UCC Filings: an Ounce of Prevention

Why Every Credit Professional Should Utilize UCC Filings to Improve Sales & Reduce Debt Write-Offs

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The subjectivity in evaluating creditworthiness magnifies the need for credit tools. Article 9 of the Uniform Commercial Code (UCC) provides an opportunity for trade creditors to collateralize or “secure” their goods and/or accounts receivable, utilizing the personal property assets of their customer. In the event of your customer’s bankruptcy or default, a properly perfected UCC filing elevates your status to that of a secured creditor, putting you in the best possible position to get paid.

Created to Promote, not Demote

In 1952, the UCC was created in an effort to promote commerce between states. Prior to the creation of the UCC, selling between states was similar to how we sell between countries today – there was a great deal of risk involved and little financial security available. Once the UCC was in place, it afforded creditors additional security, therefore enabling the extension of more credit, aka more sales.

Why Should I File UCCs?

When implementing a UCC filing program, it is important to understand the widespread benefits. A sound UCC filing program will minimize financial risk, reduce DSO, improve cash flow and increase sales. Wait, “increase sales” – I know you are wondering if you read that correctly – yes, increase sales. UCC filing is more than reducing risk; it’s about the opportunity to expand your market by providing you with the security needed to sell to marginal accounts, and by providing the added security needed to increase existing clients’ credit lines.

One Part Financing Statement + One Part Security Agreement

When your customer signs a security agreement, the UCC perfects or records the security interest. A security interest collateralizes your company through equipment, inventory, the proceeds from the sale of your inventory, and your accounts receivable. Once the filing is completed, it protects all transactions for five years, protecting your bottom line as a secured creditor.

Types of UCC Filings

There are primarily two types of secured transactions under Article 9 of the UCC: *Blanket Filing and Purchase Money Security Interest (PMSI) Filing.*

A Blanket filing is a security interest in all assets of your customer on a non-priority basis, eliminating potential conflict with your customer’s primary lender. The priority or payout in a bankruptcy is determined by the filing date *(first in time, first in right)*. The UCC filing elevates the status of your accounts receivable to that of a secured creditor. Blanket filings are applicable when providing financing, selling services, or in situations when your customer “consumes” or otherwise does not stock your goods.

A PMSI filing provides the same benefits as the blanket filing, with the addition of the priority of repossession of specific identifiable goods, primarily inventory or equipment that your company would provide.

- PMSI in Equipment

  Securing collateral that is defined as equipment 9-102(33) - "Equipment" means goods other than inventory, farm products, or consumer goods. The "equipment" is used in the course of the debtor's business - it is not stocked.

- PMSI in Inventory

  Securing collateral that is defined as inventory 9-102(48) - "Inventory" means goods, other than farm products, which: (A) are leased by a person as lessor; (B) are held by a person for sale or lease or to be furnished under a contract of service; (C) are furnished by a person under a contract of service; or (D) consist of raw materials, work in process, or materials used or consumed in a business.

Other Types of UCCs

- Consignment Sales: Goods sent to an agent for sale with title being held by consignor until a sale is made.
- Bailment: Goods which will be processed or improved in some manner, delivered in trust for a limited period.
- Tooling: Tools provided to an outside manufacturing company in order for that company to provide a finished product for sale.
- Warehousing Situations: Stocked goods or inventory held at a third party location.
- Installments/Promissory Notes: Payment for a debt, made in intervals.

UCC Filing Program is a Team Effort

In order for a UCC filing program to be successful, there needs to be interdepartmental cooperation. Of course, the credit department will be involved, as UCCs are a means of mitigating your company's financial risk, but a successful program needs to include involvement from your sales department. After all, it's quite likely that your sales representatives will be acting as the conduit for signed documentation (i.e., Security Agreement), which means they should have a vested interest in the process.

My Sales Force and Customers Won't Go for This

Why not? Your sales team should be thanking you for the opportunity to extend more credit and your customer's only involvement in the process is signing a security agreement. (This agreement or contract may be a stand-alone document or can be added to a standard credit application or other document.)

- There is no cost to your customer.
  The core of a properly perfected UCC filing is the security agreement. Your customer doesn't have to pay to sign a security agreement – it's like signing any credit agreement. The costs associated with the UCC filing will be paid for by your company (and those costs are minimal).

