

Introduction to U.S. Law

Outline of U.S. Law on Secured Transactions

"This outline was originally a product of Damien Falgoust who was graduated from University of Texas School of Law. Please read his notes as follows: "This outline is **e-mailware!** While there is no cost for using the outline, you must drop me a line at dfalgoust@mail.utexas.edu to tell me what you think, if it helped you, etc.; it'd also be nice if you dropped by my web page at <http://www.geocities.com/NapaValley/3573/> and signed my guest book. Feel free to redistribute this outline unmodified to anyone who may find it useful. This outline is provided "as is" and I make no promises as to its accuracy (it worked for me, your mileage may vary). Good Luck on exams! --- Damien Falgoust --- University of Texas School of Law."

I. Introduction

- A. The text for this course is DOUGLAS WHALEY, PROBLEMS AND MATERIALS ON SECURED TRANSACTIONS (1997). All problems are from this text or from special in-class handouts.
- B. Abbreviations used
 1. JW – Jay Westbrook
 2. PMSI – purchase money security interest
 3. p-note – promissory note
 4. OCOB – Ordinary course of business; BOCOB – Buyer in the ordinary course of business
 5. UCC – Uniform Commercial Code; BC – Bankruptcy Code
 6. TIB – Trustee in Bankruptcy
 7. FMV – Fair Market Value
- C. The “chapeau” is the text of a statute before the subsections begin.
- D. This course is primarily about *secured financing* and reading *statutes* – especially Art. 9 of the Uniform Commercial Code (UCC) and the Bankruptcy Code.
 1. *Always* start with the words of the statute – not policy, not legislative history, but the words themselves.
 2. Five years ago, the decision was made to revise the UCC. In the July 1998, the NCUSL did so, reorganizing and renumbering the UCC. There aren't many substantive changes, and the revisions have yet to be adopted in any state, so for this course use the “old” (i.e., current) numbering scheme.
- E. JW: Three levels of analysis that lawyers do:
 1. Appellate: lawyer is limited to the facts in the trial record.
 2. Trial: many permutations of possible facts and results. Try to make them appear as favorable to you as possible.
 3. Business Planning: literally an infinite number of scenarios. Goal is to avoid any possibility of litigation.
- F. A broad overview of the UCC:

1. Art. 1: General Provisions
 - a) Most important is 1-201, containing definitions. This is important because frequently substantive rules are embedded in the definitions – and the definition often isn't the same as ordinary usage.
2. Art. 2: Sale of Goods (note in the US, to take property on an unpaid debt you must have a security interest).
3. Art. 2A: Leases
4. Art. 3: Negotiable Instruments (i.e., promissory notes [p-notes] and checks – good for collateral)
5. Art. 4: Bank Deposits and Collection (JW: basic rule is “bank wins”).
6. Art. 5: Letters of Credit
7. Art. 6: Bulk Transfers (repealed in 17 states, this only applies to sales of *all* of one's inventory)
8. Art. 7: Documents of Title
 - a) Any reference in Art. 9 to “documents” refers to this.
 - b) Essentially, the paper document is the same as the goods – he who controls the paper controls the goods they refer to.
9. Art. 8: Investment Security (i.e., stocks and bonds – don't confuse this with “security interest”!)
10. **Art. 9: Secured Transactions.** There are 5 parts:
 - a) 100's – General Provisions
 - (1) § 9-102 – Policy and Scope – note the index at the end.
 - (2) § 9-103 – Choice of Law
 - (3) § 9-104 – Transactions which fit conceptually into Art. 9 but are excluded for political reasons (ex: landlord's, mechanic's lien).
 - (4) § 9-105 – **Definitions** for Art. 9. Note subsection (2), cross-referencing to other parts of the UCC with relevant definitions.
 - (5) § 9-109 – **Classifying the Collateral** – *Always start Art. 9 problems with this!*
 - b) 200's – Validating a security interest against the *debtor*
 - c) 300's – Validating a security interest against *third parties*
 - d) 400's – The mechanics of filing (where, how, etc.)
 - e) 500's – Enforcement of a security interest (default and seizure)

G. Central Issues in Secured Credit

1. Collecting against an unsecured debtor – we don't have debtor's prison anymore, so generally you seize property. With security you can do this pretty easily, but it's a bit more complicated otherwise.
2. Priority among competing creditors
3. Dealing with fraudulent debtors
4. Protecting the debtor and unsecured creditors – § 9-201 makes secured parties the default winner unless an intervening rule exists to the contrary – like, for example, the Bankruptcy Code.

II. Enforcement of Debt Obligations

A. Introduction to enforcement

1. First of all, recognize an important distinction between being “bankrupt” and being in “general default.” The former means filing a bankruptcy petition; the latter means inability to pay one’s debts.
2. The basic problem of collecting an unsecured debt is one of time: it takes a long time to get a judgment and enforcement – and you’re probably racing other creditors. The solution is to get a *security interest* in property – essentially, a right to self-help by seizing property yourself.
 - a) This brings up the problem of debtor fraud: a debtor can use the same property repeatedly as collateral for multiple loans. The key to solving the problem is *notice*, which is given by *perfecting* one’s interest. More on this later.

B. Unsecured Creditors under State Law

1. “Execution” and Priorities among “executing” creditors.

a) Terminology and procedure:

- (1) “Judgment Creditor” – what you are once you get a judgment against the debtor (this could be for anything – a breach of contract, a tort, whatever). It is absolutely useless unless further actions are taken because it only makes you an unsecured creditor.
- (2) “Writ” – a court order to collect certain property. This tells the sheriff to go seize some of the debtor’s property and sell it, giving the judgment creditor rights to the proceeds to the extent of the debt.
 - (a) The type of writ we are dealing with is called an “execution writ,” or “writ fi. fa.” for you Latin fans (*feri facias*), or “writ of attachment” interchangeably.
 - (b) The process of getting the writ, having the sheriff seize property is often collectively called “execution.”
- (3) “Levy” – what the sheriff does if the property is too big to seize; he tacks a little sign up that gives notice of the seizure.
- (4) “Judgment Lien Creditor” – what you become once property has been seized (or levied, as the case may be) and you have rights in the proceeds of the sheriff’s sale.
 - (a) This is generally only applicable to *specific property*, however. See *infra* for more on this issue.
 - (b) This essentially makes the creditor “perfected” as though he were a secured creditor as of the date of levy.
- (5) After the sale, the creditor gets any proceeds to the extent of the debt; anything left over is returned to the debtor.

b) Priorities among unsecured judgment creditors

- (1) The general rule is “first in time” – that is, the first creditor to levy gets first crack at the proceeds from that property.
- (2) This is moderately complicated by “deemed” rules – for example, if A gets a writ on Monday, and B gets a writ on Tuesday, but the sheriff doesn’t levy on either until Wednesday, in most states A would win because the date of the writ is the “deemed date” of levy.

(a) Problem 1.1

(i) Timeline:

- (ii) Each judgment is worth \$10k.
 - (iii) We can improve B's position by executing the writ "symbolically"; in most states, if we get a lien it will date back to the date of the writ. Thus, B would get \$10k (full satisfaction) and C would be left with \$5k.
 - (iv) If we *don't* execute, then C gets \$10k *and the rest goes back to D!!* There is no interest in property until it is levied!
- (b) Not true in all states though – others use differing rules.
- (3) You **cannot** get a "generic" judgment lien on the debtor's property in most states – i.e., the levy must be against *specific property*, and not things that turn over like inventory (e.g., the widget on the shelf today is not the same as the widget that was there yesterday).
- (a) Hiawatha – Levy on *equipment* gives creditor priority; levy on *inventory* does not.
 - (b) Compare that to § 9-204(1) – Art. 9 permits security interests to be valid against after-acquired property (e.g., security agreement against "inventory" is permissible).
 - (c) Problem 1.2
 - (i) Same as above. The moral is *you have to physically seize inventory*. A levy won't do.
 - (ii) Of course, the best thing to do is to get a security interest in the inventory.
- (4) Actual knowledge is not relevant to determining who is first in time.
- (a) Broken Bow – Debtor lies and tells sheriff that bank has security interest on property he's seizing; shortly thereafter, he gives the bank a security interest. Bank's actual knowledge is irrelevant – the judgment creditor had a levy and thus was perfected first.
 - (b) The basic point is that a creditor should check to see if there are any outstanding liens against the property before he gives the loan.

2. Garnishment

- a) Garnishment is just like execution, except that the property is in the hands of a third person.
 - (1) There is a "mini-lawsuit" between the judgment creditor and the third party to get a garnishment writ.
- b) Garnishment is most commonly used against a debt owed by a third party to the debtor. There are two common subcategories: employers and banks.
 - (1) Employers
 - (a) In most states, wages can be garnished to pay off a debt (though Texas forbids it except for child support), though most states place limits as to how much can be seized.
 - (2) Banks
 - (a) A checking or savings account is really just an unsecured debt owed by the bank to its customers; thus, it can be garnished.
 - (b) Banks have an important defense: **set-off**. This lets them offset from the debtor's funds any amount the debtor owes to *them* before it pays to the

judgment lien creditor.

