# SECURED TRANSACTIONS

## Creditors' Remedies Under State Law

### I) Remedies of Unsecured Creditors Under State Law

A) Who is an Unsecured Creditor?

1) Anyone owed a legal obligation that can be reduced to a money judgment is a creditor of the party owing the obligation (does not have to be money though). The unsecured creditor is always in the underdog position, hoping to get its money back.
2) Unless a creditor contracts with the debtor for secured status or is granted it by statute, the creditor will be unsecured
3) If the unsecured creditor has already obtained a court judgment to establish liability, the creditor is a judgment creditor (still unsecured)

B) Main concepts with unsecured creditors

1) It is very difficult to go against a debtor when the creditor is unsecured. Very often the debtor is judgment proof.
2) Remedies for the unsecured creditor are cumulative: secured creditors also have their rights, but they also have additional rights.
    a) If the debt becomes no longer secured, the secured creditor can fall back on these remedies.

C) How Do Unsecured Creditors Compel Payment?

1) Self-help --- unsecured creditor that takes possession of property of the debtor may be charged with **larceny, theft, or sued for conversion**, etc.
    a) If your client does this, try to get the debtor to take the money back, or negotiate, to avoid criminal problems.
    b) Self- help doesn't work. Must get a judgment. If a mall amount, advise the client to go to small claims court but he will still have to execute the judgment.
        i) The lawyer shouldn't probably talk to the debtor—problems with speaking to unrepresented person. The lawyer may consider writing a letter.

2) Judicial process: this is a procedural requirement for the creditor.

D) **Execution Process**

1) Need judgment from court: become a judgment creditor.
2) Get a writ of execution -- this puts lien on property and is required when attempting to recover against property. This is a procedural right: for the secured creditor it would be filing a financing statement.
3) Letter to sheriff to requesting levy with writ (instruct the sheriff what to seize)
    a) Can't leave it up to their imagination to decide what to seize: THUS, be quite explicit in your instructions even though a specific description is not required.

b) Deliver writ to sheriff; Sheriff attempts to seize: Most of the time they return the writ w/o any property. The debtor will say things are encumbered or will not allow the sheriff in. The sheriff will usually return without an execution.
c) If the sheriff does seize, has sheriff's sale.
d) Once sold, proceeds go to:
i) Secured creditor (if one exists on this property)
ii) Judgment creditor
iii) Remainder goes to debtor

E) **Viitale v. Hotel California**

1) If sheriff fails in his duty, creditor can sue for amercement, requiring sheriff personally to pay the remainder of the judgment
2) ***Amercement***: a pecuniary penalty in the nature of a fine, imposed upon a person (here, sheriff) for some fault or misconduct, he being "in mercy" for his offense. (Black's Law Dictionary)

F) Limitations on Compelling Payment

1) Judgment creditor retains the obligation to use discovery to locate assets: can't just show up at the debtors place of business looking for assets.
2) Creditor has the right to demand information (backed up by civil contempt charges and jail)

3) PROPERTY EXEMPT FROM EXECUTION (Wisconsin statute) (Differs from state to state so check the state's statute to see what is exempt). Debtor's interest in or the right to receive the following property is exempt from levy
a) Provisions for **burial** of debtor and debtor's family
b) **Business and farm property** (equip, inventory, farm products and professional books) not to exceed $7500
c) **Consumer goods** (household goods and furnishings, clothing, keepsakes, jewelry, appliances, books, musical instruments, firearms, sporting goods, animals, other tangible personal property held for the personal, family or household us) not to exceed $5,000
d) **Motor vehicles** not to exceed $1200 (can add any unused amount from other exemptions to increase the exempt value of a motor vehicle)
e) **Net income** (75% of debtor's net income for each one week pay period) (amount must be 30 times the greater of state or federal minimum wage)
f) **Deposit accounts** not to exceed $1000

4) HOMESTEAD EXEMPTION (Wisc. stat.)
a) Debtor's residence, occupied by him
b) Exempt up to $40,000 except mortgages, laborer's, mechanics', and purchase money liens and taxes
c) In Wyoming the exemption amount for a house is $10,000

G) Advice to a client entering an unsecured loan
1) Define default
a) Allow accelerated payments if assets fall below X amount
b) Target loan/asset ratio (will require monitoring)
i) Require (in the contract) debtor to pay transaction costs
c) Define a skipped payment to anyone as default to you
d) Accelerating the loan gives the lender the legal right to seek collection of the whole amount
2) If the client wants to become a creditor, tell them that there are a lot of duties. There could be a partnership formed between the creditor and the debtor which gives rise to other responsibilities.
3) If the Debtor is now in default: try to get a judgment and execute on the writ. Find the property (possibly deposition). Try to squeeze out money on top of the secured creditor. check to see if the debtor has filed bankruptcy.

H) Sources of information about Debtor's Assets (do this <u>before</u> the lawsuit)
1) Public record title search (motor vehicles, home), UCC search for other debts, check to see if the debtor has filed bankruptcy.
2) Discovery (last resort because it tips off the debtor that you're looking)
a) "Discovery in aid of execution" (not very effective, he can move the assets immediately after the deposition)
i) Did he loan out money, do any clients owe him any money, tort claims, tax refund, annuities, heir to an estate (but because of the dep, he might get disinherited), dividends, wages, salary, bank accounts, security deposit on an apartment (or on phone, utilities), down payments (layaways)
3) Garnish his paycheck
a) Writ of garnishment (freezes the account)
b) (If Bank won't pay) judgment against garnishee
c) If defaults, can schedule garnishee for sheriff's sale

## II) Security And Foreclosure (Assignment 2)

A) Nature of Security
1) Security interest is a lien See article 9 of UCC, §101 of Bankruptcy: Lien: a charge against or an interest in property to secure payment of a debt or performance of an obligation.
a) Virtually anything recognized as property can be recognized as collateral. (Collateral defined 9-102 (12)).
2) Types of liens
a) Security interest: common contract. **Exemptions do not apply to security interests**, only judicial and statutory liens.
b) Statutory lien: like a mechanics lien
c) Judicial lien

B) Definition of security interest: § 1-201 (37)

1) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation.
2) Section has factors to consider to see if a lease is a security interest.
3) Leases and the UCC.
   a) 9-109 (a)(1): [scope of article 9]: the article applies to all transactions regardless of its form if it is a security interest. (Look t the transaction and see if it a security interest—is the lease a security interest)
   b) § 1-201(37): This section defines what a security interest is. (37) deals with leases; because the option to buy is only $10, it is a security interest.

C) Foreclosure is a process that operates on the ownership of collateral. It transfers ownership from the debtor to the purchaser at the foreclosure sale and cuts off the debtor's right to redeem. Foreclosure was originally the only way to get the value of the collateral
   a) Keeps debtor from being able to redeem the property at some later date (equity of redemption)
   b) Policy: it wasn't right for forecloser to keep the entire security upon default
      i) Because debtor has been filling up the property with his equity
      ii) Debtor would theoretically lose all equity upon failure to make the last payment
   c) One can't rely on documents and labels. A transaction is in the nature of security if the effect is to provide on party with an interest in the property of another, which interest is contingent upon the nonpayment of a debt.
   d) Under **§ 9-102**, if the transaction looks like security interest, then creditor must go through foreclosure proceedings.

D) Right of Redemption (Real Estate)
   1) Right to redeem cannot be waived or abandoned by any stipulation of the parties made at the time of mortgage, even if embodied in the mortgage.
   2) Creditor's sole remedy is to institute an action in foreclosure
   3) Debtor will have a right to redeem at any time prior to the actual sale of the premises by tendering to creditor the principal and interest due on the mortgage.
   4) Deed in lieu of foreclosure: Sign over the deed instead of making the lender go through the foreclosure process.
      a) So long as the instrument is one of security, the borrower has in a court of equity a right to redeem the property upon payment of the loan ***(Basile v. Erhal Holding Corp.*** (NY 1989))
      b) A deed conveying real property will be considered to be a mortgage when the instrument is executed as security for a debt.
      c) A deed in lieu must be done after default, not before the time of the mortgage. Have the borrower sign an affidavit that they know exactly what is happening and that their right to redemption will be forfeited.

E) Foreclosure Procedure
   1) Article 9 provides a uniform procedure for personal property foreclosure that can be very quick and easy, but also permits judicial foreclosure if preferred.

**2) Judicial Foreclosure**

a) Called *judicial* if it is accomplished by the entry of a court order
b) Court will set a date for the foreclosure sale, and the Court has to confirm the foreclosure.
c) Parties to the mortgage foreclosure case have some period of time in which to object to the manner in which it was actually conducted. Common objections:
   i) Sale was not advertised;
   ii) Someone was prevented from attending the sale or bidding;
   iii) Some arrangement between interested parties "chilled" the bidding; or
   iv) The highest bid was grossly inadequate
d) Disbursing the sale proceeds (in order)
   i) Foreclosing creditor
   ii) Junior lien creditors or mortgages
   iii) Debtor
e) Only when all issues have been resolved and plaintiff has established that he is entitled to foreclosure, will the court enter a *final judgment of foreclosure*.
f) Debtor will ordinarily remain in possession until sale has been confirmed. If the debtor will not then surrender the purchaser is entitled to a *writ of assistance*, which directs the sheriff to remove the debtor from the premises and put the purchaser in.

**3) Power of Sale Foreclosure**

a) About 25 states permit the mortgage lender and the borrower to opt for a quicker, simpler method of foreclosure against REAL property
   i) Include in the security agreement a "power of sale"
b) Deed of trust
   i) States that the collateral will be held in trust by the creditor or a third party such as a bank or title company
   ii) Borrower agrees that in the event of default, trustee can sell the property and pay the loan from the proceeds of the sale
   i) This does not alleviate the necessity of foreclosure, but does eliminate need for litigation

4) UCC Foreclosure by Sale of personal property

a) § 9-610(a): After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following **any commercially reasonable preparation** or processing.

b) § 9-623 (a): A debtor, any secondary obligor, or any other secured party or lienholder may redeem collateral.
   i) (b): [Requirements for redemption.] To redeem collateral, a person shall tender:
      (1) fulfillment of all obligations secured by the collateral; and
      (2) the reasonable expenses and attorney's fees described in Section 9- 615(a)(1).
   ii) (c): [When redemption may occur.] A redemption may occur at any time before a secured party:

(1) has collected collateral under Section 9-607;
(2) **has disposed of collateral** or entered into a contract for its disposition under Section 9-610; or
(3) has accepted collateral in full or partial satisfaction of the obligation it secures under Section 9-622.

c) § 9-617 (a): [Effects of disposition.] A secured party's disposition of collateral after default:
(1) **transfers to a transferee for value all of the debtor's rights in the collateral**;
(2) discharges the security interest under which the disposition is made; and
(3) discharges any subordinate security interest or other subordinate lien

## III) Repossession of Collateral (Assignment 3)

A) **Why** Secured Party Wants Possession Pending Foreclosure
1) Debtor may have little incentive to preserve and maintain the property;
2) The value of the use of the collateral between foreclosure and sale may be substantial; or
3) If the debtor is in possession of the property prior to the foreclosure, it may be difficult for purchasers to evaluate the property (depressing the resale price)

B) The Right to Possession Pending Foreclosure—Real Property
1) Debtor's Right to Possession During Foreclosure
a) **G/R**: Creditor cannot have possession prior to foreclosure (exception: receivership)
b) Various remedies by which purchasers get possession: Action for eviction or ejectment, Obtain a court order for removal, Writ of possession, Writ of assistance .
c) In some jurisdictions the purchaser must file an action for eviction or ejectment and obtain a court order for removal. In others the court can issue a writ of possession or writ of assistance on motion by the purchaser.
d) A defaulting debtor can nearly always count on retaining possession of the family homestead while the debtor struggles to save it from foreclosure

**2) Appointment of A Receiver**
a) Receiver would collect the rents and use the money to maintain the property, or to rent out the property as necessary
b) Courts rarely appoint receivers unless the terms of the mortgages provide for such appointments: The creditor should place into the original documents (the security agreement) that a receiver can be appointed.
c) Receiver typically takes possession of the collateral during the foreclosure sale and delivers possession directly to the purchaser at the foreclosure sale
d) The receiver is an officer of the court with fiduciary obligations to all who have an interest in the property: the receiver is often the creditor.
e) Once the court appoints the receiver, the court is involved at all times. The judge approves transactions to avoid impropriety.

3) Assignment of Rents

a) If the parties contemplate the that debtor will rent the collateral to others during the time of the mortgage, the mortgage is likely to include a provision by which the debtor assigns the rents from the property to the mortgagee as additional security.
   i) The creditor should, and usually does, state in the security agreement that upon default the creditor will get he rents, profits, ect.
b) Gives the mortgagee the right to collect the rents directly from the tenants in the event of default under the mortgage

C) **The Right to Possession Pending Foreclosure—<u>Personal Property</u>**

1) UCC favors secured parties in right to possession pending foreclosure.
2) **§ 9-609 gives the secured party the right to take possession immediately on default but the creditor cannot breach the peace**.
   a) No need to involve the courts unless the debtor objects and refuses to allow the property to leave

3) The Article 9 Right to **Self-Help Repossession**
   a) Derived from **§ 9-609:** 9-609(a)(2) provides that the creditor may **render equipment inoperable** and leave it with the debtor
      i) E.g. when the equipment is large and removal to a warehouse would be costly, secured creditor may remove key parts so that the equipment could not be used.
      ii) E.g. software with Revlon (entering through back door and activating a worm upon non-payment)

4) The Limits of Self-Help: Breach of the Peace
   a) **§ 9-609(b)(2)** permits self-help repossession only if the secured party can repossess <u>without</u> breach of the peace
      i) There can be no possibility of imminent violence.
      ii) Misrepresentation is OK if it avoids violence. The lawyer should not advise the clients to misrepresent.

   b) When the creditor cannot use self- help:
      i) Then the creditor should file an action for replevin and get the assistance of the sheriff to re-possess.

5) ***Salisbury Livestock Co. v. Colorado Central Credit Union***
   a) Confrontation or violence is not necessary to find a breach of the peace
   b) A demand for the property is unnecessary if such demand would be futile (requires factual finding that demand would have been futile)
   c) Trespass is not necessarily a breach of the peace

6) **<u>Replevin</u>**: Use this if unable to get possession: any party entitled to possession of tangible personal property is entitled to the writ.
   a) Directs the sheriff to take possession of the property from the debtor and give it to the creditor

b) To obtain this, creditor has to file a civil action against the debtor
c) Issuance of the writ is usually conditioned on the creditor posting a bond to protect the debtor in the event that the debtor ultimately prevails in the replevin action

7) Creditor can complete the foreclosure by selling the collateral in a commercially reasonable manner U.C.C. § 9-610. (See article 9 sale and deficiency).

8) Del's ***Big*** Saver ***Foods v. Carpenter Cook***
a) In the context of wages, a debtor's property may not be taken without notice and a prior hearing. Due process requires (1) that the debtor be provided a hearing before his property is taken, or (2) that the debtor be provided certain pre-seizure procedural safeguards.

9) Self-Help Against Accounts as Collateral (getting $ from people who own the debtor $)
a) The creditor will place into the security agreement that, upon default, it will have a right to collect the accounts. (the agreement has to provide for it).
b) **§ 9-102 (a)(2)** defines accounts receivable as merely accounts
c) **§ 9-607** allows the secured creditor who knows the identity of account debtors to simply send them written notices to pay directly to the secured creditor. Article 9 stops short of saying that the account debtor must follow the instructions of the debtor it is court law.
i) ***Marine Nat'l Bank v. Airco:*** Creditor may collect the account even though the result was that the account debtor had to pay (the $17K debt) twice
ii) Practical problems
- Sending of the letter suggests to the account debtors that the vendor is in financial trouble.
- There is no obligation on the art of the account debtors to pay the bank.
- The account debtor should ask questions because if they continue to pay the debtor, they may have to pay again to the creditor.
- If there is a court proceeding then the account debtor could possibly put the money in escrow for the court.

D) The debtor approaches the attorney after a default:
1) Try to work out a payment plan with the creditor. The creditor has an immediate right to possession. Advise the client to give the collateral back. Or, tell the client not to allow the items to be taken, force the judicial process.
2) Prob. 3.3: If the debtor attempts to hide collateral from creditors, it could adversely affect his ability to receive a discharge in Bankruptcy
a) Do not suggest to the client to conceal the property.
b) Bankruptcy Code: The debts will not be discharged if the debtor conceals any property.
c) If sheriff has the writ of replevin, then allow him to take the property
d) If no papers, no need to relinquish the property. Could tell the debtor to bring the sheriff to prevent repossession.
3) Also, notice rules of professional conduct, the lawyer cannot engage in fraud.

## IV) Judicial Sale and Deficiency (Assignment 4)

A) Strict Foreclosure
1) Some foreclosure proceedings do not require a sale of the collateral
2) Most common type of strict foreclosure is "contract for deed" or "installment land contract"
3) "Contract for deed" long recognized as a security device
   a) Is a court process, but no sale necessary
   b) if the debtor does not pay the full purchase price upon default, or within the statutory "grace period", the debtor's interest in the property is forfeited
   c) Title remains with the seller (court confirms this)
   d) Typically on sale of real estate for small down payment
   e) Occasionally, debtor forfeits substantial equity interest as well
      i) Subject of protective litigation

B) Foreclosure Sale Procedure
1) This type of sale applies more to real estate but can also apply to personal property.
2) Sale happens after foreclosure or execution on judgment (formal, regulated auction)
3) State statutes specify the manner in which sale must be held
4) Court officer (sheriff, clerk, etc) identifies the highest bidder
5) Purchase price must be paid within a few hours or days
6) Debtor may object to the sale on the grounds that
   a) Officer did not conduct the sale in accord with the law; OR
   b) That the sale price was inadequate

7) May prevent the reasonable price (explained in part C)
   a) Sales are poorly advertised, prospective buyers are given little opportunity to inspect, caveat emptor applies to the title, sales take place in hostile environment, buyer may be unable to use the property for the statutory redemption period.

8) Disbursement of proceeds of sale
   a) First to costs of sale (reimburse foreclosing creditor)
   b) Then to foreclosing creditor up to amount of debt secured by property
   **c)** Then to other lien holders in order of priority
   **d)** Any left over goes to debtor
   **e)** Debtor's exemptions only apply to judgment creditors

9) If the proceeds are not sufficient to pay all of debt to foreclosing creditor (FC), then FC can get deficiency judgment: can collect it in same manner as any unsecured debt

10) The common law right to redeem is cut off at time of sale (foreclosed). In half the states, the debtor also has a statutory right to redeem the collateral from the buyer after the sale.
11) Mortgage debtor has the right to redeem the property from the mortgage by paying the full amount due under the mortgage, including reasonable interest and attorneye's fees. This is common law right.

C) **Problems** with Foreclosure Sale Procedure

1) ***Armstrong v. Csurilla***

a) Debtor can only set aside the sale on the basis of a low price if the disparity is so great as to shock the court's conscience or when there are additional circumstances
b) Difficult to do: Easier to overturn sale on procedural irregularity.

2) Advertising

a) Regulated by state statute.
b) Wisc. Statute: posting written notice describing real estate to be sold with reasonable certainty in 3 public places in town where property is to be sold at least 3 weeks prior to sale date
c) Officer conducting sale rarely concerned about the purchase price.
d) Posters often select newspapers of limited circulation because the cost of running the ad is cheaper.
e) Rarely attracts buyers interested in owning the property

3) Inspection

a) Foreclosing creditor usually has the right to inspect (granted by the mortgage contract)
b) Others can observe the property from adjacent public places. BUT, have no right to enter the property. Therefore, they do not know what they are getting.

4) Title and Condition

a) Rule of *caveat emptor* still applies: buyers take subject to any defects of title that they could have discovered through search of public records or inspect of the property
b) ***Marino v. United Bank of Illinois, N.A.***
   i) Marino bid successfully on property about which he had asked the creditor's attorney. Did not investigate whether there were any encumbrances on the property
   ii) Buyer has no right to set aside the sale when he had not been notified of interests superior to his own. He was responsible for researching title and he failed to do so
   iii) Caveat emptor unless there was fraud, misrepresentation or mistake of fact
   iv) To establish fraudulent misrepresentation
      - Must show false statement of fact made by D;
      - D's knowledge or belief that the statement is false;
      - D's intent to induce P to act;
      - An action by P in justifiable reliance on that statement; and
      - Damage to P resulting from such reliance.
   v) Caveat Emptor can also apply when property bought was environmentally contaminated and clean-up costs were in excess of value of property

5) Hostile Situation
   a) Judicial sales take place in hostile environment
   b) Often no one with a motive or an obligation to furnish information to prospective purchasers.
   c) Officer may have liability for furnishing incorrect information: As a result: most have little to say about the condition of the property or the terms of the sale.
   d) Debtor's best strategy: provoke some procedural irregularity in the sale and litigate over it as a means of delay.
   e) Possibility that after the bidding is concluded, but before the buyer can be put into possession, the debtor will destroy the property.
   f) Courts recognize that the more they overturn, the riskier it will be to bid and the lower the prices will be.

6) The Statutory Right to Redeem
   a) Must pay the price the bidder paid to purchase the property
   b) Bidder may have to wait months or years for possession
   c) Debtor can later redeem the property, making buyers reluctant to make improvements to the property for which they would not be reimbursed

D) Anti-Deficiency Statutes
1) Either
   a) Prohibit the court from granting deficiency judgments in particular circumstances;
   b) Give the court the discretion to refuse to grant them; or
   c) Limit the amount of the deficiencies to be granted.
2) Does not address the plight of the debtor who has substantial equity in property but loses it through a forced sale of the property for an inadequate price.
3) Most common type: credits the debtor for the FMV of the property even if the property brings a below market price at sale

E) **Credit Bidding** at Judicial Sales
1) Foreclosing creditor allowed to bid on credit (up to the amount of the debt) instead of having to pay cash at the sale
2) The foreclosing creditor's advantages to bidding: will know of the sale even if poorly advertised, may be familiar with title and condition of the property already, may have an enforceable contractual right to inspect.
3) Advantages to creditor who makes a high credit bid: minimizes the risk that the sale will be set aside for inadequacy of price; minimizes the likelihood that the debtor will exercise his statutory right to redeem.
4) Only motivated to bid to the value of the debt
   a) If the property is worth less than the debt, assume that the debtor is liable for the deficiency
      i) Lower the bid = higher the deficiency
      ii) Should creditor be allowed to collect the deficiency?

