

Permanent Editorial Board for the Uniform Commercial Code

PEB COMMENTARY NO. []

Proceeds of Collateral

Draft for Public Comment

June 16, 2021

Comments on this draft must be submitted by no later than August 15, 2021.

Comments may be submitted by email to UCCComments@ali.org

**This draft has been approved for publication by the PEB
subject to revisions based on comments received.
The PEB reserves the right to withdraw this proposed PEB Commentary.**

PREFACE TO PEB COMMENTARY

The Permanent Editorial Board for the Uniform Commercial Code acts under the authority of the American Law Institute and the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws). The PEB has resolved to issue supplemental commentary on the UCC from time to time. The supplemental commentary of the PEB generally will be known as a *PEB Commentary*, to distinguish it from the Official Comments to the UCC. A *PEB Commentary* may be denominated a commentary, a report, or otherwise as determined by the PEB.

The Resolution states that:

The underlying purposes and policies of the *PEB Commentary* are those specified in UCC Section 1-103(a). A *PEB Commentary* should come within one or more of the following specific purposes, which should be made apparent at the beginning of the Commentary: (1) to resolve an ambiguity in the UCC by restating more clearly what the PEB considers to be the legal rule; (2) to state a preferred resolution of an issue on which judicial opinion or scholarly writing diverges; (3) to elaborate on the application of the UCC where the statute and/or the Official Comment leaves doubt as to the inclusion or exclusion of, or application to, particular circumstances or transactions; (4) consistent with UCC Section 1-103(a)(2), to apply the principles of the UCC to new or changed circumstances; (5) to clarify or elaborate upon the operation of the UCC as it relates to other statutes (such as the Bankruptcy Code and federal and state consumer protection statutes) and general principles of law and equity pursuant to UCC Section 1-103(b); or (6) to otherwise improve the operation of the UCC.

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PEB COMMENTARY NO. _
Proceeds of Collateral

Issue: UCC § 9-102(a)(64)(A) defines “proceeds” to include “whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral.” For purposes of this definition, does it matter that property that may be “proceeds” also comes within a type of collateral defined in Article 9? The status of personal property as “proceeds” of other collateral is important because of the rules in the Uniform Commercial Code that apply to the attachment, perfection and priority of a security interest in proceeds of collateral. *See* UCC §§ 9-203(f), 9-315, and 9-322(c), (d), (e), and (f).

Analysis:

Section 9-102(a) of Article 9 defines “proceeds” as follows:

(64) “Proceeds”, except as used in Section 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.

Article 9 divides all of personal property into a set of categories, which Article 9 refers to as “types”¹ of collateral. The definition of each type of personal property is worded in a way to make each type of collateral mutually exclusive of each other type of collateral. The types of personal property are collected in the definition of “general intangibles”:

“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.²

¹ See UCC § 9-108(b)(3).

² See UCC § 9-102(a)(42); “goods” includes four mutually-exclusive sub-types of collateral. *See* § 9-102, cmt. 4.a.

“Proceeds” is not listed as a “type” of collateral.³ Rather “proceeds” is a description of the relationship between one type of personal property (colloquially referred to as “original” collateral⁴) and other types of property, to the extent covered by the definition of “proceeds.” “Proceeds” can exist for any “type” of personal property if the property fits within the definition of “proceeds.” Any “type” of personal property that can be original collateral may be “proceeds” of original collateral if the property fits within the definition of “proceeds.”

For example, Example 5, in Comment 6 to section 9-322 treats one “type” of property listed in Article 9 (“accounts”) as “proceeds” of another “type” of property listed in Article 9 (“inventory”) (emphasis added):

Example 5: On April 1, Debtor authenticates a security agreement granting to A a security interest in all Debtor’s existing and after-acquired inventory. The same day, A files a financing statement covering *inventory*. On May 1, Debtor authenticates a security agreement granting B a security interest in all Debtor’s existing and future *accounts*. On June 1, Debtor sells *inventory* to a customer on 30-day unsecured credit. When Debtor acquires the *account*, B’s security interest attaches to it and is perfected by B’s financing statement. At the very same time, A’s security interest attaches to the *account* as *proceeds* of the *inventory* and is automatically perfected. See Section 9-315. Under subsection (b) of this section, for purposes of determining A’s priority in the account, the time of filing as to the original collateral (April 1, as to *inventory*) is also the time of filing as to *proceeds* (*account*). Accordingly, A’s security interest in the *account* has priority over B’s. Of course, had B filed its financing statement before A filed (e.g., on March 1), then B would have priority in the *accounts*.

The decision in *1st Source Bank v. Wilson Bank & Trust*, 735 F.3d 500 (6th Cir. 2013) did not apply this rule correctly. There Secured Party 1 had a security interest pursuant to a security agreement in certain of the debtor’s equipment (tractors and trailers) *and* the debtor’s “accounts.” “Equipment” and “accounts” are each a type of collateral under Article 9.⁵ Secured Party 1 perfected the security interest in the equipment by filing a financing statement that indicated that the tractors and trailers and their “proceeds” might be collateral. The financing statement did not indicate that “accounts” (or any similar property) might be collateral.⁶ Secured Party 2 later obtained and perfected a

³ For example, “proceeds” is not included in the types of collateral listed in the definition of “general intangibles.”