- (c) Thus, if the debtor has \$500 in checking, but also has a loan outstanding to the bank of \$300, the bank will only have to turn over \$200 to the judgment lien creditor.

C. Secured Creditors under State Law

1. The meaning of “default”

- a) **Part 5 of Art. 9 governs what happens when a debtor “defaults” on a secured debt – but it never defines what “default” is.**
- b) **“Default” is defined in the loan agreement; that is, the definition is part of the terms agreed on by the contracting parties.**
- c) § 1-208 permits Options to Accelerate at Will – that is, a loan agreement may provide that a party can require immediate full payment if he “deems himself insecure.”
- (1) He must have a *good faith* belief that the likelihood of payment is impaired; § 1-201(19) defines “good faith” as “honesty in fact,” but comments make clear that it’s “in line with reasonable commercial standards.”
- (2) **The burden of showing lack of good faith falls on the debtor.**
- d) Problem 118: Loan agreement on sale of mobile home with acceleration clause on default. Is it default if...
- (1) It’s a bad quarter financially for the *lender*? No – that’s pretty clearly has nothing to do with the debtor’s ability to repay.
- (2) The economy generally tanks? Maybe, but probably not, for the same reason as above.
- (3) Creditor discovers debtor is talking to a lawyer? Probably no – the creditor has no idea why he’s seeing the lawyer.
- (a) Note § 2-609 – a party to a contract has the right to demand assurances of adequate performance if there are “reasonable grounds for insecurity.” Does this mean the creditor must make the inquiry? Probably no.
- (b) § 2-609 rarely arises in consumer contexts.
- (4) Creditor hears false report that debtor isn’t paying his grocery bills, but the truth is easily discoverable? It is arguable that perhaps the creditor should investigate.
- (5) Anonymous call tells creditor that debtor is moving to Mexico? Yes. Although people have the right to move, the move is suspicious enough to trigger reasonable insecurity.
- (6) Confiscation of the mobile home upon debtor’s arrest for marijuana possession? Yes, clearly so.
- (7) What if debtors gave them a demand p-note instead? § 1-208 does not apply, but the effect is the same (because it’s a *demand* note).

2. Repossession and Resale

- a) A secured creditor has the right to repossess, that is, to seize the secured property without a court order in order to sell it.
- b) In some cases, there may be a notice requirement.
- (1) **Klingbiel** – Contract says creditor can accelerate “without notice.” Creditor

becomes anxious and accelerates, then tries to seize car (debt was a PMSI for the car).

- (a) Even though the contract said “without notice” for acceleration, the court says this is not the same as a right to repossess without notice.
 - (b) That’s dumb! Why? Because the contract *also* gives the debtor the option to repay – and he can’t do that without notice. (Plus, when there is a repossession based solely on the anxiety of a creditor, courts tend to bend over backwards to help the debtor).
 - (c) The moral of this story is that the debtor’s attorney should always look for notice clauses.
- (2) § 9-504(3) (third sentence) – imposes a duty to give reasonable notice to the debtor of the repossession sale *unless* there is a recognized market for the secured property (e.g., the NYSE), or the goods are highly perishable.
- (a) Sale must be commercially reasonable.
 - (b) Creditor can’t bid at private sale unless there is a recognized market. (Public = public auction).
 - (i) Remedies for improper sale
 - (a) Majority rule: absolute right to sue for the *deficiency*.
 - (b) Minority rule: presumption of loss – unless seller can show the deficiency would be there anyway.
 - (c) Actual rule is in § 9-507 – but courts have ignored.
 - (ii) See more detail *infra*, Problem Set III
- c) **A secured party can only repossess so long as he does so without committing a breach of the peace** (§ 9-503).
- (1) What is a breach of the peace?
 - (a) Problem 120 (repossessing a car):
 - (i) Smashing car window at 2 a.m.? Yes!
 - (ii) Showing up with an off-duty policeman? Probably yes due to the implied intimidation. If you want a cop, get a real one (i.e., get a writ).
 - (iii) Breaking into garage with locksmith where contract gave right of entry? Arguable either way.
 - (iv) You can *always* trick and fool people (well, probably not with official process, but other stuff is fine).
 - (2) Sanchez – Creditor shares liability for a breach of the peace with an independent contractor – it is a *nondelegable duty* (majority rule).
- d) Problem Set III
- (1) Facts
 - (a) F borrows \$80k for business, secured by equipment and guaranteed by P. Things go bad. Mr. & Mrs. F split up, Mr. F moves into hotel.
 - (b) CC (a repo company) takes equipment an auctions it for \$500. CC was the high bidder; they later sell it for \$10k. They sent notice to hotel where Mr. F was staying.
 - (c) CC gives money (\$9500) to the bank less \$800 in costs.

- (2) What is the bank's deficiency on the loan to F?
 - (a) **Be Careful.** The deficiency is \$79,500 – because the \$500 proceeds from the sale are all that F has been deemed to have satisfied the loan with.
 - (3) **Was there good notice to husband F? Under § 9-504(3), yes. Note the § 1-201(25) definition of “notice.” (actual knowledge, receipt of notice, or reason to know of sale).** Husband got notice.
 - (4) **How about to Mrs. F? No! §1-201(26) (“notifies” means reasonable steps, either bringing notice to person’s attention or delivery to place of bus.).** Neither was done here.
 - (5) Who has burden to prove notice? § 1-201(38) defines “send”; it’s unclear, but probably on the seller.
 - (6) Who has burden as to “reasonable sale” requirement? § 9-507(1) seems to indicate that challenging party has burden.
 - (7) Is low price automatically unreasonable? No – § 9-507(2).
 - (8) **What are the sanctions for insufficient notice? § 9-507(1) says that injured party can recover whatever loss was suffered by failure to comply with notice requirements.**
 - (9) Additional Facts:
 - (a) Bank wants more collateral, so F borrows friend's (S) diamond ring to pledge. S moves away. F defaults. Bank sends S and F notice, but S is no longer at that address (and no forwarding address, either).
 - (b) Is S entitled to notice? § 9-105(d) – “debtor” can mean person owing money *or* owner of collateral, so yes.
 - (c) Did the bank give sufficient notice? Probably not.
 - (i) But then, they may not have to. Since they're selling the ring at an auction like the Texas Jeweler's Exchange, it may be a recognized market (like the NYSE).
 - (d) Note S's debt is nonrecourse – the Bank can't pursue her beyond selling the ring.
3. **Redemption and Strict Foreclosure (the § 9-505 “Deal”)**
- a) **Debtor can recover collateral by curing the default. (“redemption”)**
 - b) **Strict foreclosure means the creditor can keep the collateral in full satisfaction of the debt instead of selling it so long as debtor (or other party entitled to notice) does not object. § 9-505.**
- D. Bankruptcy and the Automatic Stay
1. There are two flavors of bankruptcy: liquidation (Ch. 7) and reorganization (Ch. 11 and 13).
 2. The **Automatic Stay** (BC §362(a)) effectively ends all collection efforts upon the filing of the bankruptcy petition.
 - a) This includes repossession – a secured party must give repossessed property back unless it was sold before the filing of the petition.
 - b) **Brooks** – the creditor must return the collateral to the debtor's locale. (This is to protect unsecured creditors: if this wasn't the case, the debtor's cost of tracking down the collateral comes from funds that could otherwise be used to

pay them.)

- c) If the secured party knew of the filing, he can be hit with sanctions for holding onto the collateral; otherwise, he'll just have to return it.
3. A debt will be essentially split in two if the collateral securing a debt is worth less than the debt amount (i.e., the debt is "undersecured"). BC § 506(a).
 - a) It is secured to the extent of the collateral's value.
 - b) It is unsecured to the extent of the remaining debt.
4. A secured claimant can get *post-petition interest* to the extent of the value of the collateral if the debt is "oversecured." Thus, if a \$1,100 asset secures a \$1,000 debt, the creditor can get post-petition interest up to \$100. BC § 506(b)

III. Obtaining an Enforceable Security Interest

A. Introduction – Technical Validity of the Forms

1. There are two documents that go into making a valid security interest: the security agreement which makes the security interest valid against the debtor and a filed financing statement which makes it valid against the rest of the world (unless the interest is one that can be perfected without filing).
2. Technical Requirements of the Security Agreement – § 9-203
 - a) A security agreement is something that *creates* or *provides for* a security interest. § 9-103(1)(l)
 - b) If the collateral is in the possession of the secured party (a *pledge*), then **no written security agreement is needed**. § 9-203(1)(a)
 - c) **Otherwise, the security agreement must be signed by the debtor and describe the collateral**. § 9-203(1)(a) (as well as *value* having been given, and the *debtor having rights* in the collateral, subsection (b) and (c)).
 - (1) The debtor having rights can get knotty; we'll see that later. The basic point is that the creditor can't have a greater interest in the property than the debtor has.
 - d) It is *very important* that the security agreement be valid because if the interest does not attach, it *cannot* be perfected.
 - e) Problem 14 – FB buys computer, signs agreement with store that title remains with store until they are fully paid. Contract describes the computer, but does not mention a security interest. Is it valid?
 - (1) §§ 1-201(37) and 2-401(1) make it clear that reservation of title *only* means the reservation of a security interest.
 - (2) Thus, the requirements of § 9-203(1) have been met, and the security agreement is valid.
3. Technical Requirements of the Financing Statement
 - a) The financing statement (sometimes called a "UCC-1" after its form number) must contain **the signature of the debtor**, **the mailing address of both parties** (so later parties can request information, see § 9-208), and a **description of the collateral**. § 9-402(1)
4. Technical Requirements of both Security Agreement and Financing Statement
 - a) Debtor's Identity (Hatfield)
 - (1) Recall that the debtor must sign both the security agreement and the financing statement.