5) Prob. 4.1: Balance on mortgage $53K, value of property $45K.

a) Bid up to $45K -- could not get deficiency judgment after sale
b) If bid $10K, lawsuit from debtor (lack of appropriate value)
c) Can bid up to the value of the property: would guarantee that attack of sale would not happen
d) Could also bid up to entire mortgage amount: this would make debtor pay the full mortgage in order to use his right to redeem
e) If another bidder bids $46 K
   i) Allows Mortgagor to get full value of property plus $1K more
   ii) Buyer pays costs of sale: if costs are $2K secured creditor only gets $44K

F) Bidding
1) Classic bidding strategy: do **protective bid** (to protect own interests)
   a) Lesser of value of property **or** costs plus debt
2) If sole bidder
   a) Bid just costs: will be sued because not fair price
   b) Statute says 50-75% of value okay: if bid low on that: gets the property, gets deficiency judgment for balance, also gets to do "credit bid" for amount they paid at sheriff sale
   c) Should bid the minimum amount to avoid debtor contesting the sale
3) If there's a competing bidder (CB)
   a) **Maximize what we get AT the sale**
      i) If also get property and make a profit, even better
      ii) If CB bids half value of property: then get $9M less costs for sale, difference between deficiency and$9M, BUT don't get the property
         • Difference between getting $9M today and having to pursue guarantors for the balance; and
         • Getting more today and having to pursue later

## V) Article 9 Sale and Deficiency (Assignment 5)

B) Article 9 Sale outline:
1) 9-610: Disposition after default: commercially reasonable
2) 9-611: Notice: creditor must give notice to the debtor
3) 9-612: Timeliness of notice: 10 days or more before disposition
4) 9-613: General form of the notice
5) 9-614: Form of notice: consumer goods
6) 9-615: application of proceeds (order of priority)
7) 9-626: deficiency: consumer transaction deficiency is left up to the courts

C) Requirement that property be sold cannot be waived in the initial security agreement. 9-602(10), 9-620. The debtor has a right to have the collateral sold.
1) The debtor can consent, after default, to the secured party retaining the collateral in full or in partial satisfaction of the obligation it secures. (Consent will not be real)
   a) UCC 620(c)(2) implies consent if the secured party sends the debtor a proposal for retention of the collateral in full satisfaction of the debt and does not receive notification of rejection w/i 20 days.

b) Right to consent is subject to three conditions
   i) There must be no objection from others holding liens against the collateral.
   ii) If the collateral is consumer goods the debtor can consent, in writing or by silence, to strict foreclosure only after repossession. UCC 9-620(a)
   iii) Strict foreclosure is not permitted if the debtor has paid 60% on consumer goods purchased on credit or 60 % of the loan against other consumer goods.
c) § 620(c)(1): partial satisfaction requires an authenticated record after default: no implied consent.

D) Sale Procedure under Article 9 (**§ 9-610**)

1) Secured party gets possession: can fix up to sell (the secured party conducts the sale, not like judicial foreclosure).
   a) 9-610 (a): After default, a secured party **may** sell, lease, license, or otherwise **dispose** of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.
   b) 9-610 (b) gives broad latitude to determine the method and timing of the sale. But must be **commercially reasonable. (see cmt. 4)**
      i) Creditor can sell at public or private sale, as long as it is commercially reasonable.
   c) (c) A secured party may purchase collateral:
      i) (1) at a public disposition; or
      ii) (2) at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

2) § 9-611(c)(1) requires the creditor to give the debtor prior notice of the sale to the debtor, secondary obligors, and, if consumer goods, anyone else who has notified the creditor of an interest. Purpose: to enable debtor to observe the sale, participate in it, or otherwise protect its rights.
   a) § 9-611(d): exception for perishables.
   b) § 9-612: reasonable time for notice is a question of fact. Except for consumer transactions, notice 10 days before the sale is a reasonable time.
   c) § 9-613: gives the contents and form of notice for non-consumer transactions.
   d) § 9-614: gives contents and form of notice for consumer transactions.
   e) Notice provision cannot be waived except by a post default authenticated agreement. (9-624(a)). But 9-603 gives the parties the ability to contract for standards: Could set what is a reasonable time as long as it is not manifestly unreasonable.

3) § 9-623 incorporates common law right to redeem (see page 5).
   a) Redemption accomplished by paying full amount of debt plus the secured creditor's attorneys fees and expenses of sale.
   b) If the only defect in the sale is that it was commercially unreasonable, the debtor is likely to be left with merely the right to sue the creditor for damages.

E) Problems with Article 9 Sale Procedure

**1)** Failure to Sell the Collateral
   a) § 9-610(a) provides that a secured party *may* sell the collateral after default
   b) If the secured creditor's delay in selling is commercially unreasonable, the secured creditor's deficiency will be limited to the amount that would have been left owing if the sale had be commercially reasonable. 9-626(a)

2) The Requirement of **Notice** of Sale: **9-611** requires that the secured party send notice to the debtor, guarantors, and some lienors.
   a) ***FDIC v. Lanier*** (5th Cir. 1991)
      i) Notice is not defective b/c it fails to identify the goods to be sold. Notice, here, also indicated to P that property won't be sold before a certain date
      ii) **§ 9-613(1)(c)** provides that creditor must indicate time and date of public sale.
      iii) Requirements are less stringent for private sale: Creditor need only provide notice of the time after which any private sale is to be made.
   b) There is an exception for notice when the collateral is perishable.
   c) Notice can be waived only after a post-default agreement (not in the original security agreement).

3) The Requirement of a **Commercially Reasonable** Sale
   a) **9-610(b)** requires that "every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable.
   b) ***Chavers v. Frazier*** (Bankr. MD Tenn. 1989)
      i) Issue: Whether sale of aircraft within one month of repossession with only one week of advertisement at a public sale was commercially reasonable
      ii) No. Deficiency is inappropriate when sale is hasty, used inadequate advertising, hinted at a "distress sale", failed to provide maintenance records, and obtained inadequate purchase price.
      iii) Shows the stark contrast between Art. 9 and judicial sale cases (where all of this would have been reasonable)
      iv) Simply choosing a public auction as the means to sell the collateral is not per se reasonable

F) Deficiency
   1) The debtor has to put the amount of the deficiency in issue (9-626 (a)(1)).
   2) § 9-626: (3) Basically, if the secured party fails to act in a commercially reasonable manner, the deficiency is limited to an amount by which the sum of the secured obligation, expenses, and attorney's fees exceeds the greater of:
   (A) the proceeds of the collection, enforcement, disposition, or acceptance; or
   (B) the amount of proceeds that **would have been realized** had the creditor acted in a commercially reasonably manner
   3) (4) For purposes of paragraph (3)(B), the amount of proceeds that would have been realized is equal to the sum of the secured obligation, expenses, and attorney's fees unless the secured party proves that the amount is less than that sum.

# Creditors' Remedies in Bankruptcy

## I) Bankruptcy and the automatic stay

A) Types of Bankruptcy

1) Chapter 7 (liquidation): Chapter 7 debtor is entitled to keep the property of the bankruptcy estate that would have been exempt from creditors' remedies on a judgment under state law. In addition, in some states, debtors have the option to exempt the property listed in §522(d) instead of the property exempt from execution under state law.

2) Chapter 11 (reorganization for business)
3) Chapter 12 reorganization of family farms
4) Chapter 13 (reorganization only for individuals)

B) Bankruptcy and the Automatic Stay (**BR § 362**): Stopping Creditors' Collection Activities

1) Forms are filed with the clerk of the bankruptcy court. Upon receiving the forms the clerk stamps the front page with the date and time filing. At that instant, a bankruptcy estate is created, and a stay against any collection is automatically imposed.
2) § 362 provides a stay against collecting **any pre-petition debt** (all debts arising before the filing of the bankruptcy).
   a) Automatic stay applies to all assets that are subject of the bankruptcy, which is all property that the debtor has an interest in (541 (a)(1))
   b) Prevents direct collection attempts (e.g., levying against the property) as well as indirect attempts (e.g., initiating a lawsuit to establish the debtor's liability on a debt as a prerequisite to eventual collection).
   c) Automatic stay applies to all actions including judgments (362(a)(2)) and the sheriff attempting to collect. Entity includes a person or the government (101(15))

3) Limitations
   a) Does not prevent criminal proceedings against the debtor.
   b) Does not prevent government from collecting fines and penalties assessed as a result of debtor's continuing violations of government regulations (e.g., FAA safety restrictions).
   c) Only actions to collect pre-filing obligations are stayed.
4) Automatic stay remains in effect for entire proceeding as against unsecured creditors.

C) **Lifting the Stay for Secured Creditors**

1) Initially, the creditor should file a proof of claim (501(a). This is the amount of the claim as of the date of the filing of the petition.
2) **§ 362(d)** provides grounds for lifting stay for secured creditors
   a) If trustee or debtor does not provide the creditor with adequate protection (defined under § 361); or
   b) Even with adequate protection, if
      i) There is no equity in the collateral in the hands of the debtor; and
      ii) The collateral is not necessary to an effective reorganization

3) If the court does not act o a motion for relief from the stay within 30 days, the stay is automatically lifted (362(e)).

4) **Cushion** of **equity:** excess of the collateral's value over the loan amount.
   a) BR courts recognize that a sufficient cushion alone will adequately protect a secured creditor against loss
   b) To determine how large it must be to be "sufficient," consider:
      i) The nature of factors that might change the value of the collateral;
      ii) The volatility of the market in which the creditor might have to sell it; and
      iii) The rate at which the secured debt is likely to increase in amount.

5) ***In re Craddock-Terry Shoe Corp*** (Bankr. WD Va 1988)
   a) Shoe corp in BR. Creditors have security interest in mailing list, which they say is declining in value. They want: 1) lift of automatic stay; or 2) adequate protection
   b) H: Creditors are entitled to adequate protection for all decline in value of collateral since date of petition. Replacement liens in remaining assets are fine.
      i) No lift of automatic stay because the collateral is necessary for a reorganization

## II) The Treatment of Secured Creditors in BR

A) The Vocabulary of BR Claims
   1) Non-recourse debt -- cannot be enforced against the debtor
      a) Discharged
      b) **But,** if it was secured, the security interest continues to encumber the property following bankruptcy
         i) If not paid after BR, then creditor can foreclose then
         ii) If the proceeds are insufficient to satisfy the debt, too bad
            - Creditor cannot get deficiency against debtor because debtor no longer owes the debt (discharged)

B) The Claims Process
   1) BR § 101(5) defines claim: the claim is the total amount owed, not just the current payment.
   2) **BR § 502** determines the value of each allowable claim in the BR proceeding-- the amount the creditors were owed under non-bankruptcy law as of the date of bankruptcy.
   3) Proof of claim: if uncontested, it's allowed (its usually not contested)
      a) If contested then could have jury trial
      b) If the debtor outside of bankruptcy had a legal defense to payment, the bankruptcy estate will have the same defense. §558
   4) §507 gives some groups of unsecured creditors priority over others

C) Calculating the Amount of an **Unsecured** Claim
   1) As of the moment of filing, each unsecured creditor is entitled to a pro rata share of a fixed pool of assets
   2) Cannot collect unaccrued interest or costs.

D) **Calculating the Amount of a Secured Claim**

1) **BR § 506** determining secured status: how to figure and allow a secured claim
   a) (a) lesser of the claim **or** the value of the collateral
2) If the collateral is worth less than the amount of debt, bifurcate the claim
   a) Part is secured (up to the value of the property)
   b) And the remainder is unsecured
3) **BR § 506(b)**: allows the secured creditor to get post-petition interest, attorney fees or costs on its claim if 3 conditions are met:
   a) Attorneys fees and costs must be reasonable;
   b) Payment of them by the debtor must be provided for under the agreement under which the claim arose; and
   c) Can only be accrued to the extent that the secured creditor is over secured.
      i) To the extent that the value exceeds the amount of the claim secured by this property. Or, up to the amount of the collateral.

