

Uniform Commercial Code (“UCC”) Section 9-207(c)(3) provides:

“Except as otherwise provided in subsection (d)<sup>1</sup>, a secured party having possession of collateral or control of collateral under 9-104<sup>2</sup>, 9-105<sup>3</sup>, 9-106<sup>4</sup>, or 9-107<sup>5</sup> may create a security interest in the collateral.”

If debtor does not get this right of its secured party (“SP1”) to repledge debtor’s collateral<sup>6</sup> waived, debtor permits SP1 to create a senior security interest in debtor’s collateral and effectively subordinate debtor’s interest in its collateral to a secured interest of debtor’s secured party’s secured party (“SP2”). Debtor may satisfy its obligations to SP1 in full, yet SP1 may be unable to return the collateral to debtor because SP1 may have defaulted under its loan facility and be unable to get the collateral back from SP2. In such a situation, debtor is left with only a claim against SP1 for conversion. Debtor’s explicit agreement to permit SP1 to create a senior security interest, or legal rules permitting SP2 to cut off debtor’s rights or become immune from debtor’s claims, would effectively subordinate debtor’s interest to SP2’s interest.<sup>7</sup>

Note, this concern may be limited to single lender transactions. If there is a collateral agent holding collateral for the benefit of multiple lenders, the loan documents typically provide that the collateral agent is not permitted to pledge the collateral because it is obligated to hold the collateral for the benefit of the secured parties. Note also, under Section 8-511 of the UCC, the claims of entitlement holders have priority over the claims of the securities intermediary’s secured party if such secured party has not obtained control of the financial asset.<sup>8</sup>

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<sup>1</sup> Subsection (d) excludes a secured party that is a buyer of accounts chattel paper, payment intangibles, or promissory notes or a consignor.

<sup>2</sup> 9-104 provides for control of deposit account.

<sup>3</sup> 9-105 provides for control of electronic chattel paper.

<sup>4</sup> 9-106 provides for control of investment property.

<sup>5</sup> 9-107 provides for control of letter-of-credit right.

<sup>6</sup> As used herein collateral means deposit accounts, electronic chattel paper, investment property and / or letter-of-credit rights that are in secured party’s possession or control.

<sup>7</sup> See comment 6 to Section 9-207 of the Uniform Commercial Code.

<sup>8</sup> 8-511(c) provides if a clearing corporation does not have sufficient financial assets to satisfy both its obligations to its entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders.