

UCC Financing Statements: *Filing Myths* and *Default Facts*

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UCC Financing Statements: the Filing Myths and the Default Facts

There are risks associated with extending credit to a customer, and as diligent credit professionals, you take steps to mitigate that risk. Often times, you begin by reviewing your customer's credit history, the amount of outstanding debt and payment history. But, assessing your customer's credit-worthiness is only the beginning. You know that risk mitigation is an ongoing endeavor. Once you decide to extend credit to your customer, you need to ensure you are a secured creditor. Implementing basic credit management remedies, like UCC filings, could save your company hundreds of thousands of dollars.

Article 9 of the Uniform Commercial Code (UCC) governs secured transactions in personal property and affords trade creditors the opportunity to secure their goods and/or accounts receivable by collateralizing the personal property assets of their customer. A properly perfected UCC Financing Statement (UCC, UCC filing or UCC-1) grants the creditor a security interest, therefore reducing the risk associated with extending credit.

In order to create a security interest, you must:

- Have a signed [Security Agreement](#) and the security agreement must contain a granting clause and collateral description.
- Record the Financing Statement to make the security interest public record.
- Notify the prior secured creditors in order to Establish Priority in Inventory.

Death and Taxes

Although this may seem disheartening, it's important to point out that a properly perfected UCC is not a guarantee. The old adage is true "...the only guarantees in life are death and taxes." However, a properly perfected UCC puts creditors in the best possible position to get paid. To dispel a few myths about UCCs:

• "It will hurt my sales!"

Fact: Becoming a secured creditor enables you to extend greater credit limits, sell to marginal accounts and provide credit to accounts with limited credit history. A UCC filing is another tool that allows you to say "YES" instead of a red stamp of "Credit Rejected."

• "It'll never work. I'll always be behind the bank & never get paid."

Fact: Bank relationships change - i.e. refinance. You may find you need to subordinate to a bank, but you will still remain ahead of other secured creditors.

• "My customer's bank won't let them sign the security agreement."

Fact: The bank should not have a problem with you being a secured creditor, however, the bank may request that you subordinate.

• "The UCC filing will hurt my customer's credit rating."

Fact: UCC filings do not impair your debtor's credit rating. The filings will appear on the credit report, but simply to provide confirmation that another creditor has a secured position or that you pledged collateral for trade credit.

• "If I ask my customer to sign a security agreement, they are going to leave me & buy from a competitor that won't ask them to sign a security agreement."

Fact: Are you 100% sure your competitors are not filing UCCs or, at the very least, including security language in their agreements? The legal departments at companies throughout the country take advantage of the opportunity to incorporate security language - it is a basic risk mitigation tool. Reassure your concerned customer that the UCC filing simply allows you (the vendor) to be a secured creditor in the unlikely event they file bankruptcy.

• "Eh, it's not worth the money or the hassle!"

Fact: We will handle the "hassles" for you. We can assist in developing your collateral description, review your agreement to ensure it contains important aspects like the granting clause, pull the articles to confirm your debtor's name & jurisdiction, prepare and record the actual filing, monitor the filing for expiration & monitor your customer for changes with the Secretary of State. Allow us to relieve you of the hassles.

CASE STUDY Filene's Basement

In this bankruptcy, secured creditors were paid 100% of their claim and unsecured creditors were only paid 50% of their claim.



You Filed a UCC & Your Customer Defaults

Congratulations, you filed a UCC in order to position yourself as a secured creditor! Unfortunately, your customer has defaulted on payment terms. You have attempted to work with your customer, but they are still unable to meet the commitment. Now what?

Any time your customer has defaulted on payments, it is strongly recommended you take immediate action to recover the funds; the longer an account remains unpaid, the harder it becomes to collect. A great, and relatively inexpensive, first step is to send a Demand Letter. A demand letter is a demand served upon your debtor, advising legal action may be taken if payment is not received within a specified time frame.

In the event the demand letter does not prompt payment, you may need to proceed with further legal action. Your next course of action is dictated by the type of UCC you filed.

Did you file a **PMSI** UCC?

If your customer has defaulted on payment(s) and you have filed a Purchase-Money-Security-Interest (PMSI) UCC, you need to determine whether or not you would like your equipment/inventory (aka goods) back.

- If you do not want your goods back, you can place your claim with an attorney to file suit. By filing suit, you may be allowed to receive **Judgment** to garnish accounts or attach to assets.
- If you do want your goods back, and your customer has the goods, you have the right to repossess without disturbing the peace.

If you are unable to peacefully repossess the inventory/equipment, you could:

- Send a demand letter with a copy of the UCC filing
- File suit against your debtor
- File a temporary restraining order (TRO)
- Proceed with **Replevin** Action

• Did you file a **Blanket** UCC?