(2) Hatfield – debtor’s identity is sufficiently given when it mistakenly contains individual’s name rather than the corporation named after him because that is enough for later creditors to discover the existence of the security interest.

b) Description of Collateral

(1) Problem 23 – Security agreement/Financing statement on guitar purchase giving interest in “all property I own or ever will own” sufficient as a description of the collateral? Probably not, though the trend is toward broad interpretation.

(2) Problem 24 – Is jewelry given up as a pledge (i.e., bank has possession) but returned so debtor can wear it one night at a social function susceptible to seizure by second creditor where debtor also gave the bank a financing statement for “all...personal property”? (Probably so – see § 9-305 and “Pledging,” infra).

(3) The big question: is the description sufficient to give notice to later creditors?

c) Mailing Address

(1) Problem 29 – Is lack of address for well-known person a “minor error” that isn’t “seriously misleading” and therefore permissible? (§ 9-402(b)) Courts are divided.

(2) Same Problem – What if the address is incomplete, as in the zip code is omitted? Again, the question is if the address is sufficient to permit the person to be located easily.

B. Attachment: Making the Interest Enforceable Against the Debtor

1. Generally, a security agreement is good (“attaches”) against the debtor when the parties agree it is good against the debtor; default is whenever all the required elements of the security agreement are present. § 9-203(2).

2. Can the Financing Statement act as a Security Agreement?

a) This is a *bad idea*; you only want to argue this if your client has screwed up and forgotten to do the security agreement first, i.e., it’s a litigation strategy, *not* a business strategy.

b) American Card – financing statement is *not* sufficient to act as a security agreement under § 9-402(1), second to last sentence (permitting security agreement to act as financing statement if it has all the elements of the latter), because does this financing statement does not contain a grant of a security interest.

(1) This case has been roundly criticized by almost everyone. But many courts agree. (Hey, where does § 9-203 require a “grant” anyway?)

c) Bollinger – financing statement plus long-term course of dealing that indicates intent to create a security interest is sufficient for attachment.

C. Perfection: Making the Interest Enforceable Against 3rd Parties

1. The Problem of the “Secret Lien”

a) The basic problem of granting secured credit is the possibility of “secret liens” – that is, the same debtor gives the same security interest to multiple creditors without telling them about each other.

b) For many centuries this was handled as a “fraudulent conveyance.” Eventually, with the success of recordation statutes for deeds in real property (which faced a

similar problem), a similar system was initiated for security interests culminating with the UCC.

- c) We call this system of giving notice to other creditors “perfecting.”
- d) Clow v. Woods (1819) – court invalidates security interest in favor of sheriff’s levy because it was secret – there was no notice given to the public.
- e) Remember, **an interest must attach before it can be perfected!!** (See § 9-303(1) – perfection occurs when both 1) attachment and 2) steps to perfect have been taken place).

2. Perfection by Possession (Pledging)

- a) **Perhaps the easiest way to perfect is for the creditor to possess the collateral.** In such a case there is no need for filing. § 9-305, first sentence.
 - (1) This applies to goods, instruments, money, negotiable documents, and chattel paper, and the proceeds of letters of credit. § 9-305
 - (2) Time of perfection begins with possession and continues only for as long as the goods are possessed, and there is no relation back (unless some exception applies – see §§ 9-304(4) and (5) for instruments, certificated securities, and negotiable documents).
- b) Dolly Madison – stock held in escrow is *not* the same as possession (JW thinks this is dumb – some other cases agree).
- c) Problem 33 – possession of warehouse receipt is sufficient to perfect because the *receipt is the collateral*. (This is the kind of thing the §§ 9-304(4) and (5) exceptions noted above apply to)

3. Automatic Perfection (PMSI’s)

- a) A Purchase Money Security Interest (PMSI) in consumer goods is *automatically* perfected **permanently** on the type of goods involved. § 9-302(1)(d)
 - (1) This is because of history, because the asset is unlikely to be used for collateral twice, and for efficiency’s sake.
 - (2) There is an exception for automobiles; they are governed by state registration statutes.
- b) Problem 35 – BSI contracts with B for aluminum siding; they get a security interest in B’s current and future personal property. They later buy a sewing machine with a loan from FFC, granting a security interest in the machine. FFC did not file. B files bankruptcy.
 - (1) First step is **always** to classify the collateral (see *infra*). Here, the sewing machine is almost certainly a “good.” See also index in § 9-102.
 - (2) Did BSI’s interest attach to the machine?
 - (a) No. § 9-204(2) forbids after-acquired property clauses in the case of consumer goods (exception to general rule in (1)).
 - (3) Was the loan a PMSI even though FFC was the *lender* and not the *seller* of the machine?
 - (a) Yes. §9-107 defines “PMSI” as an interest taken by *either* the seller in the goods sold *or* a lender whose loan enables the purchase (or enables acquisition of some right in the property).
 - (4) What if B used the FFC money to buy booze instead of the sewing machine?
 - (a) Then it is *not* a PMSI, although if they end up buying the machine you

can argue that money is fungible.

(b) How can the lender protect himself? Write a check jointly to debtor and seller and require both to sign.

(5) Who gets the machine?

(a) FFC trumps the TIB because the TIB is a judgment lien creditor (see § 9-301(3)), and secured party is generally beats a judgment lien creditor. § 9-201

c) Also, a PMSI in **non-consumer goods** has a 10-day grace period within which to file – essentially 10 days of temporary automatic perfection. § 9-301(2)

d) *Cross-collateralization* may kill a PMSI. This is when the purchase is secured by other goods in addition to the good purchased.

(1) Many courts say this “taint” makes it a plain-vanilla security interest (the “transformation rule”), relying on § 9-107(a)’s requirement that the debt secure “all or part” of the loan; since the collateral now secures more than just the purchase price, it can’t be a PMSI.

(2) A few courts will divide the loan into PMSI and non-PMSI portions (the “dual status” approach), relying on the “to the extent” language in § 9-107. This creates serious accounting headaches, though.

4. Perfection by Filing

a) The basic supposition of § 9-302 is that perfection is done by filing unless an exception (possession, PMSI, etc) applies.

b) Where to file – § 9-401 presents three options; which one is correct depends on which one the state chose to adopt. They are:

(1) OPTION 1: Secretary of State’s office unless fixtures are involved (then file in state real estate office).

(2) OPTION 2: For:

(a) Farming equipment (or anything related to farming, including intangibles) or consumer goods, county of debtor’s residence (or location of goods if debtor is nonresident).

(b) Fixture filings, including timber and minerals, goes to real estate office.

(c) Secretary of State for everything else.

(3) OPTION 3: Like option 2, but in the catchall Secretary of State filing you must also file in county of place of business of debtor (or residence if no place of business).

c) In Texas, the rule is consumer goods – county filing; timber and minerals – real estate filing; all else – Secretary of State. (Texas UCC § 9.401)

d) Kalinosky – Erroneous filing in wrong county, though an honest mistake, meant that creditor was unperfected (**moral: file everywhere!**)

e) Problem 38 – State law says to file in county of debtor’s residence. SJ borrows money from bank and gives security interest in boat he’s buying in two days. They file in J county, where SJ lives. But SJ moves to R county right before he bought the boat.

(1) Is the bank perfected? When did this attach, since SJ didn’t own the boat – and thus didn’t have rights in it – until after the move?

(2) Since you can’t perfect until it’s attached, they probably needed to file in R

county. But they might be able to argue that this was a PMSI and thus they were automatically perfected without having to file (you need more facts to develop this).

5. Special Perfection Rules

- a) Certain types of collateral (see classifications, infra) have special limits on how they can be perfected.
 - (1) Documents – perfection depends on if they are negotiable or non-negotiable.
 - (a) **Negotiable – by filing (§ 9-304(1)), possession (§ 9-305), or “automatic temporary perfection” (§ 9-304(4), the 21-day new value provision).**
 - (b) Non-negotiable – Filing, notifying bailee of security interest, or having document re-issued in secured party’s name (§ 9-304(3))
 - (2) **Instruments – Instruments can **only** be perfected by possession. § 9-304(1) (They can be temporarily perfected for 21 days if for new value. § 9-304(4).**
 - (3) Chattel Paper – by filing (§ 9-304(1)) or by possession (§ 9-305).
 - (4) Accounts – you cannot possess (§9-305); can only perfect by filing (§ 9-302).
 - (5) General Intangibles – Only by filing (§ 9-302)

6. Classification of Collateral

- a) **This is *unbelievably important!*** Virtually every secured credit problem hinges on what type of collateral is involved (it determines where to file, how to perfect, and if special conflict rules apply).
- b) Collateral is classified according to the debtor’s use. It is unclear whether this is the debtor’s intended use, his first use, or his use at the time of default. Intended use is *probably* the best answer, but it is unclear.
- c) JW’s method of categorizing – 10 categories within 3 headings:
 - (1) GOODS (§ 9-105(h) – all things moveable or fixtures, so long as not in another category.
 - (a) *Consumer Goods* – § 9-109(1) – used primarily for personal, family, or household purposes.
 - (b) *Equipment* – § 9-109(2) – used primarily in a business (but *not* inventory!). **This is the default classification.**
 - (c) *Farm Products* – § 9-109(3) – crops, livestock, etc. in possession of someone engaged in farming operations.
 - (d) *Inventory* – § 9-109 (4) – items held for sale or raw materials being used in preparation of finished goods.
 - (2) QUASI-TANGIBLES (obligations represented by paper)
 - (A) ***Instruments* – § 9-105(1)(i) – a negotiable instrument or any other writing evidencing a right to the payment of money that is not itself a security agreement or lease (i.e., a p-note)**
 - (B) *Investment Property* – § 9-115(f) – any security or commodities contract
 - (C) *Documents* – § 9-105(1)(f) – a document of title, like a warehouse receipt (see § 1-201(15))
 - (D) *Chattel Paper* – § 9-105(1)(b) – writing evidencing both a monetary obligation and a security interest/lease in specific goods.

- (3) INTANGIBLES (things without paper representation)
 - (A) *Accounts* – § 9-106 – essentially, accounts receivable (this can include contract rights for goods and services)
 - (B) *General Intangibles* – § 9-106 – anything that doesn't fit into the above descriptions (and isn't money). (This can include contract rights that are not for goods and services).
- D) Problem 11: Classify the following collateral –
 - (1) A professional pianist's piano – almost certainly equipment
 - (2) Cattle for sale by farmer – farm products; his tractor – equipment (see comment 5); chickens – farm products (see comment 5); manure – farm products (a "product of livestock")
 - (3) A mobile home – a consumer good *if used as a home*; the fundamental rule is **the debtor's use governs**.
 - (4) Right to sue someone for breach of contract – if the contract was one for the sale of goods, then it's an account; otherwise, it's a general intangible.
 - (A) How about the right to sue for a tort? – Explicitly *excluded* from Art. 9 in § 9-104(k) (You can still use it as collateral; Art. 9 just doesn't govern it). Same goes for a security interest in a lawsuit already won (except for judgments on security interests). § 9-104(h).
 - (5) Pencils used by Sears – Inventory (see § 9-109 comment 3; it's used up quickly, so it's inventory and not equipment)
 - (6) A liquor license or right to the return of a security deposit – General intangibles.
- E) In Re Morton – The intended use of the collateral **at the time the interest was created** governs what type of collateral it is.
- F) Morgan City Feeders – Cows used in trail drive are *equipment*, not inventory
- G) Problem 13 – Elvis fan gets Elvis' guitar, holds it for many years (he did not play it). If he uses it for a loan, what type of collateral is it?
 - (1) § 9-109, comment 3 implies inventory ("held for sale"); however, this isn't in the ordinary course of business. It's not equipment since it's not used in his business.
 - (2) It's therefore probably a consumer good.
- 7. Other Filings
 - A) **Financing statement is good for five years; they you have to file a continuation statement or it lapses. § 9-403**
 - (1) If you let it lapse (i.e., there's a "gap" between new and old filings), then you lose to anyone who filed before your second filing. § 9-403(2)
 - B) **Full payment of debt yields right to termination statement. § 9-404**
- 8. Improper Filing
 - a) If the party challenging the security interest *knew* of its existence (and the filing was made in good faith), the improper filing doesn't matter. § 9-401(2)
 - (1) This is the biggest exception to the general "first to file" rule. It is *very narrow*, however.
- 9. Certificates of Title (Automobiles)

- a) Most states have special rules for autos and other vehicles. § 9-302(3)(b) recognizes this by making filing unnecessary for these particular items (unless they are inventory, e.g., at a car dealer) and making compliance with the state law the equivalent of filing (subsection (4)).

IV. Priority Among 3rd Parties

A. Simple Disputes

1. **The general rule is the perfected interests beat unperfected interests (§ 9-301(1)(b)), and competing perfected interests are resolved by the first in time rule (§ 9-312(5)(b)).**
 - a) There is a similar rule for competing unperfected interest – first to attach. (§ 9-312(5)(b))
2. Problem 54 – EB (a bookstore) borrows \$10k from ONB, gives floating lien over inventory. EB never files. MTS sues on another debt owed by EB and levies on the inventory. Who gets the proceeds?
 - a) § 9-301(1)(b) – an unperfected creditor is subordinate to a judgment lien creditor; EB is unperfected, so they lose.
 - b) What if EB had filed for bankruptcy? § 9-301(3) – TIB is the same as a judgment lien creditor.
3. Problem 55 – CTA uses accounts receivable as collateral for a loan from MSB; MSB fails to file; BNB gives CTA another loan for a security interest in the accounts receivable, and they file. Who wins?
 - a) Note you *have* to file to perfect on accounts receivable since you cannot “possess” them.
 - b) The chapeau of § 9-301 makes unperfected person subordinate; thus, BNB wins.
4. Problem 56 – JE gets two loans on its inventory, one from FNB, and one from SNB. FNB files on 9/25, but does not give the proceeds to JE until 11/10. In the interim, SNB both files and gives the proceeds to JE on 10/2.
 - a) Here, both parties are secured. Therefore the only issue is who has priority.
 - b) § 9-312(5)(a) – general rule is that priority goes to the first to file.
 - (1) Comment 5, Ex. 1 – This thus becomes a race to file. This reason is *notice* – here, SNB had reason to know of FNB’s interest, while FNB could not have known of SNB.
5. Coin-O-Matic – presents the problem of *future advances* (basically, extending further credit on the basis of an earlier, perfected security interest securing the new debt as well as the old).
 - a) § 9-312(7) permits a future advance to be covered by an previously-filed financing statement.
 - b) However, the court (and many others) say there must be a future advance clause in the security agreement. Thus, this is now standard boilerplate language when drafting security agreements. These clauses are authorized in § 9-204(3).
6. Problem 55 – LM gets loan from ONB for security interest in lumber; ONB misplaces its financing statements. A month later, NLC gives similar interest, but does not file. The next day they learn of each other.
 - a) At 10:30, ONB puts a guard around the lumber; at 10:45, NLC perfects; at 11:00 ONB loads lumber on a truck and drives it away. Who wins?
 - b) ONB wins because it perfected by possession before NLC perfected by filing; several courts define “possession” as “physical control” – which ONB had when

it put guards around the lumber. The burly guards also give notice to the world of ONB's claim.

(1) Note there is no definition of "possession" in § 9-305 (perfection by possession); however, § 9-503 (secured party's right to repossess) indicates that repossession is the same as possession.

7. Problem 59 – P pledges his stamp collection for loan from CNB; CNB takes possession. It is an oral agreement. P then gives a security agreement to Dad; Dad files.

a) Who has priority? CNB, perfection by possession

b) What if P takes the collection home to add some new stamps? § 9-305 – perfection ends if no possession (and there is no relation back for second possession); thus, Dad would win.

(1) Since there is no written security agreement, giving up possession may also mean losing *attachment*. § 9-203(1)(a)

(2) Note § 9-304(5) – perfection remains for 21 days if possession was relinquished for "[...] storing, shipping, [...] processing for ultimate sale." (Is CNB a bailee?) Thus, if CNB could show P was preparing the collection for ultimate sale, they might win. Doubtful, though.

c) What if CNB files before releasing the stamps to P? He's OK. § 9-303(2) – if perfected one way and later perfected another way *with no gaps*, then date of original perfection remains valid.

B. PMSI's Generally

1. PMSI's get special priority, even if they are later in time than some other interests.

2. Recall that a PMSI in consumer goods is perfected automatically (assuming attachment) (§ 9-302(1)(d)) and that a PMSI in everything else has a 10-day "grace period" within which to file (§ 9-301(2)).

a) The grace period is *not perfection*, however; it just has that effect, by trumping an intervening interest that arises during the grace period.

3. A PMSI beats any other security agreement on the purchased collateral or its proceeds (other than inventory) so long as it is perfected *within 10 days of the debtor taking possession*. § 9-312(4).

4. Problem 61 – PH has outstanding debt from SNB that is perfected and secured by an after-acquired property clause on all equipment and inventory. PH gets a PMSI from SI to buy furniture for new apartment complex on 6/8. SI did not file. Who wins on...

a) ...6/10? SI wins, because they are within the 10-day grace period (these aren't consumer goods because they're not for household use).

b) ...6/19? SNB wins, because SI is no longer perfected.

c) What if PH goes bankrupt on 6/10? Normally, automatic stay would prevent any efforts to perfect. But BC § 546(b) permits perfection after filing for bankruptcy during a state-law grace period. (BC §362(b)(3) actually suspends the stay for this).

