puts the securities account in its name. § 9-106. Generally control of a certificated security occurs by delivery with any necessary endorsement. § 9-106. "Delivery" (as defined in § 8-301) without an endorsement (unless the certificate is endorsed in blank) will constitute perfection by possession, but not "control." § 9-313. A secured party with control of investment property will generally have priority over a secured party that perfects solely by the filing of a financing statement. § 9-328(1).

(iii) Letter-of-credit rights; and[36]

36. "Control" is the only way to perfect a security interest in letter-of-credit rights, § 9-312(b)(2), except to the extent the letter-of-credit rights are a supporting obligation for other collateral. § 9-308(d). Control requires the consent of the issuer of the letter of credit or compliance with other practice. §§ 5-114(c), 9-107.

(iv) Electronic chattel paper.[37]

37. A security interest in electronic chattel paper may be perfected by filing or control. §§ 9-312(a), 9-314(a). "Control" requires compliance with special rules for the electronic identification of the secured party "on" the electronic copy. § 9-105. A secured party that perfects a security interest in electronic chattel paper by control will generally defeat a secured party that has perfected its security interest only by filing. § 9-330(b).

3.4 *Marking of Chattel Paper*. Debtor will not create any Chattel Paper without placing a legend on the Chattel Paper acceptable to Secured Party indicating that Secured Party has a security interest in the Chattel Paper.[38]

38. Purchasers of chattel paper will have priority in chattel paper claimed "merely" as proceeds of inventory if the purchaser (i) purchases in ordinary course of its business, (ii) acts in good faith, (iii) gives new value, and (iv) takes possession. In addition, the inventory secured party must not have marked the chattel paper (by "indicating" the security interest of that secured party). § 9-330. Marking tangible chattel paper does not operate to perfect the security interest, as does the electronic identification that a secured party

can use to perfect a security interest in electronic chattel paper by obtaining "control" of the chattel paper.

4. Post-Closing Covenants and Rights Concerning the Collateral.

4.1 *Inspection*. The parties to this Security Agreement may inspect any Collateral in the other party's possession, at any time upon reasonable notice.

4.2 *Personal Property*. The Collateral shall remain personal property at all times. Debtor shall not affix any of the Collateral to any real property in any manner which would change its nature from that of personal property to real property or to a fixture.

4.3 *Secured Party's Collection Rights*. Secured Party shall have the right at any time to ~~notify any account debtors and any obligors under instruments to make payments directly to Secured Party. Secured Party may at any time judicially~~ enforce Debtor's rights against the account debtors and obligors.[39]

39. *A secured party may enforce all of debtor's rights against an account debtor, including proceeding against collateral provided by the account debtor. § 9-607(a). The secured party may enforce claims against third persons obligated on the account debtor's obligation. A junior secured party that collects a check as proceeds of an account or inventory may defeat the senior if the junior qualifies as a holder in due course. § 9-331. The junior would have even greater protection if the common debtor deposited the account debtor's check in the debtor's deposit account and then wrote its own check to the junior secured party. In that case the junior would prevail unless it acted in "collusion" with the debtor to violate the rights of the senior secured party. § 9-332(b).*

4.4 *Limitations on Obligations Concerning Maintenance of Collateral.*

(i) *Risk of Loss*. Debtor has the risk of loss of the Collateral. ~~Secured Party shall not be responsible for any injury to, loss to, or loss in value of, the Collateral, or any~~

40. *Revised Article 9 clarifies that the debtor generally bears most risks concerning the collateral. § 9-207.*

~~part thereof, arising from any act of nature, flood, fire or any other cause beyond the control of Secured Party.~~[40]

(ii) *No Collection Obligation*. Secured Party have no duty to collect any income accruing on the Collateral or to preserve any rights relating to the Collateral.

