



Security Interests for Sellers of Goods and Services and the Value of an Unperfected Security Interest

Jul 01, 2020

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Many of our clients who provide goods or services on credit^[1] have a form sales contract that includes the grant of a UCC Article 9 security interest in the buyer's property (frequently just the expensive items provided by the seller). A security interest is granted by a secured debtor through an "authenticated" security agreement.^[2] There is no requirement that a security agreement be a separate stand-alone contract (see UCC 9-203(B)(3)(a)^[3]). Typically, for non-lender secured parties this means a sales contract on the seller's form that includes the grant of a security interest that the buyer signs^[4] and returns to the seller.

It will be helpful to this discussion to take a short diversion into UCC Article 2 (Sales) and the required authenticated security agreement, in which several common scenarios emerge. Normally, the buyer's purchase order (even if authenticated by the buyer) does not grant a security interest in favor of the seller. Furthermore, a sales contract prepared by the seller (but not authenticated by the buyer) is not enough to grant a security interest to the seller even if that contract contains the grant of a security interest. Finally, a seller does not necessarily get a security interest through an Article 2 "battle of the forms" determination^[5] that the seller's form document controls. That determination does not mean the buyer "authenticated" the seller's contract form that granted the security interest.

If, however, there is an authenticated security agreement, the next steps in obtaining a security interest require making sure that (a) the granted security interest has "attached", (b) the secured party gave value, and (c) there is a debt to be secured. Typically, all those requirements are met when the seller provides goods or services to the buyer without payment in full. After meeting all those challenges, the seller is now a secured creditor with a security interest.

At this point, the secured creditor has a security interest in the collateral described in the security agreement and the identifiable proceeds of that collateral. UCC Section 9-203(F) (the Ohio version of this section states that the “attachment of a security interest in collateral gives the secured party the rights to proceeds provided by [section 1309.315 of the \[Ohio\] Revised Code](#) and is also attachment of a security interest in a supporting obligation for the collateral.”)

Despite meeting all these tests, the secured creditor is not a *perfected* secured creditor unless the secured creditor has met the perfection requirements of Article 9 of the UCC – typically by the filing of a UCC-1 form with the appropriate secretary of state. Being a *perfected* secured creditor establishes the priority of the seller’s security interest in the collateral, thus providing protection against a buyer’s future secured creditors, judgment creditors, tax liens, etc. An *unperfected* secured creditor seller, by contrast, does not have lien priority protection.

Many of our seller clients regularly do not take the additional steps necessary to perfect their security interest. Presumably, this is because the seller thinks the credit risk they are taking does not warrant the required work and expense to perfect their security interest. Perhaps the buyer is known to be financially strong or the amount owed is modest. That does not mean, however, that the unperfected security interest is not potentially valuable. First, a security interest can be perfected any time after it is attached. For example, the seller could elect to perfect its interest when the buyer misses its first payment.

Second, an unperfected security interest potentially has value because the remedies available to a secured party under Article 9 are available to both perfected and unperfected secured creditors. Primarily, these are the self-help remedies that permit a secured creditor to claim the collateral or its proceeds without judicial involvement provided those acts can be accomplished without “a breach of the peace”[\[6\]](#) (see UCC Section 9-609). Specifically, an unperfected secured creditor [seller] can take collateral [the provided goods, perhaps] or the collateral’s proceeds from the defaulted secured debtor [buyer]. It can be as simple as appearing

at the buyer's property and asking that they return the collateral. In fact, I often recommend a nonconfrontational approach by a known seller's employee lest the appearance of the seller / secured party's attorney prompt the buyer / defaulted secured debtor to contact his counsel rather than comply with the collateral turnover request.

When property is seized from a debtor [perhaps a defaulting buyer] by a judicial officer^[7] pursuant to a garnishment, execution, attachment, levy, or other judicial direction, that seizure does not extinguish the debtor's interest in that asset. Rather, the debtor's interest in the seized asset is terminated when a judicial order transfers the seized asset – perhaps an order confirming a sheriff sale or directing the clerk of court to distribute garnished funds. If the seizing creditor does not already have a lien on the seized asset (such as a security interest), many states' laws provide that seizure of the assets attaches a lien on that date in favor of the seizing creditor. See, for example, Ohio Rev. Code. Section 2329.03 titled *Lien Without Filing Certificate* which states:

Lands and tenements of a judgment debtor shall be bound with a lien for the satisfaction of any judgment of any court of general jurisdiction, including district courts of the United States, within this state, without the filing of the certificate provided for in [section 2329.02 of the Revised Code](#), from the time when the same are seized in execution. Goods and chattels of a judgment debtor shall be bound from the time they are seized in execution.

The UCC provides other rules when an Article 9 secured creditor gets possession of collateral without judicial process. The rules and the consequences of the secured creditor's acts vary depending on whether the secured creditor retains the collateral, sells the collateral at a private sale, or conducts a public sale of the collateral. See UCC Section 9-610 titled *Disposition of Collateral After Default* and related rules that require a secured creditor to provide notice of collateral disposition to the defaulted secured debtor. Of note is the requirement that any excess sale proceeds realized by the secured collateral must be paid to the secured debtor [buyer] if the secured creditor elects to sell the collateral and the net sale proceeds exceed the secured debt (see UCC Section 9-615). The above-mentioned rules for a secured creditor's

disposition of collateral imply that a secured borrower's [defaulting buyer's] interest in the collateral is not eliminated merely by the secured creditor taking possession of the collateral. Given that rule, the unperfected secured creditor remains at risk that a competing lien will attach to the seized collateral until that property has been transferred by the secured creditor in accord with the above-discussed rules (found primarily in UCC Sections 9-610 through 9-615). Therefore, I always recommend that an unperfected secured creditor perfect its security interest as soon as trouble arises, and certainly when it takes possession of the collateral.

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[1] Classic credit terms offered by providers of goods and services are either short term such as "due in 30 days" or periodic payments due over months or years to pay for expensive office equipment, furniture, and machine tools.

[2] Under UCC Section 9-102, a "security agreement" is "an agreement that creates or provides for a security interest."

[3] Official comment 3 to this section includes this: "Neither that definition nor the requirement of paragraph (3)(A) rejects the deeply rooted doctrine that a bill of sale, although absolute in form, may be shown in fact to have been given as security. Under this Article, as under prior law, a debtor may show by parol evidence that a transfer purporting to be absolute was in fact for security. Similarly, a self-styled "lease" may serve as a security agreement if the agreement creates a security interest. See Section 1-203 (distinguishing security interest from lease)." In short, the old contract interpretation rule remains true – the parties' intent controls.

[4] A physical or electronic signature is the common but not only way to authenticate a security agreement. See, UCC Section 9-102(a)(7).

[\[5\]](#) UCC Article 2-207 and related sections have the “battle of the forms” rules. Those rules are beyond the scope of this blog post.

[\[6\]](#) Article 9 does not define the term “breach of the peace.” Counsel must look to other sources for guidance.

[\[7\]](#) Some seizures are by non-judicial officers like Internal Revenue Service Revenue Officers. The rule is the same, the asset seizure does not terminate the debtor’s interest in the asset.

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