E) **Selling the Collateral by the trustee**

1) Judicial sales procedures are often grossly inefficient to maximize the sale price.
2) When the trustee liquidates the property of the estate, ordinarily only sells the debtor's equity in the property **subject to** a security interest, because that is all the trustee has access to under BR § 541(a)
3) The sale of the property would terminate the automatic stay.
4) BR § 554(a) allows trustee to abandon property that is burdensome or of inconsequential value to the estate (e.g., debtor has bare title to it).
   a) Abandonment also terminates the stay
5) The trustee can also sell the property free and clear of the security interest if it complies with the provisions in BR § 363 (f). This is covered in assignment 27.

F) Who Pays the Expenses of Sale by the Trustee

1) Absent benefit to the secured creditor from the creditor's expenditures, the trustee cannot deduct anything from the proceeds of the sale.
   a) To determine "benefit," court compares what actually happened to what would have happened if the stay had been lifted.
2) BR 506(c) authorizes a trustee who has incurred "reasonable necessary cost and expenses of preserving, or disposing of property securing an allowed secured claim to recover.

G) Chapters 11 & 13 Reorganizations

1) Confirmation of the plan: discharges the old secured debts and substitutes new ones.
2) Standards for cram-down: confirmation of a plan to which the creditor has not agreed.
   a) Ch. 13 (§ 1325): unless the secured party accepts the plan, the debtor must either:
      i) Surrender the collateral to the secured creditor in satisfaction of the secured claim; or
      ii) Distribute to the creditor property with a value as of the effective date of the plan that is not less than the amount of the secured claim
         - Determine the amount of the allowed claim
         - Value the proposed distribution
         - Determine that the latter is at least as great as the former
      iii) Can pay over time, and can pay in a form other than cash

H) Valuing Future Payments

1) Not sufficient that the payments equal the *amount* of the allowed claim, they must have value as of the effective date of the plan. This concept is known as the **time value of money.** Have to include interest in the payouts

2) THUS, when designing Ch. 11 or Ch. 13 plan, do so by reference to distribution in Ch. 7. That is the minimum amount.

3) ***In re E.I.*** **Parks**

a) Mortgage holder's claim was included in a plan for reorganization of Ä's business. Was fully secured. Under cram-down plan, debtor agreed to pay the full debt, amortized over 30 years, but payable in 10 years, under the treasury rates, plus an additional 2% interest for risk.

b) Whether secured creditor could block the plan because the plan would not give SC the same interest rate it would have chosen to loan for such a high risk

c) Court held Calculating the market rate of interest solely from the viewpoint of the (coerced) creditor tends to jeopardize the success of a Chapter 11 plan and defeat the rehabilitative purpose of BR reorganization.

# Creation of Security Interests

## I) Formalities for Attachment (Assignment 8)

A) **§ 9-203(b)** Requirements for Attachment: Formalities for Article 9 Security Interests

1) Collateral must be in possession of secured party **OR** the debtor must have authenticated a security agreement which contains a description of the collateral.

2) Value must have been given; AND

3) Debtor must have rights in the collateral

-- Only when these three requirements are met does the security interest attach to the collateral and be enforceable against the debtor.

B) Security agreement and financing statement

1) Financing statement: this is what is filed to let others know of the debt.

a) The security agreement can be filed by the financing statement.

b) Financing statements are not now signed.

c) File these statements with the secretary of state.

2) Security agreement

a) The collateral must be described in the security agreement (But see the composite doctrine rule on p. 164)

b) The security agreement attaches to the collateral when value is given, the debtor has rights in the collateral, and the security agreement is signed (9-203).

3) When can the description be made
   a) If there is no description in the security interest, it does not attach. It does not attach until the description is made.
   b) Can include the description later in some jurisdictions. (these courts say that the sequence of events is immaterial).

C) When a debtor has signed a security agreement, the §9-203(b)(3)(A) requirement of an authenticated security agreement is fulfilled.

D) Formalities of article 9 security interests
   1) Possession
      a) Even if oral agreement to create security agreement (E.g., pawnshop) if debtor does not redeem the property by paying off the loan, the pawnbroker sells the collateral and keeps the proceeds of sale.

   2) Writing -- most agreements are in writing, but the secured creditor takes possession of the goods pursuant to an oral agreement to create a security interest
      a) Security agreement
         i) Must be signed by debtor
         ii) Must contain description of collateral
      b) ***In re Ace Lumber Supply***
         i) Demonstrates the consequences of failing to obtain a signed security agreement. Debtor borrowed $ from creditor; did not sign security agreement. Instead, merely filed a financing statement with the UCC
         ii) Issue: Whether Debtor executed a security agreement in favor of the creditor to entitle creditor to perfect a security interest in Debtor's property, accounts receivable and equipment.
         iii) Court held there is simply no language in the only written instrument filed by Debtor (financing statement) which embodies any intent to create a security agreement.
         iv) Court recognized but did not apply the **Composite document rule** is available to provide evidentiary support to create a security interest in collateral: BUT, financing statement alone is insufficient
         v) **Composite doctrine rule**: Read the promissory note, the financing statement, and correspondence between the parties together to arrive at a security agreement. Then see the testimony of the parties to see if they actually intended to create a security agreement.

   3) Justification for the requirement of an authenticated security agreement
      a) Preventing fraud
      b) Minimizing litigation
      c) Cautioning debtors
      d) Channeling transactions
      e) Discouraging secured credit.

E) Value has to have been given

1) Value in **§ 1-201(44)** defined extremely broadly
   a) Includes consideration in contracts.
   b) Also includes consideration for pre-existing debt: to now secure an outstanding unsecured debt.
   c) Can include a binding commitment on bank to lend.

F) The Debtor has Rights in the Collateral
1) **§ 9-203**: debtor cannot grant security interest in someone else's property: three subtexts:
   a) If debtor owns limited property interest, the security interest will only attach to that limited right (*nemo dat*) (he who hath not, cannot give)
   b) Some "owners" who acquired their rights by fraud have the power to transfer to a bona fide purchaser ownership rights that they did not themselves have
      i) **§ 2-403:** Transfers good title to a good faith purchaser for value.
   c) Discussions about time at which the interest becomes enforceable: the security agreement does not become enforceable until the instant the debtor has rights in the collateral.

2) § 2-501(1): The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are non-conforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs
   a) (a) when the contract is made if it is for the sale of goods already existing and identified;
   b) (b) if the contract is for the sale of future goods other than those described in paragraph
   c) c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers;
   d) (c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve months after contracting or for the sale of crops to be harvested within twelve months or the next normal harvest season after contracting whichever is longer.

G) Formalities for Real Estate Mortgages
1) Differ from state to state: Most states require that the mortgage be in writing and signed by the debtor in the presence of one or more witnesses.
2) Ohio Statute
   a) Acknowledgement of deeds, mortgages, land contracts and leases
   b) Requirements for attachment (?)

## II) What Collateral and Obligations are Covered (assignment 9)

A) In most security agreements there will be two descriptions of collateral:
1) In security agreement: this is the one discussed in this section.
2) In financing statement to be filed in public record (assignment 18).

B) Interpreting Security Agreements

1) Debtor against creditor: the security agreement is a contract between the debtor and the creditor: § 9-102 (a)(73) (K rules of interpretation)
   a) The court will determine the intent of the parties.
   b) Where the security agreement is ambiguous, parol evidence may be introduced.
   c) Where the writing results from a mutual mistake, the security agreement may be reformed.

2) Creditor Against Third Party
   a) **§ 9-201(a)**: can bind third parties, but courts read the terms of the security agreement literally. The secured party takes collateral that others were counting on for collateral.

3) Interpreting Descriptions of Collateral
   a) **Categories of collateral**
      i) § 9-102 (a)(2) accounts: bank accounts usually not included.
      ii) § 9-102 (a)(33) equipment: could include racehorse
      iii) § 9-102 (a)(48) inventory
      iv) § 9-102 (a)(47) instruments
      v) § 9-102(a)(23) consumer goods
      vi) § 9-102(a)(42) general intangibles: could include liquor license

   b) When the parties use one of the above terms in a security agreement, the courts usually (but not always) give the terms their Article 9 rather than their common meaning.
      i) However, authors of the book believe that a better view is that words used in a security agreement, should be assigned the meaning that the parties intended in using them.
   c) Application of the new or old Article 9 for definitions
      i) Example: there is a different definition for account.
      ii) The new Article 9 applies to old security agreements except as 9-702 provides exceptions (some courts).
      iii) Some courts look at the understanding of the parties.
      iv) 9-701 is the transition section in the statute.

C) Sufficiency of Description: Article 9 Security Agreements

1) Purpose of description is to enable interested parties to identify the collateral
2) ***In re Ziluck***
   a) Security agreement said interest claimed in "all merchandise charged to your account."
   b) Issue: whether the security interest has attached and thereby has become perfected under § 9-308(a)
   c) Court held that the description does not provide any details which would enable a 3d party to identify the assets covered by the security agreement under **§ 9-203(b)(3)**
   d) Hypothetical lien creditor status.
   e) The description of collateral in a security agreement must be more specific than that required in a financing statement

3) After this case, Article 9 was amended to state that "A description of collateral as all the debtors assets or all the debtor's personal property or similar words does not reasonably identify collateral. §9-108(c).
   a) Why should descriptions that say "all of the debtor's property be invalid?
      i) The debtor wouldn't be able to get future loans.
      ii) The debtor wouldn't be able to sell his property until he got a waiver.
      iii) Adds to confusion: is it after acquired, it is his.
      iv) Protective measure for the debtor.

D) Describing After-Acquired Property (AAP)
1) AAP: refers to property that a debtor acquires after the security interest is created. § 9-204(a) allows after acquired property to be included in the security agreement; still have to be descriptive of what property is covered.
2) Accounts and inventory that are generated after the security agreement is signed are AAP.
3) ***Stoumbos v. Kilimnik.***
   a) Security agreement provided for after acquired language with respect to accounts receivable. Kilimnik argues that the court should find that this interest automatically extends to after acquired inventory.
   b) The majority view is that no express language is required because inventory is constantly turning over, and no creditor could reasonably agree to be secured by an asset that would vanish.
   c) Court held that the Purchase agreement does not contain the usual language granting a security interest in all inventory but only in the items specifically described in paragraph 1.

4) Because additional acquisitions of collateral covered by the after-acquired property clause are simply a windfall to the creditor, the clauses become ineffective upon the filing of a BR case BR § 552(a))

E) Sufficiency of Description: Real Estate Mortgages
1) Mortgage must describe the land sufficiently to identify it
2) Frequently described in reference to a plat map
3) Permanent buildings and other structures permanently affixed to the land (known as *fixtures*) become part of the real estate: THUS, in a sense, every real estate mortgage automatically reaches "after affixed" property.

F) What Obligations Are Secured
1) Virtually any obligation can be secured if the parties make their **intention** clear.
2) Secures any existing debt in that amount.
3) Can also secure a debt that does not yet exist but which the parties contemplate will come into existence in the future.
   a) If the future obligation will come into existence as the result of an additional extension of credit by the secured creditor, it is a **future advance § 9-204**(c))
   b) ***Dragnet clauses***: clauses purporting to secure every obligation to the secured creditor of any kind that may come into existence in the future.

i) If the creditor loans additional money, a security agreement with such a future advance clause will assure that the subsequent loan is secured from its inception.

ii) Some states disfavor the use of dragnet clauses by demanding strict proof that the later advance is one that was in the contemplation of the parties at the time they executed the real estate mortgage.

iii) Some states require that a recorded mortgage indicate a maximum amount of indebtedness to be secured.

## III) Proceeds, Products, and Other Value-Tracing Concepts

A) Proceeds

1) When a debtor and creditor anticipate transformations in collateral, they usually chose to have the security interest continue in the collateral as it changes form (requires **tracing**) or, if the debtor disposes to a third party, to have the security interest attach to whatever the debtor receives in return (replacement collateral).