4.5 *No Disposition of Collateral*. ~~Except as to inventory held for sale or lease in ordinary course of business, Debtor has no right to sell, lease or otherwise dispose of any of the Collateral.~~ Secured Party does not authorize, and Debtor agrees not to:

(i) make any sales or leases of any of the Collateral,

(ii) license any of the Collateral; or

(iii) grant any other security interest in any of the Collateral.[41]

4.6 *Purchase Money Security Interests*. To the extent Debtor uses the Loan to purchase Collateral, Debtor's repayment of the Loan shall apply on a "first-in-first-out" basis so that the portion of the Loan used to purchase a particular item of Collateral shall be paid in the chronological order the Debtor purchased the Collateral.[42]

41. A transferee takes free of a security interest if the secured party authorizes the disposition "free of the security interest." § 9-315(a). The statute makes clear that the secured party must intend to release its security interest in connection with its approval of the disposition. The express prohibition on transfer in the security agreement has been broadened to cover all types of collateral. Article 9 now protects ordinary course nonexclusive licensees of general intangibles and lessees of goods, as well as buyers of goods. §§ 1-201(a)(9), 9-320 and 9-321. The language in the security agreement is intended to create circumstances so that the debtor will "violate" the rights of the secured party if the debtor makes a transfer, thereby giving the secured party greater protection against certain transferees. As noted above, a junior secured party may obtain prior rights in proceeds of collateral where the proceeds are negotiable instruments or money.

42. For inventory only, a PMSI in inventory remains a PMSI to the extent it secures purchase money obligation for other inventory. § 9-103(b)(2). A secured party may have a PMSI in software to the extent the secured party finances the software in an "integrated" transaction with the goods in which the software will be used. § 9-103(c). "Embedded" software will constitute part of the "goods" themselves. § 9-102(a)(44) and (75). Article 9 authorizes the parties to agree on a "reasonable" method of determining how much of the secured obligation is a "purchase money obligation." § 9-103(e). The PMSI for the price will have priority over an enabling loan. § 9-324(g). Multiple enabling PMSIs will rank in order of filing. § 9-322(a) and 9-324(g)(2).

5. Debtor's Representations and Warranties.

Debtor warrants and represents that:

5.1 *Title to and transfer of Collateral.* ~~Its~~ It has rights in or the power to transfer the Collateral and its title to the Collateral is free of all adverse claims, liens, security interests and restrictions on transfer or pledge except as created by this Security Agreement.[43]

43. *Consignee of goods or seller of accounts or chattel paper does not have to have "rights in" the collateral to have the ability to grant another security interest or to make another sale if the consignor or the buyer has not perfected its security interest. § 9-203(b)(2). This recognizes that although the consignee or the seller may not "own" the property, those persons still have the "power" to grant an effective security interest in the property. See §§ 9-318 and 9-319. Generally, §§ 9-406 – 9-409 invalidate contractual and statutory restrictions on the transfer of contractual rights to the extent those restrictions would impair the creation or perfection of the security interest in those rights or permit the creation or perfection to constitute a breach of the debtor's agreement with the other party to the agreement . For certain contract rights, such as the right to receive money, Article 9 also disregards contractual or legal restrictions on enforcement of the right to enforce the security interest.*

5.2 *Location of Collateral.* All collateral consisting of goods is located solely in the States (the "Collateral States") listed in Exhibit ~~C~~ B.[44]

44. *As explained in the following note, the new Article 9 generally provides for the filing of a financing statement in the state where the debtor is incorporated. However, the secured party will need to continue to search in the applicable states under old Article 9 for five years after the effective date of Article 9 (i.e. until July 1, 2006) because financing statements filed under old Article 9 remain effective until their natural lapse date, but not for more than five years after the effective date of Revised Article 9. § 9-705(c).*

5.3 *Location, State of Incorporation and, Name of Debtor*. Debtor's:

(i) chief executive office is located in the State (the "~~Debtor~~ Chief Executive Office State") identified in Exhibit B;

(ii) state of incorporation is the State (the "Debtor State") identified in Exhibit B; and

(iii) exact legal name is as set forth in the first paragraph of this Security Agreement.[45]