- There is no impact to your customer's credit rating.
  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.

- Your company is not the only company securing its accounts receivable through the UCC process. Financial institutions and your competitors are filing UCCs as well.
  Trust me – your company is not the only company mitigating risk through UCC filings. Hundreds of thousands of companies throughout the country (even in Canada, Mexico, Australia and New Zealand) are securing receivables through the UCC process. Did you know that mortgages, car loans and secured lines of credit often have security language written right into the document? And, when you sign that document, the security language allows those companies to file a UCC. UCCs are a simple part of everyday business.

Other Important Points to Share with Your Customers *AND* Your Sales Force

Aside from the aforementioned perks of no cost to customer, no impact to customer's credit score & the plethora of parties already filing UCCs, here are a few other key points to share with doubtful parties.

- In the unlikely event that your customer files for bankruptcy protection, a properly perfected UCC elevates your company to a secured creditor position.
  If your customer never files bankruptcy and never defaults on payment, then it will seem as though the *UCC doesn't even exist – it's like an invisible shield: it's there to offer protection if you encounter harm, but completely unnoticeable in a world of fiscal harmony*. If your customer does file bankruptcy and you have properly perfected a UCC filing, you may be able to recover goods and/or funds extended to your customer.

- Minimized Risk = Fewer Write-Offs *(Hey Sales Team! If customer write-offs are factored into your compensation/bonus, you may want to pay attention.)*
  It's simple: fewer write-offs lower the costs associated with your product > lower costs mean you can sell at a lower price while maintaining profit margins > selling at a lower price makes your company more competitive, opening the doors to a larger market share > more sales with stable profit margins = a happy boss!

- UCC filings create sales opportunities.
  Sounds counterintuitive - an extra step will result in more sales opportunities? The UCC offers additional security, which means you may be able to sell to marginal accounts that were previously out of reach. How many times have you had the sale lined up only to hear your credit rep tell you "Well, they are going to need to put more money down; based on their financials we can't justify extending the credit."? The UCC may substitute for monies down or compromised credit limits.

UCC filings create a competitive advantage. As you know, the business world is aggressively competitive. Many companies are securing their credit through UCC filings and those who aren't are placing themselves at a competitive disadvantage. Take the opportunity to minimize losses and to create opportunities.

It Works! Check Out a Success Story

A company filed a Chapter 7 liquidation bankruptc: "Our inventory was part of the bankruptcy estate. The trustee offered our inventory back to us because we were a secured creditor. The inventory wasn't worth anything to us at this stage. The trustee agreed to sell the inventory as part of the auction of bankruptcy assets. We received the benefit of the sale of the goods. We were paid in full after the auction. The unsecured creditors received the pro-rata that remained." – Dave Feigenbaum, Director of Corporate Credit at Kichler Lighting.

A seller of lighting products has been utilizing the UCC filing process for several years, and according to one of their employees, their success stories are countless: "We've had a lot of success. There have been years when we collected, between Inventory and cash, over six figures through our filings."

How Do You Begin?

Determine when and where security is applicable in your business. For example, your company may deem filings are necessary for all customers with credit lines higher than $10,000.

Once you have set an account threshold, begin implementing the UCC filings by having your customer sign a security agreement. The best time to have your customer sign the agreement is at the time of contract, and it's a best practice to include the security agreement within the terms of your loan or credit application.

Remember these three keys:

- UCCs put you in the best possible position to get paid
- UCCs provide the opportunity to repossess inventory
- UCCs lead to more sales opportunities

UCC filings may offer an advantage to your company that helps both the sales and credit teams. Don't delay in exploring the possible advanages your company could gain.

About the author:

Kristin Alford*, NCS Education & Marketing Specialist, has assisted credit professionals throughout the US and Canada secure their receivables through the mechanic's lien and UCC filing process. With more than 40 years of experience, NCS has gained national recognition as the premier leader for securing accounts through mechanics liens and UCCs. NCS has educated more than 90,000 credit professionals on securing their receivables and reducing their risk. Empower yourself with free webinars, OnDemand webinars, seminars, videos and social media.*