If your customer has defaulted on payment(s) and you have filed a Blanket UCC, you could:

- Send a demand letter with a copy of the UCC filing
- Send **9-607** notices
- Place the outstanding debt with a collection agency, using the Security Agreement and UCC filing as leverage to get paid
- File suit against your debtor

• Has your customer filed bankruptcy?

Keep in mind, the bankruptcy court freezes all debtor assets. "The **automatic stay** provides a period of time in which all judgments, collection activities, foreclosures, and repossessions of property are suspended and may not be pursued by the creditors on any debt or claim that arose before the filing of the bankruptcy petition."

• If your customer filed **Chapter 7**:

File your secured proof of claim, regardless of whether you filed a PMSI or Blanket UCC.

• If your customer filed **Chapter 11**:

- **PMSI UCC:** If you would like your goods back and your goods are at your customer's location, contact the Trustee to repossess. If the Trustee is uncooperative, a Motion can be filed with the bankruptcy court, however, motions to repossess may be denied, due to the necessity of your goods in the business operation.
- **Blanket Filing:** File a secured proof of claim and monitor for distribution.

It is important to remember, a UCC filing is a remedy and not a cause of action in suit.

• My customer filed bankruptcy - can I continue a UCC filing once the automatic stay is in place?

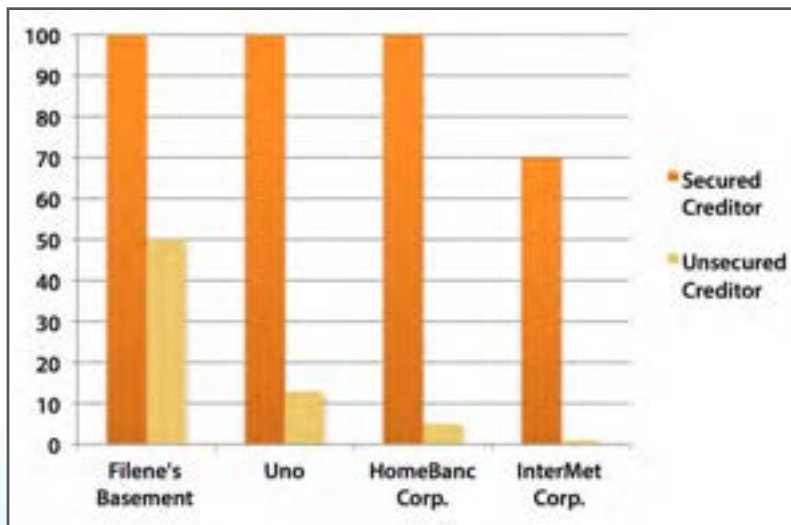
When the bankruptcy code was amended, section 362(b)(3) was created to grant secured creditors the opportunity to maintain or continue the perfection of their security interest, even if the automatic stay is in place.

“... (3) under subsection (a) of this section, of any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee’s rights and powers are subject to such perfection under section 546 (b) of this title or to the extent that such act is accomplished within the period provided under section 547 (e)(2)(A) of this title...”

There have been some cases where the secured party did not continue their filing and the bankruptcy court still allowed the security interest, however, it is strongly recommended you continue any UCC filing in order to maintain your priority and your position as a secured creditor.

Do Creditors Really Get Paid?

Yes, creditors really do get paid - although every bankruptcy exit plan is different. Let’s take a look at a few bankruptcy cases, which demonstrate the immense benefit of being a secured creditor rather than an unsecured creditor*.



Filene's Basement

“Secured creditors have been paid in full, holders of priority claims and convenience class claims have received 100% of their allowed claims, and unsecured creditors have been paid 50% of their allowed claims.”

Uno

“The plan gives the holders of \$142 million of senior secured debt 100 percent of the stock in the new company. Unsecured creditors who sell their claims will receive about 13 percent.”

HomeBanc Corp.

“The accompanying disclosure statement says that unsecured creditors with \$223.5 million in claims would recover between 1 percent and 10 percent. Secured creditors with claims of \$69.6 million would be paid fully.”

Intermet Corp.

“The disclosure statement says first-lien creditors should expect a 70 percent recovery while second-lien term loan lenders, owed \$107 million, and unsecured creditors with \$93 million in claims, could realize around 1 percent.”

**The information presented here illustrates that secured creditors are in the best possible position to get paid. However, this assessment does not guarantee a payout in future bankruptcies.*

There is No Question

There should be no question as to whether or not it is in your best interest to take steps to secure your receivables – it is absolutely in your best interest. In the unfortunate event that your debtor defaults, you will have options as a secured creditor where your unsecured counterparts may not. There are no guarantees; however, foregoing the opportunity to become a secured creditor is a risk you cannot afford to take.

To Learn more:

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