45. *All filings are at the "location" of the debtor. § 9-301(1). This replaces the former rule that provides for filing at the location of collateral for goods. "Location" of the debtor means the state of formation for entities that registers to come into existence. § 9-307(e). This replaces the former rule that looks to the state of the debtor's chief executive office. For a security interest perfected by possession, the location of the collateral remains relevant. § 9-301(2). The financing statement must use the registered name of debtor if there is one; the use of an incorrect name is seriously misleading if a standard search does not find it. The statute again confirms that trade names are neither sufficient nor necessary. §§ 9-502(a)(1), 9-503, 9-506(b). A secured party will probably want to obtain a formal certified copy of the debtor's articles of incorporation to confirm the state of incorporation and the exact name of the debtor. A financing statement does not have to indicate the representative capacity of the secured party. § 9-503(d). As noted above, for five years after the effective date of the new Article 9, a secured party will want to conduct searches in the*

states that would have been appropriate under the former Article 9.

6. Debtor's Covenants.

Until the Obligations are paid in full, Debtor agrees that it will:

6.1 preserve its corporate existence and not, in one transaction or a series of related transactions, merge into or consolidate with any other entity, or sell all or substantially all of its assets;[46]

46. Article 9 now contains a set of rules that concern when a "new debtor" becomes bound by the security agreement and when a financing statement naming the original debtor is effective to perfect a security interest in collateral acquired by the new debtor. See §§ 9-102(a)(56), 9-102(a)(60), 9-203(d), 9-326, 9-508. Generally, under these provisions, the security interest created by the new debtor in favor of its secured party will prevail over that created by the original debtor in favor of its secured party in collateral acquired by the "new debtor."

6.2 not change the state ~~where any Collateral consisting of goods is located, except to another Collateral State;~~ <u>of its incorporation;</u>[47] <u>and</u>

47. If the debtor transfers the collateral to a person incorporated in another state (including in a "reincorporation" transaction) the secured party has one year to file a financing statement in that state. § 9-316(a)(3).

6.3 ~~not change the state of its chief executive office; and~~[48]

48. As noted above, Article 9 no longer requires a filing in the state of the debtor's chief executive office. § 9-301(1).

6.4 not change its corporate name without providing Secured Party with 30 days' prior written notice.[49]

49. The secured party has four months to file an amendment to the financing statement if the debtor changes its name to make the financing statement "seriously misleading." § 9-507(b).

7. Events of Default.

The occurrence of any of the following shall, at the option of Secured Party, be an Event of Default:

7.1 Any default,[50] Event of Default (as defined) by Debtor under the Loan Agreement or any of the other Obligations;

50. As with former Article 9, the new Article 9 does not contain a definition of "default."

7.2 Debtor's failure to comply with any of the pro-

visions of, or the incorrectness of any representation or warranty contained in, this Security Agreement, the Note, or in any of the other Obligations;

7.3 Transfer or disposition of any of the Collateral, except as expressly permitted by this Security Agreement;

7.4 Attachment, execution or levy on any of the Collateral;

7.5 Debtor voluntarily or involuntarily becoming subject to any proceeding under (a) the Bankruptcy Code or (b) any similar remedy under state statutory or common law; ~~or~~

7.6 Debtor shall fail to comply with, or become subject to any administrative or judicial proceeding under any federal, state or local (a) hazardous waste or environmental law, (b) asset forfeiture or similar law which can result in the forfeiture of property, or (c) other law, where noncompliance may have any significant effect on the Collateral; or

7.7 Secured Party shall receive at any time following the Closing an SOS Report indicating that Secured Party's security interest is not prior to all other security interests or other interests reflected in the report.[51]

51. The filing office may reject a financing statement for a limited number of reasons stated in the statute (e.g. no filing fee; no debtor name). § 9-516(b). A refusal by filing office to accept a financing statement for any other reason does not prevent the financing statement from being effective (§ 9-516(d)), except that a subsequent purchaser (including a secured party) that gives value in reliance of the absence of the financing statement will have priority. § 9-516(d). Former law makes a filing effective if wrongfully refused. However, most decisions under former law protect the first filer against subsequent searchers, even if the subsequent searcher relies on the absence of a filing. In addition, a subsequent secured party bears the full risk of an index-

ing error by the filing office, even if the subsequent secured party relied on the absence of a financing statement as reflected in a search. § 9-517.