2) No worries when replacement collateral is of a type already covered by the security agreement

3) **Value tracing concepts**: certain kinds of transformations of the collateral should follow the value in prescribed ways: proceeds, products, rents, profits, and offspring

4) Proceeds Definition

a) § 9-102 (a)(64) defines proceeds as "whatever is acquired on the sale, lease, license, exchange or other disposition of collateral". (**see the definition and comment**)

b) Including rights arising out of collateral are considered proceeds. 9-102 (a)(64)(c).

c) Secured creditor should include all possible transformations in security agreement. Even if the security agreement makes no mention of proceeds, a **security interest automatically covers them.** 9-203(f) and 9-315(a). (after acquired is not automatically included but it may be implied).

5) When the disposition is authorized by secured creditor, SP agrees to release its security interest in the collateral, attaching to proceeds instead.

a) If not authorized, then SA continues in the collateral notwithstanding the disposition.

6) Continuation of Security Interest After Unauthorized Disposition of Collateral

a) Illinois Statute

i) Where the debtor willfully and wrongfully fails to pay the proceeds to the secured party, an unauthorized sale is a crime.

b) Even if the security agreement expressly prohibits sale of the collateral, the debtor has the power under 9-401 to transfer ownership to a buyer.

i) Must be read with 9-315(a)(1) which provides that a security interest "continues in collateral not withstanding sale."

ii) Unless the secured party has authorized the debtor to sell the collateral free of the security interest, the security interest continued in the original collateral and also in the proceeds 9-315(a)

iii) Exception if creditor had known about it and had not objected.

7) Limitations on the Secured Creditor's Ability to Trace Collateral (bank accounts)

a) Security interest continues to encumber proceeds only so long as they remain **"identifiable"** (§ 9-315(a)(2): remains perfected

b) Tracing is most often required when the debtor *commingles* cash proceeds with other money in a bank account

c) **Lowest Intermediate Balance Test**:

i) The amount of collateral remaining in the account is equal to the lowest balance of all funds in the account between the time the collateral was deposited to the account and the time the test is applied

ii) Example:

| *Description* | *Deposit* | *Withdrawal* | ***Balance*** |
|---|---|---|---|
| Opening Balance | | | $ 3,000 |
| Sale of Ford Prefect (collateral) | 12,000 | | 15,000 |
| Tuition Payment | | 11,000 | **4,000** |
| Student Loan | 6,000 | | 10,000 |
| Books | | 5,000 | 5,000 |

iii) Lowest intermediate balance between selling the collateral ($12,000) and the closing balance ($5,000) --> $4,000

B) Other Value-Tracing Concepts

1) **Product**: what the collateral produces.
   a) Most commonly used in the context of agriculture
   b) Wool is the product of sheep; milk of cows, etc.
   c) These products may also be proceeds of the collateral named because they "arise out of collateral" 9-102 (a)(64).

2) **Profit**: describes the excess of revenues over the expenses where the business itself is the collateral (Technical: the right to go to someone's land and take something).
3) **Rents**: received for the use of collateral
4) **Offspring**: most often used with regard to animals
   a) E.g. calf is offspring of cow (although may also be thought of as a product of a cow).

Even if a description of collateral does not mention proceeds, their inclusion is implied. 9-203 (f)

C) Non-value-tracing Concepts

1) E.g., AAP, replacements, additions, substitutions
2) Don't need to know the source of the AAP, etc.: Just need to know that they fit the description in the security agreement, and that debtor owns them.

## IV) Tracing Collateral Value During Bankruptcy (assignment 11)

A) Distinguishing Proceeds from After-Acquired Property

**1)** Bankruptcy Code § 552(a): After a bankruptcy is filed, if the debtor somehow gets more property, the security interest does not extend to that new property. **Cannot attach to after acquired property.**

a) (b): List the things that the creditor can attach to after the claim is filed: proceeds, product, offspring, or profits.

b) Policy: The creditor cannot acquire additional collateral value during bankruptcy. Bankruptcy will not prefer one creditor over another: any after acquired property is up for grabs among all of the creditors.

2) ***In re Delbridge*** (Bankr. E.D. Mich. 1986)

a) Farmer was in Ch. 11. Had dairy cows, subject to a lien for products, proceeds, etc.

b) Issue: Whether milk which comes into existence post-petition is a "product" of the cow

c) Use the formula to allocate that which the farmer's post petition labor produced, and that which the cow produced pre-petition (Security interest follows products under §552(b)).

$$CC = \frac{D}{D + E + L} \times P$$

**KEY:** CC = cash collateral
D = average depreciation of cow
E = expenses for food, etc
L = FMV (avg) for farmer's labor
P = average cash proceeds/ price of milk sold

d) Collateral is cow (pre-petition ingredient)

**e)** Fee & farmer's labor is post-petition, the court makes a decision based on the equities: **G/R: the court will do some kind of balancing and consider the value put in by the creditor and the value put in by the debtor.**

f) Amended Bankruptcy Code §552(b) to make clear that a security interest could extend to room revenues.

3) ***In re Hotel Sierra Vista.***

a) Bankruptcy court concluded that the post petition room revenues were cash collateral. Issue: Can the creditor attach to money brought in by the hotel selling rooms?

i) The court says that the money is part of the service and not proceeds of the property (1994 amendment changed the language). Now the court says only the net revenues go to the creditor. The difference between the service revenue and the room revenue.

b) Chequers had not met the burden of probing the "extent" of its interest as required by §362(o)(2).

c) What a party seeking to prove the extent of its interest under 363 must do:

i) Must prove that it holds a perfected security interest in post-petition revenues to which a lien attaches.

ii) Must prove the amount of money to which the liens attach

d) If a property is "proceeds" under Article 9 does not mean that it is proceeds under Bankruptcy Code §552(b).

B) "Cash Collateral" in Bankruptcy

1) **BR § 363**: debtor or trustee in a bankruptcy case is generally permitted to use the secured creditor's collateral. §363(c)(1): highly liquid collateral is referred to as cash collateral. If the cash collateral were cut off, the business would go under and the reorganization would be frustrated.

a) This is the most available stuff to use for the reorganization. If you cut off the cash collateral then the business will go under

2) If the debtor wants to use the cash collateral for the reorganization, must provide secured creditor with adequate protection against loss or decline in value: some other piece of property.

a) If cash, court can order that secured party be given an additional lien in inventory, eg., as adequate protection

3) BR Code requires that debtor give the secured creditor notice and opportunity for a **hearing** before it uses cash collateral.

## V) The Legal Limits on What May be Collateral (assignment 12)

A) Basics: **§ 9-102**: For most businesses, equipment, inventory, accounts, chattel paper, instruments, money, and general intangibles will cover everything.

1) Transactions involving some kinds of collateral, such as real estate and insurance are excluded from the Article 9.

2) Cannot be “all personal property owned by the debtor.”

B) **Property That Cannot be Collateral**

1) Property of a Personal Nature

a) E.g. false teeth, artificial limbs, personal clothing, furniture, appliances and household furnishings (So long as they are not of substantial value).

b) There is public policy against having personal nature property serve as collateral even though Article 9 allows it.

c) In order to be avoidable under **BR § 522**, the property must be both exempt and of a type listed in BR § 522(f)(2)

i) Exemption laws usually protect homes and automobiles: BR § 522 protects neither

ii) 552(f) authorizes avoidance of a lien that "impairs an exemption to which the debtor would have been entitled" were the lien not in existence.

d) FTC Trade Regulation

i) Cannot take a security interest in several types of items: wages, several household goods, health care aid (these apply to non-purchase $ security interests). Lists definitions of household goods

ii) Unfair credit practices

iii) Protects wages and household goods

e) Purchase $ security interest:

i) The creditor gives you the money to buy the specific item (TV) and the creditor takes an interest in the item (TV)

ii) Non-purchase $ security interest: Loan $ for one thing but the creditor takes an interest in other goods.

2) Future Income of Individuals (assignment of wages)

a) **§ 9-109(d)(3)**: does not apply to an attempt to create a security interest in income.

b) State laws vary on the extent to which they will permit wage assignments: Highly restricted.

c) Once an individual debtor files for BR, any encumbrance of his/her earnings from personal services performed after the commencement of BR is immediately void and unenforceable.

3) Pension Rights

a) The requirements that make Pension Plans eligible for tax breaks also makes them ineligible to serve as collateral for a loan. Public policy and ERISA do not allow security interests in pension plans even though Article 9 allows.

b) **In re Green**

i) Debtor had pension-type fund from employer, governed by ERISA. Had entered into a security agreement with bank, giving Bank security interest in the fund. Issue: Whether the fund is eligible to serve as collateral and transfer to Bank upon default.

ii) Cannot transfer. Although by other standards, perfected security interest should attach (Article 9 allows), the anti-alienation provisions in the profit sharing fund as required by ERISA and IRC prevents use of this fund as collateral.

c) 29 USCA § 1056(d): Assignment/Alienation: prohibited.

C) Future Property as Collateral

1) A business debtor (corporation or individual) can encumber future earnings of the business

a) Does this by encumbering accounts

b) After-acquired property clause cease to be effective once the debtor files Bankruptcy.

2) A business that has thus encumbered its future earnings can escape the encumbrance by filing BR.

a) Creditor would thus only be entitled to proceeds, products, offspring, rents, or profits of the collateral, existing at the time of the filing (BR § 552(a)).

D) Valuable Non-property as Collateral
1) If the subject of the transaction is not recognized as "property" the debtor & creditor can't create a security interest in it: classified as privileges, mere expectancies.
2) Most common type: licenses
a) Gov't theoretically prohibits the transfer of the license right or the medallion and retains the right to revoke it any time it ceases to be for the public convenience.

3) ***In re SRJ Enterprises***
a) Debtor had Nissan franchise. Upon Ch. 11, Debtor sold all assets to Buyer. Buyer also gave Debtor $125K to terminate his franchise license. The debtor claims that the license cannot be subject to a security interest because it is not property (article 9 requires that a security interest be in property). Issue: Whether this termination fee was proceeds of pre-petition value and whether that value is encumbered.
i) Ridgely court: even though the license is not property, there is some right and value to the license and so it can be collateral and the proceeds can be traced.
ii) Other court: You cannot encumber a license (b/c not property) so you cannot get property.
iii) This court: Middle approach: the creditor can take a lien on general intangibles which include proceeds from the sale of the franchise. (call it something different—market share value or general intangibles. The franchise is not actual property but it has some value.).
b) The right to transfer a license is a right between the FCC and licensee; the right to receive remuneration for the transfer is a right with respect to the two private parties.
c) The very point of having a category of "general intangibles" subject to encumbrance is to make available for financing purposes values not otherwise attributable to other categories of assets: like goodwill, market share value.

E) Defeating the Limits on What May Be Collateral
1) Debtors can create security interests in
a) The proceeds that come into existence when debtors sell those licenses and franchises; and
b) The revenues that debtors derive from the use of the licenses and franchises.
c) Does not protect secured creditor from cancellation of the licenses or franchises by the governments or franchisors who created them.

# Default: The Gateway to Remedies

## I) Default, Acceleration & Cure Under State Law (Assignment 13)

A) Article 9 does not define default.

1) Default is the debtors failure to pay the debt when due or otherwise perform the agreement between the debtor and the creditor**. <u>Default is anything the security agreement says it is</u>**.

a) Some provisions can be very ambiguous. Can be just a good faith provision where the creditor thinks the debt is unsecured.

b) Minor events of default may not convince the judge to go along.