5. Problem 62 – VW (an electronic store) gave floating lien in inventory and equipment to LNB; LNB perfects. VW then buys a guard dog for \$1,200 from AS; AS lends him the money (agreeing to take \$100/mo.); after the loan was paid, title would pass. 2 months later, VW defaults; LNB seizes dog. Can AS get the dog back?

a) No. **Title is irrelevant** (§ 9-202); since the 10 day grace period is long since up,

AS loses.

6. Brodie Hotel – debtor becomes a debtor at the time he first owes an obligation (§ 9-105(1)(d)), *not* when he first takes possession. This is important for determining when the 10-day grace period starts.

C. Inventory PMSI

1. Generally, a PMSI in inventory trumps a prior security interest if all of the following criteria are met: (§ 9-312(3))
 - a) The PMSI is perfected at the time the debtor receives possession of the inventory, and
 - b) The party secured by the PMSI **gives written notice to the holder** of a conflicting interest if conflicting party had filed (1) before the PMSI creditor files, or (2) *before* the 21-day period of temporary perfection of § 9-304(5) begins, and
 - c) Conflicting party receives notice within 5 years before debtor possesses the inventory (i.e., can't rely on notice given over 5 years ago, nor can you give notice after possession).
 - (1) Why 5 years? Because that's the life span of a financing statement.
 - d) The notice states that the PMSI creditor has or expects to receive a PMSI in the inventory and describes the inventory.
2. In a nutshell, the requirements are **timing** (PMSI perfected at time debtor takes possession, unless 21-day rule applies) and **notice** within 5 years of the creation of the PMSI. This is to protect early creditors secured by a floating lien from seeing their interest invalidated by a later PMSI creditor.
3. Also note there is no 10-day grace period for a PMSI in inventory *when determining if the PMSI will trump an earlier interest.* (Cf. § 9-312(3) and (4))
4. Why give the earlier creditor notice? So he can take steps to protect his interest, i.e., calling the loan, etc.
5. Problem 65 – MCA has a perfected security interest in HCS's inventory (a floating lien). HCS buys \$4k of inventory from MBF for a PMSI in that inventory on 12/10. MBF alerts MCA in writing on 12/11; MCA takes no action. On 12/12 the inventory is delivered.
 - a) Who has priority? MBF – all four elements are satisfied:
 - (1) The PMSI is perfected when HCS possesses,
 - (2) MBF gave written notice to MCA,
 - (3) The notice was within 5 years before possession, and
 - (4) The notice said there was a PMSI in inventory and described the inventory. (This is in the problem text).
 - b) What if MBF didn't receive the notice until 12/13? Then MBF loses, because it didn't receive notice before the debtor took possession on 12/12 (i.e., it fails #3 above)
 - c) If the notice was received on 12/11, can MBF rely on it indefinitely? No, it can only continue to sell relying on this PMSI for five years without giving notice again.
 - (1) However, if you look at the contract language, you might be able to make a Coin-O-Matic argument that this is a future advance if that clause is present in the security agreement.

6. Problem 66 – HRE buys inventory from SAW for a PMSI; SAW files the same day. MDNB gives HRE a loan, part of which pays SAW; MDNB files. On 3/28 HRE buys \$3k of inventory from SAW; he puts down \$1,500 (borrowed from MDNB for a PMSI) and gives SAW a PMSI for the rest. Both creditors knew of each other, and both gave notice. Who has priority?
 - a) Probably no answer to this one. § 9-312(3) is totally unclear as to what happens when two parties give “partial” PMSI’s for the purchase of the same inventory.
 - b) You probably look to the default first-in-time rule (§ 9-312(5)) since the other sections don’t sensibly apply

D. Buyers

1. There is a problem with the secured credit regime in that it would require the average buyer to check the filings against every piece of property he buys; this would be unworkable for most “average” purchases. The UCC solves this with § 9-307.
 - a) § 9-201 is what White and Summers calls the “Golden Rule” of Art. 9: that a security agreement is good unless there is an exception.
 - b) § 9-307(1) is such an exception. It says that a buyer in the ordinary course of business (BOCOB) (other than for farm equipment) can ignore security interests, even if perfected.
 - c) The corollary to this rule are the rules for proceeds, which serve to protect the secured party. These are covered infra.
2. So what is a BOCOB?
 - a) § 1-201(9) provides the definition: a person buying
 - (1) In good faith
 - (2) With no knowledge of that he is violating an existing security interest
 - (3) Buying in the ordinary course of business of **the seller** (but not for pawnbrokers)
 - (4) Not a transfer in bulk or in satisfaction of prior debt (see Prob. 70, infra)
 - b) The knowledge requirement is a *narrow* one. A buyer can know of the *existence* of the security agreement; he just can’t know he’s *violating* it.
 - (1) § 1-201(25) defines knowledge as *actual* knowledge (differs from “notice”).
 - (2) Note that a buyer purchasing inventory is *never* in violation – because that’s what inventory is for, to be sold! No lender would want to restrict a seller’s ability to sell his product.
3. Problem 68 – B buys a television from DTVI; DTVI goes into bankruptcy; ONB (which had a floating lien on DTVI’s inventory) wants the television back. What result?
 - a) B can safely ignore the bank because of § 9-307(1). She is a BOCOB, and can thus ignore the bank’s security interest.
 - b) What if she knew of the security interest? It doesn’t matter; it only matters if she knew she was violating the security interest (which she wasn’t – a retailer has to sell his inventory!)
 - c) What if she bought at a liquidation sale and she knew of the impending bankruptcy? Probably no effect, though you could argue this isn’t in the OCOB. Cases appear to favor the buyer, though.
 - d) What if she purchases on layaway, and DTVI still has possession of the

television? There is no real answer; possibilities include:

- (1) § 2-502 helps if the seller becomes insolvent after the first installment – that’s a fairly narrow window, though.
 - (2) § 2-103(1)(a) – “buyer” means “one who [...] contracts to buy goods” – but this doesn’t really help because it only provides a definition for Art. 2. Might be persuasive, though.
 - (3) § 2-716 – Buyer’s right to replevin or specific performance. No specific performance here because the goods aren’t unique; replevin just makes you an unsecured creditor to DTVI – and thus the secured party beats you.
4. International Harvester – stands for the proposition that to be a BOCOB, you must be one in good faith; you can’t fabricate BOCOB status. See § 1-203.
 5. OCOB ¹ the *primary* business of the seller; it can be a related business as well, so long as it is something that is done in the ordinary course of things. For instance, buying a car from Hertz is still in the OCOB even though their primary business is renting. See Problem 69.
 6. White and Summers §24-13 – 6 conditions to buying free of a prior security interest: (refer also to §§ 9-307, 1-201) (this is just a restatement of the test)
 - a) Be a BOCOB
 - b) Not a bulk purchase or for satisfaction of previous debt
 - c) Seller is in the business of selling that type of good
 - d) Buyer is buying in good faith with no knowledge of violation of security interest
 - e) Not a purchase of farm products
 - f) Competing interest is “created by the seller”
 7. Problem 70 – ONB has a perfected interest in all the cars on SM’s lot. SM owes \$5k to HT in past due insurance premiums; HT forgives the debt in exchange for a car (SM “pays” HT and then HT “pays” SM back).
 - a) HT probably *isn’t* a BOCOB because when you strip away the transactions, the car is given for a preexisting debt.
 8. First Nat’l – El Dorado – stands for proposition that an **insider can’t be a BOCOB**.
 9. Problem 71 – LCC sells car to AG for a PMSI and perfects (noting lien on certificate of title); AG is a used car dealer, but he uses this car for his own personal use. He parks it at his lot and ends up selling it to a customer. What result?
 - a) Tough. OCOB is determined by the *seller*, and it can be argued that the seller here isn’t in the business of selling his own personal car. However, it would be unfair to punish the buyer who made a rational assumption that the car was for sale.
 - b) Note the conflict between Art. 2 and Art. 9: If AG’s company sold the car, there’s an Art. 2 problem, since AG and not the company own the car.
 - c) Might this be covered by the Consumer-to-Consumer buyer rules in § 9-307(2) (see *infra*)? If so, does “filing” for that section mean actual filing or just a notation on the certificate of title? It’s unclear, but the comment seems to indicate filing only.
 10. Note that a BOCOB only takes free of an interest “created by his seller”; this means that a third-hand buyer may find himself subject to the interest created by the first-hand buyer. The “entrustment rules” of § 2-403(2) may provide relief.