8. Default Costs.

8.1 Should an Event of Default occur, Debtor will pay to Secured Party all costs reasonably incurred by the Secured Party for the purpose of enforcing its rights hereunder, including:

(i) costs of foreclosure;[52]

52. If there is sufficient proceeds of a foreclosure sale, recovery of these costs is provided for by statute. § 9-615.

(ii) costs of obtaining money damages; and

(iii) a reasonable fee for the services of attorneys employed by Secured Party for any purpose related to this Security Agreement or the Obligations, including consultation, drafting documents, sending notices or instituting, prosecuting or defending litigation or arbitration.[53]

53. Article 9 provides for the recovery of foreclosure costs, including attorneys fees (if the parties have so agreed). § 9-615.

9. Remedies Upon Default.

9.1 General. Upon any Event of Default, Secured Party may pursue any remedy available at law (including those available under the provisions of the UCC), or in equity to collect, enforce or satisfy any Obligations then owing, whether by acceleration or otherwise.[54]

54. The secured party's enforcement rights continue to be cumulative. § 9-601(c).

9.2 Conformer Remedies. Upon any Event of Default, Secured Party shall have the right to pursue any of the following remedies separately, successively or simultaneously:

(i) File suit and obtain judgment and, in conjunction with any action, Secured Party may seek any ancillary remedies provided by law, including levy of attachment and garnishment.

(ii) Take possession of any Collateral if not already in its possession without demand and without legal process. Upon Secured Party's demand, Debtor will assemble and make the Collateral available to Secured Party as they direct. Debtor grants to Secured Party the right, for this purpose, to enter into or on any premises where Collateral may be located.[55]

55. *The secured party remains subject to a nonwaivable obligation not to breach the peace in the course of attempting to take possession of the collateral. §§ 9-602 and 9-609.*

(iii) Without taking possession, sell, lease or otherwise dispose of the Collateral at public or private sale in accordance with the UCC.

10. Foreclosure Procedures.

10.1 No Waiver. No delay or omission by Secured Party to exercise any right or remedy accruing upon any Event of Default shall: (a) impair any right or remedy, (b) waive any default or operate as an acquiescence to the Event of Default, or (c) affect any subsequent default of the same or of a different nature.

10.2 Notices. Secured Party shall give Debtor such notice of any private or public sale as may be

56. *Secured party must give notice of sale to other secured parties of record. § 9-611(b). The statute provides practical rules indicating which secured parties of record are entitled to notice. § 9-611(c)(3)(B). The statute provides a "safe*

required by the UCC.[56]

harbor" form for giving notice to the debtor of a private or public sale. § 9-613(5).

10.3 *Condition of Collateral.* Secured Party ~~shall have~~ has no obligation to ~~give a notice to any other person.~~ clean-up or otherwise prepare the Collateral for sale.[57]

57. *Secured party "may" dispose of collateral "in its then condition of following any commercially reasonable preparation or processing." § 9-610(a) and Official Comment 4. Although the language of the statute is permissive, the secured party should engage in a cost-benefit analysis of whether some preparation is appropriate, taking into account the secured party's risk of not collecting the preparation costs from the proceeds of the foreclosure sale or from the debtor.*

10.4 *No Obligation to Pursue Others*. Secured Party has no obligation to attempt to satisfy the Obligations by collecting them from any other person liable for them and Secured Party may release, modify or waive any collateral provided by any other person to secure any of the Obligations, all without affecting Secured Party's rights against Debtor. Debtor waives any right it may have to require Secured Party to pursue any third person for any of the Obligations.[58]

58. *Default rules apply to secondary obligors. § 9-601(b). This continues the majority rule of former law. The debtor, secondary obligor(and other obligors may not waive most default rights. § 9-602(a). The "debtor" may be a "guarantor" to the extent it provides collateral to secure the obligation of another person. See the definition of "Obligations" in this Security Agreement. § 9-102(a)(59) and (71).*

10.5 *Compliance With Other Laws*. Secured Party may comply with any applicable state or federal law requirements in connection with a disposition of the Collateral and compliance will not be considered adversely to affect the commercial reasonableness of any sale of the Collateral.[59]

