

### Corporate Update

#### SECURED TRANSACTIONS

## The PEB Comments— Proceeds and Possession!

By **Barbara M. Goodstein and Adam C. Wolk**

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#### Introduction

As discussed in previous columns, the Permanent Editorial Board for the Uniform Commercial Code (PEB), a body appointed jointly by the American Law Institute and the Uniform Law Commission, from time to time issues commentaries on aspects of the UCC.

These commentaries are distinct from the Official Comments to the UCC, although they will oftentimes modify those Official Comments. Their purpose includes helping to resolve ambiguities in the UCC, offering potential solutions to issues that have resulted in divided opinions or scholarly views, and giving additional guidance on how the UCC interacts with other laws and applies to novel situations.

In February of this year the PEB issued four commentaries: PEB Commentaries No. 29, 30,



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31 and 32. In our April 2025 column (*Timed to Perfection: PEB Commentary on the Priority of Security Interests* (N.Y.L.J., April 2, 2025), we discussed Commentaries No. 29 and 30, which addressed, respectively, issues with the priority of security interests under UCC Sections 9-203(b)(2) and 9-318 (Commentary No. 29),

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and under UCC Sections 9-309 and 9-322(a)(1) (Commentary No. 30). We now turn to Commentaries No. 31 and 32.

### **PEB Commentaries No. 31 and 32**

Unlike Commentaries No. 29 and 30 (which both addressed priority), PEB Commentaries No. 31 and 32 look at two entirely distinct issues: the first being the interpretation of “proceeds” under UCC Section 9-102(a)(64)(A) and the second being the question of exactly when does a buyer takes possession of goods so as to qualify as a “buyer in the ordinary course of business” under UCC Section 1-201(b)(9). We will first examine Commentary No. 31 and then discuss Commentary No. 32.

#### **Commentary No. 31**

The question raised by Commentary No. 31 is whether, for purposes of the Article 9 definition of “proceeds,” it matters that certain personal property may fall within the definition of “proceeds,” but may also constitute a category or “type” (within the meaning of UCC 9-108(b)(3)) of personal property pursuant to Article 9.

The “types” of personal property under Article 9 include things in action, accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, payment intangibles, software and, in certain states, controllable electronic records (all of which are listed within the definition of “general intangibles”).

UCC Section 9-102(a)(64)(A) defines “proceeds” to include “whatever is acquired upon the sale, lease, license, exchange or other disposition of collateral.” In the PEB’s view, under Article

9, “proceeds” do not themselves constitute a collateral type.

Rather, the status of assets constituting “proceeds” is determined by origin. According to the PEB, “proceeds” can exist for any “type” of personal property if that personal property falls within the definition of proceeds. Said more simply, one “type” of property under Article 9 (e.g., accounts) can be “proceeds” of another “type” of property under Article 9 (e.g., goods).

In support of its conclusion, the PEB refers to the types of personal property within the Article 9 definition of “general intangibles.” The term “proceeds,” it notes, is not included as a type of collateral within that definition.

In the PEB’s view, this means that “proceeds” is not a type of collateral, but a term explaining how “original collateral of a certain type,” (“original collateral” being a term not defined in Article 9, but understood to refer to the initial collateral pledged), relates to other types of property.

The PEB finds that all property that can be defined as “proceeds” can have “proceeds,” no matter what type of property it is; more specifically, any property that can constitute original collateral can be “proceeds” of other original collateral.

To illustrate the application of this rule, the PEB critiqued the Sixth Circuit’s ruling in *1st Source Bank v. Wilson Bank & Trust* (735 F.3d 500; 6th Cir. 2013), stating that the court did not correctly apply the UCC in this case. In *1st Source Bank*, the bank had a security interest in the “equipment” (i.e., goods) and “accounts” of a debtor, both of which are collateral types, and perfected this interest through the filing of a financing statement that covered the equipment and its “proceeds.”

The financing statement did not refer to “accounts.” A second secured party filed against the debtor’s “accounts receivable.” The court considered whether property could be “proceeds” of other types of collateral (e.g., equipment) if this property also fell within the definition of “accounts,” and held that the term “proceeds” in the first secured party’s financing statement did not include “accounts.”

