

## EFFECTIVE SECURITY AGREEMENTS

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Governed by Article 9 of the UCC, an effective security agreement will, at the very least, reflect the attachment of security interests in all personal property securing the debt. A valid security agreement covering such collateral will reflect that value has been given by the creditor to the debtor, that the debtor has rights in the collateral or the power to transfer such rights and that the debtor has authenticated the security agreement that describes the collateral, either by actual signature or by some form of electronic acknowledgment. The description of the collateral must reasonably identify and describe the collateral and not simply state, "all of debtor's property" or words to that effect. In the context of a consumer furniture sale financed by the seller or a finance company, the creditor's security interest in the furniture purchased with such borrowed funds automatically becomes attached and perfected. Even in that situation, a security agreement should be executed to document the "purchase-money" nature of the financing.

The after-acquired property clause provides that the creditor's security interest will also attach to any property acquired by the debtor after the execution of the security agreement. Of course, until the debtor has rights in such property, the security interest cannot attach.

The creditor will typically require the debtor to represent and warrant to as many facts relating to the loan and the collateral as it can imagine. Some typical representations and warranties are (a) that the debtor has the right to pledge or grant a security interest in the debtor's interest in the property; (b) that the debtor is the owner or has control of the debtor's interest in the property; (c) that the debtor's interest in the property is genuine, free from liens, adverse claims, set-offs, default, repayment defenses and conditions precedent of any kind or character; and; (d) that the security interest in the property granted to the creditor is a first and prior security interest and that the debtor has not, and will not, grant another security interest in the property.

The creditor will often require the debtor to make covenants that relates to the loan and its repayment as well as to the care and maintenance of the encumbered personal property. The following are typical covenants. The creditor may require the debtor to (a) perform all obligations secured by the security agreement when performance is due; (b) permit the creditor to exercise its powers under the loan documents; (c) execute and deliver such documents as the creditor deems necessary to create, perfect and continue the security interests contemplated by the security agreement; (d) not permit any lien on the property, except in favor of the creditor; (e) not change its chief place of business or the place where the debtor keeps its records concerning the property; (e) not commingle proceeds; (f) not sell, transfer, encumber or otherwise dispose of any property or proceeds; (g) not modify any of the property; and (h) provide any service and do all other acts and things necessary to keep the property free and clear of all defenses, rights of off-set and counterclaims.

To expedite the rights and powers of the creditor in an event of default and to enhance the creditor's ability to protect the collateral, the creditor should require the debtor to appoint it as the debtor's true attorney-in-fact to exercise any of the following powers, (a) upon the occurrence of an event of default, to notify any person obligated on any security instrument or other document subject to the security agreement of the creditor's rights under the security agreement; (b) to collect by legal proceedings or otherwise all interest, principal or other sums payable upon or on account of the collateral; (c) to insure, process and preserve the collateral; (d) to perform any obligation of the debtor under the security agreement; and (e) to execute on behalf of the debtor or its affiliates all financing statements and renewal statements that may be necessary in the creditor's discretion to perfect the security interests created by the security agreement or otherwise.

The creditor should clarify that its obligation with respect to property in its possession shall be strictly limited to the duty to exercise reasonable care and that the creditor has no duty to take any steps necessary to preserve the rights of the debtor against prior parties, or to initiate any action to protect against the possibility of decline in the market value of the property or its proceeds. The creditor should require that at any time it may deliver the property, or any part thereof, to the debtor and the receipt therefor by the debtor should be a complete and full acquittance of the property so delivered. Thereafter the creditor should be discharged from any liability or responsibility therefor.

The occurrence of any event of default as defined in the other material debt securing documents should constitute an event of default under the security agreement. As a practice pointer, the definition of event of

default, as well as all other defined terms, should be defined on the first page of the security agreement.

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