11. Other Buyer Issues

a) Consumer-to-Consumer Transactions – § 9-307(2)

- (1) A buyer takes clear of a security interest if he:
 - (a) Buys consumer goods, and
 - (b) Buys without knowledge of the existence of the security agreement, and
 - (c) Buys for value, and
 - (d) Buys for his own personal, family, or household use, and
 - (e) The secured party has not ~~fi~~ ~~le~~ prior to the purchase (i.e., no automatic perfection)
- (2) The big question: Does the debtor have to have purchased the goods as consumer goods? Unclear due to the language – “in the case of consumer goods” is a dangling modifier.

b) Non-BOCOB that aren't consumer transactions

- (1) A buyer not in the OCOB normally can only have priority over an unperfected security interest. § 9-301(1)(c)
- (2) A buyer not in OCOB can defeat a perfected security interest to the extent it secures future advances if the advances were made after the secured party acquired knowledge of the purchase *or* made over 45 days after the purchase, whichever comes first, unless the advances were made pursuant to a commitment made without knowledge of the purchase and before the end of the 45 days. (§ 9-307(3))

c) Also note special rules for buyers of chattel paper. § 9-308

E. Statutory Liens

1. A *possessory lien* given by *statute or common law* trumps other security interests unless the statute says otherwise. § 9-310
 - a) Probably the most common type of statutory lien is the mechanic's lien.
2. Problem 83 – Garage takes mechanic's lien, but lets customer keep the car during the day (she returns it each evening). Bank repossesses the car.
 - a) Garage probably loses since the lien is not possessory: the debtor has the use of the collateral
 - b) Note it is irrelevant whether the bank consents to the repairs or not.

F. Federal Priorities/Tax Liens

1. The federal government has automatic priority over everyone else except for bankruptcy cases. 31 U.S.C. § 3713.
2. This is important in cases where bankruptcy isn't an option – like with insolvent insurance companies, for instance.

V. Proceeds

- ### A. What happens when the debtor sells the collateral? Generally, the secured party retains an interest in the proceeds (and often the collateral, to).
1. § 9-306(1) defines proceeds as “whatever is received upon the sale, exchange, collection, or other disposition of collateral or proceeds.” Insurance not payable to a third party is included.
 - a) “Cash proceeds” are “money, checks, deposit accounts, and the like.”

- b) “Non-cash proceeds” are everything else.
- 2. § 9-306(2) says that unless an exception applies, a security interest continues in *both* the collateral and its identifiable proceeds (unless the secured party authorized the disposition of the collateral).

B. Attachment and Perfection of Proceeds

- 1. Basically, there are four steps to determining perfection of proceeds: (§ 9-203(3))
 - a) Is this cash?
 - b) If not cash, is the description sufficient?
 - c) If not sufficient, would the collateral be perfected by filing in the **same office**?
 - d) If not the same office, then you must re-file.
- 2. There is a 10-day grace period within which to file and retain continuous perfection. §9-306(3)
- 3. Problem 106 – RNB has a perfected security interest in CMI’s inventory. RS bought a car from CMI; he traded in his 5-year old car and gave \$200 plus a p-note for the balance.
 - a) Does the security interest continue once the car is delivered? No, § 9-307(1) – RS is a BOCOB.
 - b) The bank’s interest continues in the proceeds; what are the proceeds here? There are three: the used car, the \$200 cash, and the p-note.
 - c) Does RNB have to take steps to attach and perfect?
 - (1) § 9-203(3) – the security agreement gives rights to proceeds by default (parties can agree otherwise). Thus, RNB’s interest is attached in the proceeds.
 - (2) § 9-306(3) – the interest in proceeds is perfected for **10 days**, after which it becomes unperfected if the creditor doesn’t perfect, **unless**:
 - (a) The original filing covers the original collateral and was filed in the same place that a filing for the proceeds would be filed in. (The “same office” rule”), or
 - (i) If cash, original filing must contain in the description of the collateral the type of property constituting proceeds.
 - (b) Filed financing statement covers original collateral and the proceeds are identifiable cash proceeds, or
 - (c) Original property was investment property and proceeds are identifiable cash proceeds, or
 - (d) The security interest is perfected before the 10 days is up.
- 4. The date of perfection is that of the original filing (comment: implicitly assumes continuous perfection under §9-306(3)). § 9-312(6)
- 5. Problem 112 – on 8/12, LNB files a financing statement covering “all business machines.” What result for each of the following transactions?
 - a) Debtor trades a computer for another computer? – It both attaches and perfects continuously (it’s the same type of equipment, so the filing must be in the correct office for the proceeds).
 - b) Debtor trades a computer for a painting for the office? – The painting is equipment (business use); thus you would file in the same office, so the interest in the painting is automatically perfected.

- c) Debtor trades duplicating machine for a car (subject to state registration law) – It attaches, but LNB must file to perfect (not “same office” rule, and other options don’t apply).
 - d) Debtor sold calculator for cash, then used cash to buy painting? The painting is *still proceeds* (§ 9-306(1) defines “proceeds” as the “disposition of proceeds”).
 - (1) However, because of the intervening cash, you can’t use the same office rule (the cash becomes the “original collateral”); thus you have to either rely on the description in the financing statement (not applicable since this isn’t a “business machine”) or re-file.
 - e) Debtor sold adding machine for cash and put it in the bank, and bank exercises its right to setoff? (i.e., proceeds vs. setoff right) §9-312 doesn’t help. Setoff is a non-UCC issue, so it depends on how the state law is written.
6. Proceeds and Debtor Insolvency (§ 9-306(4))
- a) A perfected secured party is perfected in all the identifiable cash and non-cash proceeds which aren’t commingled if insolvency proceedings are brought against a debtor.
 - b) The secured party has priority in commingled assets according to the following formula:
 - (1) Proceeds received within 10 days of insolvency - Non-commingled cash – Amount paid to the debtor within the same 10 day period = Amount of priority
 - c) As a practical matter, it’s a good idea to forbid commingling of proceeds by requiring their deposit in a separate account in the security agreement.

VI. Fixtures

- A. A fixture is basically something so attached to real estate that it is no longer personal property (e.g., a fencepost)
 - 1. The UCC does not define what a fixture is – you have to look to state real estate law. (For exam purposes, there is no “right” answer – you just have to make intelligent arguments for or against).
 - 2. § 9-313(2) and (3) permit the UCC and real estate law to coexist.
- B. Filing an interest in fixtures
 - 1. An interest in a fixture must be filed in the same office that the mortgage on the real estate must be filed (i.e., the state real estate office). § 9-313(1)(b)
 - 2. You have a choice: if you perfect by some other means, you have an interest perfected against the rest of the world, but *not* against interest in the underlying real estate. § 9-313(2), (7)
 - 3. § 9-402(5) sets out the requirements of a fixture filing:
 - a) It must show it covers the type of collateral in question, must recite that it is to be filed in the real estate office, and must describe the real estate; must also show name of record owner of real estate if not the debtor.
 - b) A mortgage will do as a fixture filing (must say goods are to become fixtures and describe them, *meet the other requirements of a financing statement* [both generally and for fixtures] except the recitation, and be duly recorded)
- C. Priority for fixtures vis-à-vis a real estate interest is governed by § 9-313
 - 1. The **general rule** is in § 9-313(7): A security interest in fixtures is subordinate to the conflicting interest of an owner/encumbrancer of the related real estate who is not the

debtor.

a) **Exception:** § 9-313(4) – fixture has priority over real estate if:

- (1) It is a PMSI for the fixture, or
 - (a) **Exception to this exception:** if it's a **construction mortgage** recorded before the goods become fixtures (and the goods become fixtures before construction is finished), then the real estate owner/encumbrancer has priority. § 9-313(6)
 - (b) A construction mortgage is a loan used to construct an improvement on real estate, including the cost buying the real estate. § 9-313(1)(c)
- (2) Debt secured by the fixture is perfected by a fixture filing before the real estate owner/encumbrancer is of record (i.e., first-in-time), and debtor has interest in or possesses the real estate, or
- (3) The fixture is a readily removable factory or office machine, or a *replacement* of readily removable domestic appliances which are consumer goods AND the debtor has a record interest or possesses the real estate, AND the debtor perfects pre-fixture or
 - (a) Note filing here can be “by any method available in this Art.” so long as before the goods become fixtures.
- (4) The conflicting interest is a lien on the real estate given by a court after the fixture debt was perfected.
 - (a) Note perfection here can be “by any method available in this Art.”

b) **Exception:** §9-313(5) – a secured fixture interest has priority over a real estate interest if:

- (1) Owner/encumbrancer of real estate consents in writing to the security interest and disclaims any interest in the fixtures, or
- (2) The debtor has a right to remove the fixture against the owner/encumbrancer.

- D. Problem 86 – SM borrows \$4M from CSB to build apartment complex; gives a mortgage on the real estate and “all things affixed thereto.” Mortgage met all requirements of financing statement but did not give the creditor’s address. Is the mortgage sufficient to create an interest in fixtures?
1. **Probably so under the § 9-402(8) “fudge factor” for minor errors, if omitting the address is a minor error not seriously misleading.**
- E. Problem 87 – Same facts (assume the mortgage is valid as a filing); SM buys a furnace from BHS. Where should BHS file? Can they prevail over CSB?
1. He should do a fixture filing in the real estate office if he wants to be perfected against CSB. (Furnace is almost certainly a fixture).
 2. They probably can’t prevail. The debt is a PMSI (that arises pre-fixture, fixture filing before it becomes fixture, debtor has interest in real estate), but the construction mortgage exception trumps it (recorded pre-fixture and the goods become fixtures before construction is complete). A filing would be after the mortgage is “of record.”
- F. Problem 88 – Same facts. What if the asset was a refrigerator? A computer?
1. If it’s a refrigerator, it’s a readily removable domestic appliance – but § 9-313(4)(c) does not apply because it’s not a *replacement*. The construction mortgage trumps the PMSI. Filing is after the mortgage is “of record.”
 - a) Of course, if the ‘fridge isn’t a fixture, you can avoid this whole discussion.

