

UCC Lien Checks! What are they good for? Something Extremely Important!

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Let's imagine this hypothetical: You're dealing in farm equipment, and business is booming. You're ready to make a sale on a brand new combine, and you can already taste that commission check; however, the buyer can only get the cash to pay a percentage of the purchase price. No matter! The buyer will have his old combine that he won't need any more, so you orchestrate a deal. The buyer will trade in his old combine for credit against the purchase price of the new combine. The buyer assures you there are no liens on the old combine and even signs off in writing. It's a win-win scenario. A few days later, weeks later, months later, or even years later, you get a letter from a bank that you've never heard of claiming to repossess the old combine. But you bought it fair and square, right? Wrong.

Surprisingly, it turns out that people don't like to pay their debts. Years ago, banks and other lenders were finding themselves in sticky situations when debtors would sell collateral, dissipate the proceeds, and claim bankruptcy, leaving the creditor with nothing. Lawmakers became wise to this and Article 9 of the Uniform Commercial Code ("UCC") was born. Article 9 of the UCC allows liens to remain on collateral even after disposed of by the debtor (whether by sale, gift, or otherwise). All purchasers of the collateral, even in good faith with no actual knowledge of the lien, stand in the debtor's shoes with respect to those rights on the collateral. In our hypothetical above, if the buyer fails to pay the debt and release the lien on the old combine, the bank can foreclose on and repossess the old combine, even though it is now owned by you and your dealership, an innocent third party!

Article 9 of the UCC requires creditors to report to the general public that they have a lien on the collateral, including equipment and inventory, among others. Creditors do this by filing a UCC-1 Financing Statement with the Illinois Secretary of State. This allows any potential buyers of collateral (including dealerships accepting trade-ins) to know whether or not the collateral they are about to purchase (or accept in a trade) has a lien on it. Prospective purchasers, or dealers accepting trade-ins, can go to <http://www.ilsos.gov/uccsearch/> and search by debtor name to determine if there are any potential liens on personal property owned by the individual or entity proposing to sell or trade-in the used equipment. Unfortunately, the website only informs a prospective purchaser (the dealership in our hypothetical above) that a lien exists on some of that debtor's personal property, held by some random bank or other creditor. The collateral is not listed in detail on the website. If results are generated for that debtor, the dealership would need to order a copy of the relevant UCC-1 from the Illinois Secretary of State or have the debtor produce a copy of the UCC-1 to know for sure if the equipment or inventory at issue has a lien on it.

Many dealership contracts require the buyer (i.e. the one trading in used equipment) to assert that there are no liens on the personal property traded in. This would give the dealership a cause of action against the buyer if the equipment was later repossessed, but that would do the dealership no good if, for example, the buyer goes bankrupt.

The only way to truly protect yourself from unknown liens is to: 1) use the website above to ensure that no lien exists on the equipment you are purchasing or that is being traded in, or 2) get a signed release from the bank or other creditor which owns the lien on said equipment.