59. *An Official Comment to § 9-610 directly addresses this issue. It notes that this would be an appropriate circumstance for the parties to agree on a "standard[] measuring the fulfillment of the ... duties of a secured party" if the standard is "not manifestly unreasonable." § 9-603.*

10.6 *Warranties*. Secured Party may sell the Collateral without giving any warranties as to the Collateral. Secured Party may specifically disclaim any warranties of title or the like.[60] This

60. *Secured party automatically gives "title" warranties unless disclaimed. The statute provides sample disclaimer language. § 9-610(d), (e) and (f). The reference to other "like" warranties does not mean warranties of quality. A secured party gives implied warranties of quality only if they would arise under other law in the circumstances, such as UCC Article 2. See § 9-610,*

procedure will not be considered adversely to affect the commercial reasonableness of any sale of the Collateral.

Official Comment 11.

10.6 *Sales on Credit*. If Secured Party sells any of the Collateral upon credit, Debtor will be credited only with payments actually made by the purchaser, received by Secured Party and applied to the indebtedness of the Purchaser. In the event the purchaser fails to pay for the Collateral, Secured Party may resell the Collateral and Debtor shall be credited with the proceeds of the sale.[61]

61. A secured party does not have to apply noncash proceeds unless the failure to do so would be commercially unreasonable. The secured party must apply any noncash proceeds in a commercially reasonable manner. § 9-615(c) and Official Comment 3. This gives the secured party ability to accept a note from a buyer at a foreclosure sale and establish a commercially reasonable discount value or credit the debtor as the secured party receives payments. A secured party that is in the business of accepting notes in the ordinary course of its business is more likely to have to apply the note at the time of sale. Hence, depending on the circumstances, the provision to the left may be too aggressive. This may be an appropriate circumstance for the parties to agree on a "standard[] measuring the fulfillment of the ... duties of a secured party" if the standard is "not manifestly unreasonable." § 9-603.

10.7 Purchases by Secured Party. In the event Secured Party purchases any of the Collateral being sold, Secured Party may pay for the Collateral by crediting some or all of the Obligations of the Debtor.[62]

62. The secured party has a right to make a "credit bid" without this provision. As under former law, a secured party may not purchase the collateral at a private sale unless the collateral has a readily determinable price. § 9-610(c). If there is a commercially reasonable sale of collateral to the secured party, a person "related" to the secured party, or a guarantor, for an amount that is "significantly below the range" of proceeds that would have been realized from a complying sale to an independent third person, the calculation of the deficiency will be based on amount that would have been obtained from that third person. § 9-615(f).

~~10.8 *Deficiency Judgment*. If it is determined by an authority of competent jurisdiction that a disposition by Secured Party did not occur in a commercially reasonable manner, Secured Party may obtain a deficiency from Debtor for the difference between the amount of the Obligation foreclosed and the amount that a commercially reasonable sale would have yielded.~~[63]

63. The statute adopts the rebuttable presumption rule for non-consumer transactions. § 9-626(3)(B). This adopts the rule of a majority of the courts that have determined the issue under former law.

10.8 No Marshaling. Secured Party have no obligation to marshal any assets in favor of Debtor, or against or in payment of:

(i) the Note,

(ii) any of the other Obligations, or

(iii) any other obligation owed to Secured Party by Debtor or any other person.

~~10.10 *Retention of Collateral.* Secured Party will not be considered to have to have offered to retain the Collateral in satisfaction of the Obligations unless Secured Party has entered into a written agreement with Debtor to hat effect.~~[64]

64. Secured party may accept the collateral in satisfaction of the debt even if the secured party does not have possession of the collateral. Former law allows retention only if the secured party has possession of the collateral. Secured party may accept collateral in partial satisfaction of the debt with the written consent of the debtor. Under the new Article 9, the secured party may not make a "constructive" acceptance of collateral. This rejects those decisions under former law that permit an implied acceptance, usually based on an extended retention of possession by the secured party without taking any action. Instead, the duration of any delay by the secured party will go to the question of the commercial reasonableness of the sale. § 9-620.