2) Standard Default Provisions

a) Event of Default; Acceleration

b) Waiver of Default; Agreement Inclusive

i) SC may in its <u>sole</u> discretion waive a default or cure at Debtor's expense a default

3) When is Payment Due

a) Installment Loans

i) In installment loans the parties contemplate that the debtor will repay in a series of payments.

ii) Most common: real estate mortgages and car loans

iii) Also provide for enforced budgeting that is absent in single payment loans

b) Single Payment Loans

i) E.g., a loan secured by a large account receivable by the debtor may be payable on the date the account is due

ii) When loan is due on a date that there's no expectation that debtor will have the money, provided that the debtor's financial circumstances remain satisfactory, bank will renew the note for an additional period, without requiring actual payment: "rolling the note" or "rollover".

c) Lines of Credit

i) Bank contracts to lend up to a fixed amount of money (the line "limit") as the debtor needs it.

ii) Debtor "borrows" by writing a check on its bank account.

iii) Bank covers all overdrafts on the account up to the limit of the line of credit.

B) **Acceleration**

1) **Acceleration clauses**: state that in the event of default by the debtor in any obligation under the repayment contract, the Creditor may, at its option, declare all of the payments immediately due and payable.

a) Creditor can then enforce the entire obligation in a single lawsuit

2) Limits on the Enforceability of Acceleration Clauses

a) If the grounds for acceleration are merely that the secured creditor "deems itself insecure" the creditor has a right to accelerate only if it in good faith believes the prospect of payment or performance is impaired: § 1-208

b) ***JR Hale Contracting Co v. United NM Bank***

i) Co. had $400K note, containing an acceleration clause. Also sought to receive additional financing from same bank. Were late three weeks in payment of interest. Bank accelerated the loan

ii) Bank's behavior in accepting pvs late payments and in not notifying the co of delinquency constituted a **waiver by estoppel** of their ability to accelerate on default

iii) To prove waiver by estoppel: Ð must show that he was misled by his prejudice by the conduct of the other party into the honest and reasonable belief that such waiver was intended

iv) General Rule: Silence may form the basis for estoppel if a party stands mute when he has a duty to speak

3) Notice: Whether the creditor has to give notice of acceleration before it becomes effective depends on the language of the contract.

a) Problem: if you give notice to the debtor the debtor may use up the collateral. The debtor may be better off without notice because the debtor may incur more debt during the notice period.

C) **The Debtor's Right to Cure**

1) G/R: Once acceleration has occurred, the debtor can cure, or more accurately redeem, only by **paying the entire amount** of the accelerated debt and costs. Look to the contract to see when cure is available. Some state have statutes (in WYO it has to be in the K).

2) After acceleration and cure periods, the debtor must pay the entire amount of the debt to redeem the collateral. (§ 9-633 cmt. 2: see this).

3) ***Old Republic Ins. Co. v. Lee***

a) After mortgagor has accelerated the loan, may the debtor reinstate by paying only the arrears. Court found that the right of debtor to tender only arrears is terminated. Full amount is due.

4) Illinois Statute (Reinstatement): Harsh to banks: requires banks to reinstate a contract they didn't want to keep.

D) The Enforceability of Payment Terms

1) ***KMC v. Irving Trust***

a) The debtor had a line of credit with the bank. The bank refused to advance the last part of the line of credit to the debtor. The note was payable o demand. The bank said the debtor was collapsing anyway.

b) 6th Cir. declined to enforce literally the contract between a bank and a borrower engaged in the wholesale and retail grocery business

c) Just as Bank's discretion whether or not to advance the funds is limited by an obligation of **good faith**, so too would be its power to demand repayment

d) Court said that the bank should have given the debtor more notice before not extending the credit. The lender should have subjectively acted in good faith (the bank had basically pulled the rug out from under the debtor).

2) ***Khams & Nate's Shoes v. First Bank of Whiting***

a) Rejected KMC above. Issue: Whether good faith is required to terminate a line of credit.

b) No. Even if Bank's conduct frustrated Debtor's ability to secured credit from other sources, it is not required to act in good faith, provided that it behaved in accordance with the terms of the contract.

c) Literal reading of contract: Any attempt to add "good faith" requirement would reduce commercial certainty and breed costly litigation.

3) Now, Article 9 good faith requirement requires the consideration of commercial reasonableness (this follows the KMC case).

a) Good faith:

i) § 1-201 (19): honesty in fact

ii) § 9-102 (43): Honesty in fact and observance of reasonable commercial standards of dealing.

iii) § 1-203: every K imposes the obligation of good faith.

iv) § 1-208: Good faith belief that the prospect of payment or performance is impaired.

b) But § 9-601(a): the secured party has the rights provided by the agreement.

E) **Procedures After Default**

1) Most aggressive

a) Notify the company's account debtors to make their payments directly to the bank **§ 9-607):** This could result in loss of account revenues to debtor or reputation damage.

2) Most Cautious is judicial foreclosure. The downside: too slow.

3) Intermediate: **Replevin**: secured creditor can just move for an order granting it temporary possession of the collateral.

## II) Default, Acceleration & Cure Under Bankruptcy Law (assignment 14)

A) Under the right circumstances, bankruptcy law allows cure and reinstatement even after acceleration. Bankruptcy protection of the debtor who has suffered an acceleration of installment debt occurs in two stages:

1) Stage 1: Protection of Defaulting Debtor Pending Reorganization
   a) Automatic stay
   b) A debtor who provides adequate protection to its secured creditor typically will be permitted to use the collateral while the case remains pending(§§ 9-363(b)(2) and 363(c)(2))
   c) Ch. 13 debtors have to begin payment within 15 days of filing the petition: must make payments under the plan within 30 days after the plan is filed. §1326
   d) Ch. 11 debtors make payments only after the plan is confirmed.

2) Stage 2: Reinstatement and Cure
   a) Accomplished through confirmation of a plan of reorganization
   b) Modification
      i) "Rewriting the loan"
      ii) Minimum amount debtor must pay on modified secured debt:
         - Determine the amount of the allowed secured claim
         - Formulate the repayment schedule that will have the same **value** as the amount of the claim
         - Must equal amount of claim plus applicable interest (present value)
      iii) Ch. 13 payments can only extend over the life of the plan (typically three years)
      iv) Ch. 11 payments can extend 20 or 30 years for real estate
      v) Prohibits modification of home mortgage loans (§ 1322(b)(2))
      vi) Two obligations
         - Any payment that by the contract between the parties, was due on a date after the reinstatement date remains payable on its original due date;
         - Any payment that, by the contract between the parties, is overdue as of the reinstatement date is part of the obligation to cure.

   c) Reinstatement and Cure under Chapter 11
      i) Pay the back-payments and expenses and then return to the payment terms under the original contract.
      ii) Class of claims must be unimpaired. If unimpaired, presumed to have accepted the plan.
      iii) Would preserve the (perhaps favorable) interest rate of the original loan.
      iv) There may be damages and cannot alter the original contract.

   d) Reinstatement and Cure under Chapter 13
      i) Return to the payment terms under the original contract
      ii) Similar requirements as under Ch. 11 although a different time frame: must cure within a reasonable time

iii) Reinstatement is the only way to preserve the family's home if the creditor has accelerated the debt

e) When is it too Late to Reinstate and Cure?

i) If debtor invokes BR procedure, can reinstate and cure even after the state statute of limitations

ii) ***In re Deseno***

- ***Issue:*** Whether Ch. 11 BR authorizes a debtor to cure or modify a foreclosure judgment obtained under NJ law. The timing of when a person can file bankruptcy to reinstate or cure.
- Court held a foreclosure judgment is a security interest rather than a judicial lien. But, can modify the foreclosure judgment (as a security interest)

iii) Adopted BR reform act in response

- Included revised § 1322: **which allowed debtors to cure until such residence was sold at foreclosure.**
- Debtors can no longer modify the mortgage against their principal residence

3) Binding Lenders in the Absence of a Fixed Schedule for Repayment

a) Cure and restatement only restores the contract rights that debtor enjoyed before default

b) Debtors whose lines of credit were repayable on demand or at a specific time that has passed have no contract rights that BR could restore.

4) Difference between Ch. 13 and Ch. 11

a) Ch. 13 designed for small debtors: limits on size of debt, concern about involuntary servitude.

b) Ch. 11 typically businesses (but can be individuals): more expensive, custom designed.

## III) The Prototypical Secured Transaction

A) Bonnie's Boats

B) Field Warehousing: debtor can sell the collateral (has to arrange with creditor's agent)

1) Floorplan inspections

C) Out of trust: sold without permission and used the proceeds for things other than paying creditor

# Part II. Creditor-Third Party Relationship

# Perfection

## I) The Personal Property Filing Systems (assignment 16)

A) What is Priority?

1) Definition: if there is more than one lien against collateral, each will have a priority
   a) Lien with higher priority = *senior* or *prior lien*
   b) Debentures & bonds
   c) **Peerless Packing Co. v. Malone & Hyde**
      i) Creditor who had sold his grocery store filed a financing statement on the store and inventory. The suppliers of the store did not file any financing statements. The unsecured suppliers had no security because they did not file and did not require cash for the inventory.
      ii) Issue was whether this transaction constituted unjust enrichment against unsecured creditors (suppliers) who did not take cash upon delivery or a security agreement (PMSI).
      iii) Unjust enrichment is not applicable to a UCC case. Although it seems harsh, the unsatisfied creditors could have protected themselves either by demanding cash payment or by taking **a purchase money security interest**. Purchase $ security interest would have priority.

B) How do Creditors Get Priority

1) First to file notice in a public records system established for that purpose; OR
2) First to take possession of the affected property (or posting a notice on the property)

C) The Theory of the Filing System

1) The theory of the filing system is to communicate the possible existence of a lien from a creditor who has one to a creditor who is thinking of acquiring one. For the system to work, prospective creditors must know that the system exists and that there may be a message in it for them.

D) The Multiplicity of Filing Systems: Where to file

1) **§ 9-501:** This section says where to file, which is, wherever the state says to file—usually the secretary of states office.
   a) Each county maintains a real estate recording system in which not only real estate mortgages, but also Article 9 fixture filing are filed.
   b) Having priority rests on whether secured party has a perfected security interest.
   c) 3 alternatives to filing (must know which one applies).

2) **Copyright: National Peregrine, Inc. v. Capitol Fed. Sav. & Loan Ass'n of Denver**
   **a)** Creditor attempted to perfect a security interest in a copyright by filing in state system. Trustee sought to avoid the interest as unperfected

**b)** Where must a security interest in a copyright be filed?

c) In the federal Copyright Office (**§ 9-109(c)(1):** article 9 does not apply when preempted by other statutes.

d) So people will not have to search al 50 jurisdictions. Helps the transferability of the copyright because there is no way to know where the actual copyright is.

e) It is more prudent to file in both offices when there is a question. Usually there is not dual schemes, but if in doubt, file in more than one place in case the court decides that you should file in the other place.

3) **Trademark**

a) Not sufficient to file in just the Trademark office

b) Must also file in state filing system

4) Royalty payments

a) Probably file in the US copyright office and the state office.

i) Accounts are a state ucc filing and you are not really getting an interest in the copyright; just the royalties.

E) Methods and Costs of Searching

1) Typically, only the employees may search, thus they hire a search firm to handle the search with the clerks.

2) Filing is usually a little cheaper than searching

F) § 9-502(d) allows filing before attachment of the security interest.

## II) Article 9 Financing Statements: Debtor's Name (assignment 17)

A) The Components of a Filing System

1) Financing Statements: most filed in paper form (some in microfilm, few on computer, but only as graphics (not searchable))

2) The Index:

a) When filed, each financing statement gets a number (usually book and page number)

b) **§ 9-519(c)** requires filing officer to compile a debtor name index including the address of the debtor given in the filing statement

3) Search Systems

a) A misspelling early in a name can throw it into a distant part of the directory

b) In basket problem

B) Correct Names for Use on Financing Statements —**§ 9-506(a):** Provides that a "financing statement substantially complying with the requirements of part 5 is effective, even if it includes minor errors or omissions, unless the errors or omission make the financing statement **seriously misleading**." (Even if there are errors, it is still effective unless the errors are seriously misleading).