2. If it's a computer, the PMSI may be able to trump (readily removable factory or office machines) if perfected before it becomes a fixture. (Again, must ask: is this a fixture?)
- G. Problem 89 – Same facts. SM doesn't pay her attorneys, and they levy on the building and its contents. Will the parties secured by the fixtures win if they have perfected via a fixture filing? Yes. § 9-313(4)(d) exception for judgment liens gives the secured parties priority.
1. What if those creditors filed everywhere except the real estate office? They probably still win. § 9-313(4)(d): perfect "by any method permitted by this Art." Comment 4(c): the reason is because judgment creditor isn't a reliance creditor.
- H. Damage and Fixtures
1. A party repossessing a fixture must reimburse the holder of a real estate interest for the cost of repairs, but *not* for the diminution of value. § 9-313(8)
 2. Thus, if repossession a furnace does \$1,000 in damage (cost of repair), and costs the apartment owner \$8,000 to replace, the repossessing party need only compensate the apartment owner \$1,000.
 3. The holder of the real estate interest can refuse to permit the repossession until he is given security (i.e., post a bond) to pay for the repairs.

VII. The Scope of Article 9

A. Scope of Article 9 Generally

1. § 1-201(37) defines a "security interest" as an interest in property or fixtures that secures payment or performance on an obligation (other than a right of refusal or consignment).
2. § 9-102 – says Art. 9 applies to every transaction intended to create a security interest except for the exceptions in § 9-104.
3. Problem 2 – Is a mechanic's lien a "security interest"? Yes – under § 1-201(37), it is an interest that secures payment. It is outside the scope of Art. 9, however (except for § 9-310). § 9-104(c)

B. Sale of Accounts

1. § 9-102(1)(b) – the sale of accounts or chattel paper is *within* the scope of Art. 9; § 9-105(d) – "debtor" includes seller of accounts/chattel paper.
 - a) But doesn't Art. 9 only apply to transactions *intended* to be a security interest? Yes; this is an exception because distinguishing between a sale and a security agreement for accounts can be quite difficult. The exception exists in order to incorporate Art. 9's filing requirements, etc
 - b) What would be the effect of excluding sales from Art. 9?
 - (1) It means that in the event of a *sale*, rights of the various parties are governed by the state's common law – there is no filing requirement, etc.
 - (2) On the other hand, if it is a loan it is governed by Art. 9, with all the requirements of perfection, etc..
2. Problem 3 – Farmer B sold his accounts receivable to NFC; NFC notifies customers to forward their payments to them. Is the sale a "security interest" (even though Farmer B has no further interest)?
 - a) Yes, since sales of accounts are expressly included in Art. 9
 - b) The difference is what happens to the surplus upon collection
 - (1) If it's a sale, then NFC keeps the surplus (§ 9-502(2), last sentence).

- (2) If it's security, then Farmer B is entitled to any surplus.
 - c) Thus, the inclusion of sales within Art. 9 does not alter the sale/security distinction.
 3. Of course, it's generally a good idea to file anyway!
 4. Note § 9-302(1)(e) – the “isolated assignment” exception – Art. 9 does not apply to an isolated assignment of an insignificant number of accounts.
- C. Leases
1. **Leases are not covered by Art. 9**
 - a) Leases are defined in § 1-201(37); note this is *not* the definition used for tax or accounting purposes.
 - b) The test for a lease:
 - (1) The lease/security interest distinction is governed by the facts of each case. However, it is a *security interest* if the agreement is **not subject to termination by the lessee** and one or more of the following is true:
 - (a) The lease term³ economic life of the goods, or
 - (b) The lessee must renew for the remaining life of the goods or is bound to become the owner of the goods, or
 - (c) Lessee has option to renew for remaining economic life of the goods for no consideration, or
 - (d) Lessee has option to become the owner of the goods for no additional consideration.
 - (2) § 1-201(37) then says the following are **not** dispositive on whether it's a lease or not (might more than one be dispositive?)
 - (a) Present value of consideration from lessee is substantially equal to the FMV of the goods.
 - (b) Lessee assumes risk of loss, or agrees to pay taxes, fees, etc.
 - (c) Lessee has option to renew or to buy (even if for amount reasonably predicted as future FMV, including options)
 - (3) Also note the definitions of “nominal consideration,” “reasonably predictable,” and “present value.”
 - c) Note the switch from the old version of § 1-201(37): There is no longer an intent requirement. Now we don't care what the parties intended; we instead look at the facts to make the security interest/lease determination. (*Cf.* § 9-102)
 2. There has been much scholarly criticism of the current regime; they say it doesn't make sense to treat leases different than other security interests – there aren't two economically distinguishable categories; instead, it's all on a continuum. Common sense would dictate leases should be subject to a filing requirement.
 - a) Of course, you should file anyway; it doesn't impair you (§ 9-408), and it insures you've covered all the bases.

VIII. Multi-State Secured Credit Issues

A. Where to file multi-state transactions

1. Choice of Law: § 1-105 – the parties can generally determine for themselves what law will apply to any given transaction so long as it bears a “reasonable relationship” to the transaction.

- a) Since every state has adopted the UCC, this isn't much of an issue in the US; however, it is quite important for multinational transactions.
 - b) Generally, you apply the choice of law rules for the state in which the court hearing the matter sits.
2. § 9-103 governs perfection and where to file for multi-state transactions depending on the type of goods involved.
- a) § 9-103(1) – Ordinary goods (but not certificate of title property or mobile goods), documents, instruments, and letters of credit
 - (1) How to perfect
 - (a) Perfection is in the jurisdiction of the “last event” – and virtually anything can be the last event.
 - (i) JW: this is nonsensical – it's totally circular
 - (b) Exception: if a PMSI and parties understand that the goods will be kept in another state, then in that state.
 - (2) Movement of collateral into a new state
 - (a) If goods are brought into the state after being perfected elsewhere, then they remain perfected, but if action is required to perfect they become unperfected after the **first** of either:
 - (i) The expiration of the perfection in the first state (ex.: grace period lapses), or
 - (ii) 4 months after collateral brought into the new state
 - (b) For priority over a consumer goods buyer (as in § 9-307(2)), the same rules apply.
 - (c) See exception above: if **PMSI** and **parties understand** that goods will be moved, then perfection is in the second state (i.e., perfection in the first state is invalid).
 - (3) Problem 49 – NFC lends NT money for a washer/dryer in exchange for a PMSI. Does NFC have to file within 4 months there?
 - (a) No. See the chapeau: NFC only need act if “action is required” to perfect. A PMSI for consumer goods does require action to perfect; therefore, NFC need never file.
 - (b) What if they decided to file, but NT refused to sign a new financing statement? Doesn't matter; § 9-402(2)(a) (so long as new filing states that asset movement is reason for filing).
 - (4) Problem 50 – RSB (in California) has perfected security in E's inventory; E's business is in California; E moves to Seattle on 4/1, taking inventory with her. ANB (in Washington) gives a perfected security interest (properly filed in Washington) in the inventory on 4/3.
 - (a) On 5/1, who has priority? RSB, because they're within the grace period.
 - (b) What if RSB knew of the move? Or E told them she was moving in six months but left in two weeks instead? This isn't a PMSI so the “knowledge of the move” rule doesn't apply.
 - (c) (Assume no knowledge) Who has priority on 10/1? ANB, because of the 4-month rule (once the 4 months is up, you are *always* unperfected unless you re-file – see comments)

- (d) What if RSB never perfects in Washington, E moves *back* to California on 12/25, and ANB files in California? By negative inference, § 9-303(2), the gap makes RSB unperfected – you can't backdate to the original California filing.
- b) §9-103(3) – Mobile goods, accounts, and general intangibles.
 - (1) How to perfect
 - (a) Perfection is governed by the law of the state where the debtor lives.
 - (b) This is “his principal place of business, his chief executive office if more than one place of business, or otherwise at his residence.” § 9-103(3)(d)
 - (2) Movement of collateral into a new state
 - (a) If the debtor changes location, then the secured party has 4 months to re-file in the debtor's new state (or until his original perfection expires, whichever is first). §9-103(3)(e)
 - (3) Problem 44 – RHI (a highway company) owns a crane (max speed a whopping 4 m.p.h.) Is this a “mobile good”? Yes. § 9-103(3)(a) says a “mobile good” is one “normally used in more than one jurisdiction,” including “road building and construction machinery.”
 - (a) Comment 5(b) makes it clear that the good need not actually be used in multiple jurisdictions. Thus, if RHI is located in X but keeps the crane in Y, filing must be in X even if the crane is never taken from Y.
- c) Note additional rules for certificate of title property (§9-103(2)), chattel paper (4), and minerals (5).