⁴ See, e.g., UCC § 9-322, cmt. 8 (referring to “original collateral”)

⁵ See UCC § 9-102(a)(2) and (33).

⁶ A financing statement does not have to refer to “proceeds” to perfect a security interest in proceeds where Article 9 provides for that result. See *infra* note 8.

security interest in the debtor's "accounts receivable"⁷ by filing a financing statement that indicated that "accounts receivable" might be collateral.

If the accounts were "proceeds" of the equipment, then Secured Party 1 would have a perfected security interest in the accounts because its security interest in the accounts (as provided for in its security agreement)⁸ was automatically perfected for a period of 20 days.⁹ The security interest generally would continue perfected thereafter as a result of the filing of the financing statement indicating the equipment as collateral.¹⁰ In that case, Secured Party 1's security interest in the accounts for priority purposes would have the benefit of the filing date of the financing statement filed with respect to the equipment¹¹ and thus would have priority over the security interest of Secured Party 2, who filed its financing statement *after* Secured Party 1 filed its financing statement. If the accounts were *not* proceeds of the equipment, then Secured Party 1 did not have a perfected security interest in the accounts (because the financing statement did not indicate that "accounts" might be collateral) and Secured Party 2's security interest in the accounts would have priority over the security interest of Secured Party 1.¹²

The court considered whether property that satisfied the definition of "accounts" could also be "proceeds" of other collateral, concluding that it was not possible:

Although the statutory definition of the term "proceeds" appears admittedly broad, accepting Plaintiff's interpretation of the statute would render the term "accounts" - category defined separately in Chapter 9—meaningless. *See* Tenn. Code Ann. § 47-9-102(a)(2). Because we are required "to construe statutes, whenever possible, in a way which gives meaning to every portion of the statute," *DeLaney v. Thompson*, 982 S.W.2d 857, 860 (Tenn. 1998), we decline to expand the definition of the general term, "proceeds," in such a way that it would subsume the specific term, "accounts."

⁷ Accounts receivable would typically be "accounts."

⁸ Even if the security agreement had not referred to "accounts," if the "accounts" *were* "proceeds" of the tractors and trailers, then the secured party's security interest in the proceeds (the accounts) would have automatically attached. *See* UCC §§ 9-203(f) and 9-315(a)(1). In addition, the attached security interest in the accounts as "proceeds" would automatically have been perfected for a period of 20 days. UCC § 9-315(c). The perfection of the security interest would have continued after that period by the earlier filing of the financing statement covering the original collateral. *See* notes 9 and 10, *infra*.

⁹ *See* UCC § 9-315(c) and (d).

¹⁰ *Id.* This rule is subject to exceptions not relevant for this analysis.

¹¹ *See* UCC § 9-322(b)(1).

¹² *See* UCC § 9-322(a)(1).

Having concluded that “proceeds” does not include “accounts,” the court continued and held that the reference to “proceeds” in the financing statement did not suffice to indicate that the collateral included “accounts”:

Here, 1st Source's financing statements identified specific pieces of equipment and several types of collateral, “together with all present and future attachments, accessories, replacement parts, repairs, additions and exchanges thereto and therefore, documents and certificates of title, ownership or origin, with respect to the equipment, and all proceeds thereof, including rental and/or lease receipts.” However, the description of collateral in Plaintiff's [1st Source's] financing statements did not list “accounts” or “accounts receivable.” Pursuant to the maxim, *expressio unius est exclusio alterius*, to which our courts adhere, *see State v. Harkins*, 811 S.W.2d 79, 82 (Tenn. 1991) (“the mention of one subject in a statute means the exclusion of other subjects that are not mentioned”), the limiting language in 1st Source's financing statements identified the only items that were subject to the security interest. Defendants had no reason to know or expect that 1st Source also claimed a security interest in Debtor's accounts receivable.

A financing statement that indicates original collateral will often be effective to maintain perfection of an attached security interest in “proceeds” of the collateral indicated in the financing statement without referring to “proceeds” or including any indication of the collateral that constitutes the “proceeds.”¹³ Thus the financing statement's indication of “trailers” and “tractors” (“equipment”) as collateral was sufficient to perfect an attached security interest in the accounts *if* they were “proceeds” of the indicated collateral, whether or not the financing statement included an indication of “proceeds” or “accounts” (or the equivalent). This rule is part of Article 9 and searchers of the UCC filing system should know of it because it is part of the statute.

Conclusion: The lead-in paragraph to Comment 13 to U.C.C. § 9-102 is hereby amended to add the following sentence at the end of that paragraph:

Article 9's references to personal property as “proceeds” is a description of the origin of the property and not an identification of the property as a separate type of property. The fact that a particular item of personal property is also a type of collateral does not preclude that personal property from constituting ‘proceeds’ of other personal property.

¹³ This rule of the maintenance of perfection applies if (i) a security interest in the original collateral and the particular proceeds may be perfected by the filing of a financing statement, (ii) a financing statement was filed as to the original collateral, (iii) the proceeds were not acquired with cash proceeds, and (iv) the financing statement as to the original collateral was filed in the same office as would be a financing statement as to the proceeds. UCC § 9-315(a) and (d). There are other instances where a perfected security interest in original collateral results in a perfected security interest in the proceeds of that collateral. *See* UCC § 9-315 generally.