1) Individual Names

a) Requirement: must use the name by which he is generally known, for non-fraudulent purposes, in the community.
b) Results suggest that a financing statement should ordinarily by filed in the full, formal name of the debtor, as well as in any shorter versions by which the debtor is commonly known

2) Corporate Names
a) Must give official corporate name, not trade name
b) Secretary of state issues charter in that name (assures that no two corporations have the same name or confusingly similar names -- unless they are incorporated in different states)
c) Trade Names: drafters thought it would be too confusing to rely on trade names: (b) 9-503(b) and (c) make clear that trade names are neither necessary nor sufficient. But you should still search for them.

3) Partnership Names
a) Can change over time
b) Secretary of state will ensure that no two Limited Partnerships have the same or confusingly similar names: no registration required for General Partnerships

C) Errors in the Debtors' Names on Financing Statements
1) If the searcher searches under the correct name of the debtor but does not find the prior filing because the prior **secured party listed an incorrect name** for the debtor on its financing statement, the prior filing is ineffective (§9-503(a); § 9-506(a) & (c).
a) Test is whether the searcher would have found the financing statement, not whether they actually did. 9-506 (c).

2) Search made under the correct name of the debtor, but does not find prior filings made in the correct name of the debtor because the **filing officer indexed the prior filings incorrectly**; the prior filings are nevertheless effective. 9-517. (may sue if immunity is waived).

3) **Transamerica Comm. Fin. Corp. v. GE Cap. Corp.**
a) Trans. loaned money to Wardcorp and filed a financing statement under "Ward Corp". Issue is whether Trans's filing was sufficient to perfect the security interest.
b) Court found Trans.'s filing was seriously misleading to subsequent searchers. Searching under the trade name is not part of a reasonably diligent searcher's burden.
c) An error in debtor's legal name is minor and not seriously misleading only if a properly executed search would disclose the filing w/o depending on the discretion of the clerk conducting the search.

## III) Article 9 financing statement: Other Information (assignment 18)

A) Information required n Article 9 Financing statements

1) § 9-502(a) requires **three items of information be on a financing statement**:

a) Name of the debtor

b) Name of the secured creditor

i) Importance of the name of the secured party

- A researcher can talk to the secured party to get information about what its interest is.
- Ned the name to get a termination statement.
- Seriously misleading is not the same for the secured party's name because the statement is not indexed by this name.

c) Indication of the collateral

i) On the financing statement the creditor can put "all personal property."

- Cannot do this with the security agreement.

ii) May use the same description as on the security agreement.

iii) Seriously misleading: Can the researcher determine what the collateral is.

2) 9-520(a) requires the filing officer to refuse to accept it unless it contains three additional items:

a) Mailing address of the secured creditor 9-516(b)(4)

b) Mailing address of the debtor 9-516(b)(5)

c) An indication of whether the debtor is an individual or a corporation 9-516(5)(B)

3) If debtor is an organization 9-516(b)(5)(c) requires:

a) Type of organization

b) Debtor's jurisdiction

c) Debtor's organizational identification number

B) Wrongly accepted filings or rejected:

1) Although filing officers acceptance was wrongful, the acceptance nevertheless renders the financing statement effective. 9-520(c)

2) If rejected, the filing officer stamps and returns and it is still perfected well enough to defeat lien creditors but not against purchasers for value (of which other secured creditors are § 9-516 (d). This applies only when the statement was rejected for some other reason than for not filling in the proper blanks.

C) Filing officer Mistake: 9-517

1) If the filing officer indexes the filing incorrectly, it is still effective.

2) Can sue the filing officer if immunity is waived.

D) Required information

1) Whether an error in a particular item of information is "seriously misleading" depends in part on the function that information serves in the search process. Names and addresses.

2) Unless otherwise agreed between the debtor and the secured party, a secured party has the right to respond to a request for credit information from third parties, but no obligation to so do.

E) Mailing Address of Debtor

1) Teel Constr. v. Lipper
   a) Failure to include any address of the debtor is fatal to perfection
   b) Rule: When debtor's address is merely incomplete or deficient in some other way, courts generally weigh the difficulty an interested party would encounter in trying to contact or identify the debtor given only the incomplete address
   c) Rule: Sufficiency of address is question of fact

2) Deutche **Credit Corp**
   a) The original creditor filed a statement on all equipment bought by the debtor from "coyote" loader sales. The second creditor—miller—later files a financing statement on the same loader. The second creditor says that the loader was not equiptment but was inventory and the original filing was misleading because the loader was not actually manufactured by coyote.
   b) Test: Would a reasonable prudent creditor have discovered the prior security interest.
      i) "Coyote" was adequate to give notice that the loader had a lien against it and equipment made it possible to identify the thing described.
      ii) The creditor would not have been seriously mislead if the finacing statement would have been consulted.
   c) This case is probably more relaxed than the general rule: Usually financing statements need to be more descriptive: can't just rely on the ability to go and talk to the secured creditor and find out what is covered.

F) Authorization to file a financing statement

1) Title of possibly encumbered property is "clouded"
2) Before filing a financing statement, the secured creditor must obtain authorization from the debtor in an authenticated record. 9-509(a)(1).
3) 9-509(b) provides that by authenticating a security agreement, a debtor authorizes the filing. Thus all a creditor needs to do is get the debtor to authenticate a security agreement.

## IV) Exceptions to the Article 9 Filing Requirement **(assignment 19)**

A) There are essentially 3 other ways to perfect than by filing: Taking possession, automatic perfection by operation of law, and by giving notice through some person or organization that controls the collateral.

B) Collateral in the Possession of the Secured Party

1) What is Possession

a) The law looks at the legal right, not just the physical fact, to determine who is in possession. The legal right to control is not determinative.

b) Perfection by possession trumps perfection by filing for some collateral. 9-328(1), 9-330(d)

2) The Possession-Gives-Notice Theory

a) 9-313 permits perfection by possession of collateral if the collateral is goods, instruments, money or tangible chattel paper.

b) Should look to see who has possession of collateral

3) Possession as a Means of Perfection

a) The secured party will be perfected in these kinds of collateral if it takes possession *or* files a financing statement

i) Goods, instruments, tangible chattel paper, negotiable documents, and certificated securities, possession is an alternative to filing.

ii) Usually still want to file a financing statement.

b) Possession of instruments, tangible chattel paper, negotiable documents, and certified documents is **superior** to perfection by filing. See 9-330(b) for trumping.

c) Perfection in cash can only be by possession § 9-312 (b)(3).

d) Security interest in accounts and general intangibles may be perfected only by filing or automatic perfection. 9-313(a)

e) Intent is to encourage free negotiability of money and instruments, unhampered by the need to conduct searches in the Article 9 system

C) Collateral in the Control of the Secured Party

1) Deposit account 9-102 (a)(29). **Three ways can take control** of it under § 9-104:

a) The secured party can be the bank in which the account is maintained.

b) Debtor, secured party and the bank can authenticate a record instructing the bank to comply with the secured party's instructions. Consent to withdrawal.

c) The secured party can become the bank's customer by putting the account in the name of the secured party.

2) Control referred to is potential control 9-104 not actual control.

3) Control over a stock certificate: Filing 9-312(a); control 8-106(b)

a) Control by possessing stock certificate or control by having the certificate signed over to you or registered in your name.

D) Purchase Money Security Interests in Consumer Goods
1) **§ 9-309(1) exception for PMSIs :** Purchase Money Security Interest (PMSI):
a) Defined by **§ 9-103(b)(1):** if the secured debt is for the purchase price of the collateral, the security is purchase money
2) Consumer Goods
a) PMSI **automatically perfected only in consumer goods**
i) It is not the nature of the goods, but the use to which they are put or the purpose for which they are bought. 9-102 (a)(23) goods that are used or bought for use primarily for personal, family or household purposes.
b) Gallatin ***National v. Lockovich***
i) People bought a boat with a purchase money security interest. The bank filed the financing statement in the wrong county. The Bankruptcy trustee attempts to avoid the transaction and the bank attempt to fall back on the automatic PMSI exception to filing.
ii) The issue is whether Gallatin must file a financing statement to perfect its PMSI in the boat as a consumer good with high value. Bnk has to show that it was a consumer good and that it was a PMSI.
iii) Court held don't need to file a financing statement. Under the clear mandate of the UCC, a consumer good subject to exception from the filing of financing statements is determined by the use or intended use of the good; design, size, weight, shape and cost are irrelevant.
iv) The value of the consumer good: The value of the good does not matter to whether it is a consumer good. Focus on the use, not he value.
- Some states limit the exception by a $ amount or separate out some items of high value.
- The car is an exception because it has a certificate of title.
- Filing provides extra protection against 3d parties, but not required to perfect a PMSI

E) Security Interests Not Governed by Article 9 or Another Filing Statute
1) § 9-109(d): Including security interests in:
a) Wage claims
b) Insurance policies and claims
c) Real estate interests
d) Tort claims

2) ***Bluxome St. Assoc. v. Fireman's Fund Ins. Co.***
a) Settlement of a malpractice claim: parties put a claim on the proceeds; the issue is who gets the settlement. Flynn & Stewart had a security interest in a tort claim (along with 4 other creditors) and rec'd partial payment following settlement. 2 of the unpaid creditors sought to set aside this payment as unperfected. F&S had filed a financing statement and also had a valid contractual lien.
b) Issue: whether F&S as first to file maintained a priority over other creditors when it filed a financing statement that was not required.

c) Yes. Perfection of F&S's lien was not governed by Article 9 and no other Calif. law established requirements for perfection. Art. 9 does not apply to non-commercial tort claims. Because there was no law governing the proper way to perfect the lien, they did not have to do any more to be perfected; e.g., give notice.

d) Other courts might choose differently: like requiring notice to other interested parties.

## V) The land and fixtures recording systems: Real property Recording Systems (assignment 20).

A) Real estate recording systems differ from personal property filing systems: contains not only liens against real estate but information evidencing transfer of ownership, recording in real estate system cost more, real estate recording systems are not self-purging. Most importantly, the debtor's name is not as important as it is in personal property.

B) Fixtures: The law considers permanent buildings part of the land. These are fixtures. § 9-102 (41): "Fixtures" means goods that have become so related to particular real property that an interest in them arises **under real property law**. [need to now how the real property law of the state defines fixtures].

1) Security in fixtures perfected only in real estate system, UCC is unnecessary and ineffective.

2) It is difficult to predict whether the courts would consider something a fixture. Must be permanently attached to the land.

**3)** To be safe, **file in both real estate and personal property system. (CYA).**

4) Cliff's Ridge Skiing Corp

a) Michigan rule on fixtures: fixture is determined by a three part test:

i) Is the property annexed or attached to the realty

ii) Is the attached property adapted or applied to the use of the reality

iii) Is it intended that the property will be permanently attached

b) In this case, chairlifts are fixtures.

c) **How to perfect on a fixture**: Through a mortgage describing the fixtures (or after-acquired). Also file a financing statement in case the property is determined to be personal property instead of a fixture. Could just describe an appurtenance.

d) **Fixture filing**: Financing statement which includes a description of the property. File with the county and a regular financing statement with the secretary of state.

e) Perfecting in the Fixtures of a Transmitting Utility: Article 9 contains special rules for filing against the collateral, including fixtures, or a transmitting utility.