11. Miscellaneous

11.1 Assignment.

(i) Binds Assignees. This Security Agreement shall bind and shall inure to the benefit of the heirs, legatees, executors, administrators, successors and assigns of ~~Debtor and~~ Secured Party <u>and shall bind all persons who become bound as a debtor to this Security Agreement</u>.[65]

65. A security agreement is operative with respect to a person that "becomes bound" as a "new debtor" to a security agreement entered into by another person. Under some circumstances, usually in an acquisition context, one person may "become bound" by a security agreement that an acquired person has signed. §§ 9-102(a)(56), 9-203(d) and (e).

(ii) No Assignments by Debtor. Secured Party does not consent to any assignment by Debtor except as expressly provided in

this Security Agreement.

(iii) *Secured Party Assignments*. Secured Party may assign its rights and interests under this Security Agreement. If an assignment is made, Debtor shall render performance under this Security Agreement to the assignee. Debtor waives and[66] will not assert against any assignee any claims, defenses or set-offs which Debtor could assert against Secured Party except defenses which cannot be waived.

66. *Neither the debtor nor a secondary obligor may waive certain foreclosure rights under Article 9. § 9-602. An account debtor may, in specified circumstances, agree not to assert against an assignee of the secured party any claims and defenses the account debtor may have against the secured party. § 9-403. See also §§ 9-340 and 9-404.*

11.2 *Severability*. Should any provision of this Security Agreement be found to be void, invalid or unenforceable by a court or panel of arbitrators of competent jurisdiction, that finding shall only affect the provisions found to be void, invalid or unenforceable and shall not affect the remaining provisions of this Security Agreement.

11.3 *Notices*. Any notices required by this Security Agreement shall be deemed to be delivered when a record[67] has been (a) deposited in any United States postal box if postage is prepaid, and the notice properly addressed to the intended recipient, (b) received by telecopy, (c) received through the Internet, and (d) when personally delivered.

67. *Article 9 will adopt the use of the term "record" generally to replace the concept of a "writing." § 9-102(a)(69).*

11.4 *Headings*. Section headings used this Security Agreement are for convenience only. They are

not a part of this Security Agreement and shall not be used in construing it.

11.5 Governing Law. This Security Agreement is being executed and delivered and is intended to be performed in the State of Illinois and shall be construed and enforced in accordance with the laws of the State of Illinois, except to the extent that the UCC provides for ~~perfection under~~ the application of the law of ~~another state~~ the Debtor States.[68]

11.6 Rules of Construction.

(i) No reference to "proceeds" in this Security Agreement authorizes any sale, transfer, or other disposition of the Collateral by the Debtor.

(ii) "Includes" and "including" are not limiting.

(iii) "Or" is not exclusive.

(iv) "All" includes "any" and "any" includes "all."

11.7 Integration and Modifications.

(i) This Security Agreement is the entire agreement of the Debtor and Secured Party concerning its subject matter.

(ii) Any modification to this Security Agreement must be made in writing and signed by the party adversely affected.

68. *For purposes of perfection and the effect of perfection, Article 9 generally looks the state of the debtor's formation. § 9-301. There may be circumstances where the law of a state where goods are located or the debtor has its chief executive office governs questions of perfection and the effect of perfection. §§ 9-301 and 9-705(c).*

11.8 *Waiver*. Any party to this Security Agreement may waive the enforcement of any provision to the extent the provision is for its benefit.

11.9 *Further Assurances*. Debtor agrees to execute any further documents, and to take any further actions, reasonably requested by Secured Party to evidence or perfect the security interest granted herein, to maintain the first priority of the security interests, or to effectuate the rights granted to Secured Party herein.[69]

The parties have signed this Security Agreement as of the day and year first above written at Los Angeles, California.

"DEBTOR"

Vending Machine Manufacturing Co.
a California corporation

By: _____

Jane Drink-Soft
President

By: _____

Bob Soft-Drink
Secretary

69. *This may be especially important in view of the complex transition rules. §§ 9-702 et seq.*