The PEB countered that a security interest in “proceeds” of collateral in a financing statement that includes original collateral is perfected even *without* mentioning “proceeds.” Accordingly, in the PEB’s view, the financing statement’s identification of “trailers” and “tractors” (equipment) as collateral was sufficient in the *1st Source Bank* case to perfect an attached security interest in “accounts” if they were “proceeds” of that collateral, regardless of whether the financing statement included a reference to “proceeds” or “accounts.”

Commentary No. 31 concludes by adding the following sentence to the lead-in paragraph to UCC Section 9-102, Official Comment 13:

“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.”

### **Commentary No. 32**

Commentary No. 32 addresses the term “possession” in the context of a “buyer in ordinary course of business” under UCC Section 1-201(b) (9). The PEB is clearly endeavoring here to provide greater certainty around the meaning

of that term, which appears several times in the UCC but, as the PEB notes, is not explicitly defined in the statute.

Under UCC Section 9-320(a), a buyer in the ordinary course of business of goods “takes the goods free of (i) the rights of a person who entrusted the goods to the buyer’s seller and (ii) a security interest in the goods created by the buyer’s seller.”

Pursuant to UCC Section 1-201(b)(9), a buyer can be a “buyer in ordinary course of business” only if the buyer “takes possession of the goods or has a right to recover the goods from the seller under Article 2.”

The question posed by the PEB is whether, for purposes of this definition, a buyer takes “possession” of goods even though they remain with the seller under an agreement providing that the seller holds the goods for the buyer’s disposition—and some courts have held that they do.

In other words, if a buyer has not taken physical possession of goods, but a seller agrees to hold the goods on the buyer’s behalf, can the buyer qualify as a “buyer in ordinary course of business”? (Note that the Commentary specifically does not address the second leg of the 1-201(b)(9) definition, namely the scope and meaning of a “right to recover goods from the seller under Article 2.”)

The Commentary refers to court decisions holding that a buyer has direct “possession” of goods when its seller identifies such goods to the contract of sale and agrees to hold them for the buyer. But in the PEB’s view, that conclusion is not correct. The Commentary notes separately that, for purposes of the definition of “buyer” in ordinary course of business, “possession” is also

not satisfied even if a seller is acting as agent or bailee of the buyer.

The thrust of the PEB's argument is policy-based. The PEB argues that allowing buyers without direct (actual) possession or a statutory recovery right, to take goods free of a seller's security interest could have several negative consequences.

These consequences include (1) misleading secured parties, who rely on the seller's direct possession as an indicator of ownership, (2) giving a buyer greater rights against the seller's secured creditors than the buyer would have against the seller itself (since the buyer would neither have direct possession of the goods, nor a statutory right to recover the goods from the seller) and (3) a potential scenario where a buyer's only remedy would be damages, rather than a right to require delivery of goods, if a seller does not successfully deliver goods to a buyer.

For these reasons, the PEB believes a buyer is not a buyer in ordinary course of business if it does not actually possess its goods, even if it has an agreement with the seller that the seller will keep these goods for the buyer.

Commentary No. 32 concludes by adding the following sentence at the end of UCC Section 1-201, Official Comment 9:

"A buyer that does not have the right to recover the goods under Article 2 (Sections 2-502 and 2-716) does not qualify as a buyer

in ordinary course of business unless the buyer has possession of the goods. A buyer does not have possession of goods for this purpose if the goods remain in the possession of the seller pursuant to an agreement that the seller holds the goods for the buyer's disposition."

### **Conclusion**

To summarize the above, Commentary No. 31 stands for the general proposition that a security interest in "proceeds" of the collateral in a financing statement can be perfected by a financing statement that includes original collateral. Commentary No. 32 confirms that a buyer who does not physically possess goods does not qualify as a "buyer in ordinary course of business," even if there is an agreement that the seller will hold the goods for the buyer's use. This rule preserves the rights of secured parties and aligns with UCC policy goals.

As we noted in our April column on Commentaries No. 29 and 30, the PEB began issuing its commentaries on the UCC in 1990. Recently, it has become more prolific.

Of the total 32 commentaries, 12 have been issued since 2009, four of which were issued just earlier this year. We applaud these more frequent issuances by the PEB; the commentaries are a useful guide for practitioners and jurists alike through the complex structures and terminology of the UCC, encouraging both uniformity in approach and consistency in interpretation.