IX. Bankruptcy and Secured Credit

A. Avoiding Powers

1. The Strong Arm Clause (BC § 544(a))

- a) **The strong arm clause gives makes trustee in bankruptcy (TIB) have the same position as a judicial lien creditor (BC § 544(a)). Recall that § 9-301(1) makes such a lien creditor superior to an unsecured party.**
 - (1) **He also can assert any defenses available to the debtor (BC § 558)**, and also has any rights held by any unsecured creditor (BC § 544(b)). The latter applies to the entire estate regardless of the size of the unsecured creditor's claim in whose shoes the TIB is standing. Moore v. Bay
- b) The TIB is deemed to have no knowledge. Knowledge that any other creditors might have is irrelevant.
- c) The Strong Arm Clause has the effect of **allowing the TIB to wipe out an unsecured creditor.**
 - (1) The Key: this only operates **at the date of bankruptcy**. You have to look on bankruptcy day and ask “who is unsecured right now?”
 - (2) Also recall that some PMSI's can be filed post-bankruptcy if within the 10-day grace period.
- d) Problem 98 – BBB loans VV \$1k on horses; VV improperly files on 10/27. On 12/4, DSFC loans VV \$20k also on horses, and they file properly – though they knew of prior loan. On 1/8, VV files bankruptcy. What are the TIB's rights?
 - (1) The TIB is a lien creditor under the strong arm clause. Since BBB is unsecured on bankruptcy day, the TIB can invalidate his interest. As to

DSFC, they are secured, so the TIB can't wipe them out.

- (2) The \$1k avoided is preserved for the benefit of the estate (BC § 551).
 - (3) If VV's horses are sold for \$20k, the TIB can assert the rights available to BBB (BC § 544(b)), in this case that since DSFC had knowledge of the improper filing BBB's interest is superior to DSFC's (§ 9-401(2)). Thus, the TIB can keep \$1k for the estate with the remaining \$19k going to DSFC as a secured creditor.
- e) Problem 99 – SF gets loan from ISB on 4/17; SF files bankruptcy on 4/18 one hour before SF perfects.
- (1) If there are no new creditors, can the TIB avoid? Yes, ISB is not perfected *at the moment of filing*. (Why the line about “no new creditors”? To emphasize that the TIB is a *hypothetical* lien creditor and that there need not be damage done to a second creditor for him to avoid an interest).
 - (2) What if ISB filed two seconds before the bankruptcy filing? Then the TIB loses. It's all about the status of things *at the moment of bankruptcy*.
 - (3) What if ISB's interest had been a PMSI – would the filing have killed the 10-day grace period? No. BC § 546(b) permits perfection within any state-law grace period.

2. Preferences

- a) The TIB can avoid “preferences” under BC § 547 within 90 days to avoid unduly favoring any one creditor and to discourage secret liens, as well as to promote workouts.
- b) Elements of a preference (BC § 547(b)) – There are 7 elements to a preference:
 - (1) A transfer of
 - (2) An **interest** of the debtor
 - (3) To or for the benefit of a creditor
 - (4) On account of an **antecedent debt** (i.e., a debt that existed before the transfer)
 - (5) At a time when the debtor was **insolvent**
 - (6) Within **90 days** of bankruptcy (or within one year if to an insider)
 - (7) The transfer **makes the creditor better off** than he would be both in a Chapter 7 liquidation bankruptcy and if the transfer had not been made.
 - (a) Note this requires comparing the real world to a hypothetical world where the transfer was never made.
- c) The debtor is *presumed insolvent* for the 90 days preceding bankruptcy purposes of preference analysis *only* (i.e., there is no such presumption for other parts of the BC. (BC §547(f))
- d) Things to watch for in preference analysis:
 - (1) Contemporaneous exchanges – A TIB can't kill an exchange that is contemporaneous because it isn't “antecedent debt”; if the debt is created at the same time the transfer is made, the creditor is golden.
 - (2) “Better Off” doesn't have to mean monetarily; it can also encompass moving from unsecured to secured status.
 - (a) Indeed, this section is partially to prevent “secret liens” where the debtor agrees to “tip off” a favored creditor shortly before bankruptcy so the

creditor can perfect so the debtor can keep his assets unencumbered for as long as possible to make himself a more attractive credit risk.

(b) Thus, keep an eye out for **delayed filings**.

e) **Exceptions** to the preference avoiding power (BC § 547(c))

(1) BC § 547(c)(1) – trustee can't avoid a *contemporaneous exchange* for *new value*. However, this only applies to cash or quasi-cash transactions, not new loans – i.e., it doesn't protect delayed filings (Enlow).

(2) BC § 547(c)(5) – trustee can't avoid a transfer that creates a perfected security interest in *inventory or receivables* (or their proceeds) **except** to the extent that the aggregate of all such transfers caused a reduction and the transfers prejudiced other creditors.

(a) In sum: the test is 1) a transfer, 2) a reduction in the unsecured deficiency and 3) a transfer within the 90-day preference period.

(b) That is, the TIB can only attack inventory/receivables preferences if the creditor's position is enhanced.

(c) In other words, compare the reduction in unsecured debt on bankruptcy day and 90 days previous *only* (nothing in between counts).

(d) Quick rule of thumb: if the creditor is *fully secured* on bankruptcy day, he can't be attacked by the TIB.

f) Other exceptions:

(1) BC § 547(c)(3) PMSI exception; gives 20 days for a delayed PMSI filing (but no relating back, see *infra*). Fink.

(2) BC § 547(c)(4) "new value" exception permits an offset against the preference for new value provided to the debtor by the preferred creditor (new value can't be a payment nor can it be secured).

g) Deemed date of perfection is time of transfer if perfection is within 10 days of transfer, actual date of perfection if longer. BC § 547(e)(2)

(1) Also note BC § 547(e)(3) – regardless of deemed date, the transfer not made until the date the debtor acquires rights in the property – i.e., no relating back for preference analysis.

h) Problem 101 – MG has travel agency, purchases a car with SBA loan. SBA fails to perfect. SBA repossesses a few months later. A little over a month after that, MG files bankruptcy. Can the TIB recover the car?

(1) First you have to ask if SBA is perfected. § 9-302(1)(a) kicks you to § 9-305 (perfection by possession); however, this is an automobile subject to a certificate of title statute (§ 9-302(3), (4)), so it depends on state law. If they're not perfected, then the TIB can use the strong-arm clause.

(2) If they are perfected, it's a preference that the TIB can void. The deemed date of perfection is the time of perfection since it's outside the 10-day grace period of BC § 547(e)(2).

3. Fraudulent Conveyances

a) BC § 548 provides the federal fraudulent conveyance regime, though the TIB can opt to use the state regime under § 544(b). State regime is usually the Uniform Fraudulent Transfers Act (UFTA).

b) A fraudulent conveyance can be either:

(1) *Actual fraud*, i.e., an actual intent to defraud, or

- (2) *Constructive fraud*; there are a couple of tests, but for this class the important one is that **less than reasonably equivalent value was received** and the debtor was **insolvent**. BC § 548(a)(1)(B).
 - (a) Note “insolvency” means balance sheet insolvency. BC § 101(32)
 - (b) Also note that “value” includes a secured interest for present or antecedent debt. BC § 548(d)(2)(A)
 - c) Note that fraudulent conveyances and preferences are the “Scylla and Charybdis” of bankruptcy. If a transaction is for a debt, the TIB can attack it as a preference; if not a debt, he can do the same as a fraudulent conveyance.
4. JW’s advice for handling bankruptcy problems
- a) Begin with the TIB; if he can void something, you don’t usually have to go any further. Remember, bankruptcy day is the key.
 - b) Go in order, narrow to broad:
 - (1) Strong-arm clause analysis,
 - (2) Preference analysis,
 - (a) See if a security interest exists on bankruptcy day, then check the *validity* of the perfection (filed in the right place, etc.), then see if the TIB can beat it – especially with late filings.
 - (b) Then do a “hypothetical world” to see if any creditors are better off.
 - (3) Fraudulent transfer analysis.
 - c) If the TIB can’t void, *then* compare the rights of secured parties, buyers, lien creditors, etc.

B. Bankruptcy Reorganizations: Automatic Stay Redux

- 1. Recall that BC § 362 invokes a stay on all collection proceedings once bankruptcy has been filed.
- 2. BC §362(d) says that a secured party must be “adequately protected” between filing and approval of the reorganization plan.
 - a) The burden is on the TIB to show adequate protection
 - b) Adequate protection means, at a minimum, protection of the collateral from loss of value (measured on bankruptcy day) from depreciation and damage. § 361 sets out way to show adequate protection:
 - (1) Cash payments to the creditor to offset depreciation
 - (2) Providing replacement liens
 - (3) “Other relief”
 - c) Note that an “equity cushion” is considered adequate protection from loss.
- 3. The secured creditor is only entitled to protection of his *allowed secured claim* – recall that a secured claim is bifurcated into secured and unsecured debt if the creditor is undersecured. BC § 506(a). Recall he gets post-petition interest to the extent he is secured. BC §506(b).

JW’s advice for the rest of your life:

- 1. Learn from older lawyers – but don’t do anything you consider to be wrong.
- 2. Don’t let go of your sense of adventure – don’t let the humdrum of everyday overwhelm the wonder of the changing world.

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