Fixture filing: § 9-334

## VI) Characterizing Collateral for the Purpose of Perfection (assignment 21)

A) Personal property distinguished from Real: Three factors are important in making the distinction between fixtures and non-fixtures

1) The firmness with which the collateral is affixed to the real estate. Make an argument against product for fixture if the crop or plant comes back year after year.
2) The intention of the parties as to whether the collateral is to be permanent.
3) The degree to which the collateral is essential to the proper functioning of the real estate.

B) Inventory distinguished from equipment

1) § 9-102 (a)(48) states that inventory is held by a person for sale or lease or to be furnished under a contract for service. Plus, the debtor must be in the business of selling or leasing goods of that kind § 9-102 Cmt. 4.
2) § 9-102 (a)(33) if goods are inventory they are not equipment. (Characterization does not depend on the intrinsic nature of the goods, but on the manner in which they are used).
3) Farm products § 9-102 (a)(34) are the inventory of a farm. If goods are farm products, they are not inventory. [Become inventory later in the hands of the store].

C) True Lease distinguished form leases intended as Security

1) Article 9 does not apply to the leasing of personal property unless it is "intended as security"
2) § 9-505 allows the financier that wants to be a true lessor, but isn't sure it has achieved that status, to file a financing statement just in case -- without allowing it to be used as an admission by the lessor that the transaction is a security interest.
3) The labels that the parties apply will not be controlling.

D) Reality Paper

1) Realty paper is sometimes used to refer to a promissory note secured by a mortgage or deed of trust.
2) § 9-308(e) instructs that the proper method to perfect in realty paper is to perfect in the right to payment.
3) Only perfection accomplished by possession will achieve priority over a later purchaser 9-330(d), making perfection by possession preferable.

E) Chattel Paper

1) If document indicates both a monetary obligation and a security interest in specific goods the collateral is chattel paper.
2) Perfection through filing 9-312(a)(1) or taking possession 9-313(a).
3) A purchaser who gives new value in the ordinary course of its business and who acts without knowledge of a security interest perfected by filing has priority

F) Multiple Items of Collateral

1) **In re Leasing Consultants**
   a) Assigned as collateral security in eight Plastimetrix leases, each assignment covering all moneys due or to become due under the lease and the "relative equipment" described in the lease. Filed financing statement in N.Y.

b) Court found that the leases themselves were "chattel paper" and that the bank's security interest in the chattel paper was perfected by filing financing statements in N.Y. and taking possession.

c) The machines themselves were equipment located in N.J. and for perfection purposes they had to be perfected there.

# Maintaining Perfection

## I) Maintaining perfection through Lapse and Bankruptcy (assignment 22)

A) Removing Filings from the Public Record

1) When debt is paid, both parties will want it out of the record.

a) Debtor because wants clear title.

b) Creditor because he doesn't want to be bothered by inquiries about property in which it no longer has an interest.

2) Satisfaction: removing filing from real property system.

a) When a real estate mortgage is paid, the mortgagee executes a document calls a satisfaction of mortgage which is filed in real estate system

b) State statutes impose a penalty for failing to file "satisfaction"

3) Release: releases a piece of property encumbered by a mortgage

a) If such a mortgage has not been paid in full, but secured creditor is willing to release its claims on some of it, records a "release": eg., customary in development of real estate subdivisions.

b) Usual accommodation is that secured party will release that lot in return for a partial payment of its mortgage (a paydown)

c) Absent a release provision in a mortgage, the mortgagee is under no obligation to release collateral on partial payment of the mortgage

4) Article 9 Termination and Release (non-real estate)

a) **§ 9-513(c)(1)** termination statement within 20 days after receiving **authenticated demand** from the debtor: same as "satisfaction".

i) Within 20 days after a secured party receives an authenticated demand from a debtor, the secured party shall cause the secured party of record for a financing statement to send to the debtor a termination statement for the financing statement or file the termination statement in the filing office if: (1)(2)(3)(4).

ii) The creditor is subject to penalties if he doesn't terminate the statement when asked to do so by the debtor.

b) **§ 9-512 (a)** release of collateral is done by amending the financing statement.

i) A termination statement or amendment must identify, by its file number, the initial financing statement to which it relates. In addition, a termination statement must

indicate that the identified financing statement is no longer effective [§ 9-102 (a)(79)]. A termination statement or amendment becomes part of the financing statement to which it relates. Minor errors or omissions in the termination statement would be subject to the "seriously misleading" test.

B) "Self-Clearing" and Continuation in the Article 9 Filing System.
1) Financing statements are valid for 5 years § 9-515(a) and (c). [The secured party must continue the statement].
2) Unless the secured party files a continuation statement **during the last six months of the five-year period**, the financing statement automatically lapses.
a) One year after lapse, the filing officer can remove it from the records and destroy it.
3) Can also file an amendment to the statement: usually, the debtor wants part of the collateral released. There are very specific ways to file an amendment.
4) A secured party must file a continuation at the five-year intervals even if the debtor has gone into bankruptcy; this does not violate the automatic stay.
5) What to o if continuation was not made
a) The only thing you can do is file a new statement but then a new statement may not even be valid.
b) May have to get permission from the debtor to file a new statement also.

6) ***Worten Bank & Trust Co. v. Hilyard Drilling Co.***
a) Hilyard in BR. NBC had a senior security interest in H's accounts receivables in an 1979 financing statement. Never filed a continuation statement. Instead, filed a new financing statement in July 1983. In Apr. 1983, Worthen filed its security interest in the same accounts (acknowledging that it was junior to NBC).
b) Court held NBC's interest lapsed. In order to be considered a continuation statement, a second financing statement must be filed within 6 months of expiration date, refer to the file # of the original statement, and state that the original filing statement is still effective.

## II) Maintaining perfection through Changes of Name, Identity and Use. (Assignment 23)

A) Changes in the **Debtor's Name**, Identity or Corporate Structure
1) **§ 9-507(c)**
a) Provides that even though a change in the debtor's name renders a filed financing statement seriously misleading, the financing statement remains effective to collateral owned by the debtor at the time of the name change or any collateral acquired by the debtor in the first four months after the change.
b) To secure after four months, the creditor must amend the original financing statement.
c) To be aware of these changes, the creditor must continuously check in on debtor by doing such things as watch letterhead or checking corp records of state of incorp to see if anything has changed.

B) Changes Affecting the **Description of Collateral**

1) Type 1 changes: change in circumstances that do not control the place of filing. Even if it is misleading, the financing statement remains effective.
   a) Requires that filing describe the collateral well.
   b) E.g. Coyote Loader, serial number 3457567 (described in the security agreement)
   c) Financing statement says inventory (debtor begins using as equipment)
   d) Filing remains effective as against this type of filing (because same filing rules apply to inventory as to equipment) 9-507(b).

2) Type 2 changes: Change in circumstances is one that affects the method perfection appropriate for the original filing (originally under the UCC, the new collateral is covered under real property).
   a) Seriously misleading is excused but that does not excuse the failure to make the proper filing.
   b) The creditor must file in the proper system within twenty days to maintain priority.
   c) Have to look to the rules of the state filing systems to see where the debtor's permission is required.

C) **Exchange of the Collateral**

1) **Barter Transactions**: § 9-315(d)(1). Three types of barter. The distinction hinges on whether a new perfection system (real property, auto) must be used. If the property requires filing in a new system, the secured party must re-file within 20 dys. Only type two transaction are covered.

   a) Type 0 barter: proceeds received by the debtor fall within the description of collateral in the already filed financing statement.

   b) Type 1 barter:
      i) Exchange of collateral for non-cash proceeds, where those proceeds are property not covered by the description in the financing statement but are property in which a security interest could be perfected by filing in the office where the secured creditor's financing statement is already on file.
      ii) Remains perfected without a new filing

   c) Type 2 barter:
      i) Exchange of collateral for non-cash proceeds of a type in which filing is required in a filing office other than the one in which the original collateral was perfected by filing.
      ii) Do not revoke the exception of 9-315(d)(1) -- secured party must re-file.
      iii) To be continuously perfected, must make these filings within 20 days from the time the debtor receives the proceeds.
      iv) Need not get debtor's signature on new financing statement.

   d) **National Bank of Alaska**

i) Bank gave line of credit, secured by a percentage of debtor's inventory and eligible accounts receivable—and proceeds from sale. As settlement for an overdue account, debtor accepted a piece of real estate in exchange for canceling the account. Bank wanted to be on deed and debtor refused.

ii) Issue: Whether Bank has a priority interest in the real estate as proceeds.

iii) Article 9 does not deal with real estate. Thus, real estate cannot be "proceeds" from Art. 9's viewpoint. Only way to perfect is through real estate system (by recording on the title).

2) **Collateral to Cash Proceeds to Non-cash Proceeds**: the same result as barter above except type 1 and type 2 changes must be perfected within 20 days.

a) Type 0 change:

i) Sold the Coyote loader for cash, took cash to buy a Caterpillar Loader.

ii) The original filing remains effective to cover goods of the same description

b) Type 1 change:

i) Sells inventory for cash and buys the elephant.

ii) The exchange results in collateral that is no longer covered by the original description in the filing statement.

iii) § 9-315(d)(3) requires secured party to file a financing statement to cover the new collateral within 20 days or it will not be continuous perfection.

c) Type 2 change: treated like type 1 changes

i) Sold Coyote loader and bought a car (for personal use).

ii) Secured party must file in the new locations within 20 days of receipt of property by debtor (9-315(d)(3)).

3) Collateral to Cash Proceeds (No New Property)

a) Debtor may sell collateral and keep the cash. 9-315(d)(2) grants perpetual perfection in identifiable cash proceeds, and as long as they remain there (in the bank account and remain identifiable), creditor will be continuously perfected.

b) The Secured party need not rely on perfection in proceeds under 315(d), They can perfect in a deposit account by taking control of the account 9-314(a)

## III) Maintaining perfection Through Relocation of Collateral or Debtor (assignment 24)

A) State-Based Filing in a National Economy. Rules that specify the state system in which a filing should be made are in § 9-301 to 9-307.

B) If there is a question about where to perfect, file in all possible locations to be safe.

B) Initial Perfection: G/R: perfect **where the debtor is located** when dealing with non-possessory security interests. This does not include fixture filings.

1) § 9-301 while the debtor is located in a state, the local law of that state governs perfection.

2) If the security interest is possessory, the more specific provision of 9-301(2) overrules.

3) §9-307 contains additional provisions specifying **the location of particular kinds of debtors**.

a) **Individuals** "principal place of residence." This is not domicile, does not require the intent to make the place a permanent home. If there is a question, file in both places.

b) **Registered organization**: 307(e) Is located where the organization is registered.

**c) If not incorporated:** unregistered organization

i) 307(b) deems such debtor located at its place of business if only one place.

ii) 307(a) if more than one place of business, located where the "chief executive officer is located—nerve center test.

4) A **fixture filing** must be made in the office designated for the filing or recording of a mortgage on the real property—county recorder's office.

C) **Relocation** of the **Debtor**

1) When individual debtor changes his or her state of principal residence, the secured creditor who filed in the original state has **four month**s to file in the destination state 9-316(a)(2). If the secured creditor does not, the security interest becomes unperfected.

2) If the debtor reincorporates by merger or transfer of assets to another company, 316(a)(3) will apply giving the secured creditor one year in which to discover the merger and perfect.

i) The merger will be a matter of public record, generally in the original and destination states. Thus, a creditor will need to keep track.

D) **Relocation** of the **collateral**

1) If the collateral changes location (merger or sale of the assets to another entity)

a) There is one year to file a new financing statement.

b) This is the same as #2 above.

## IV) Maintaining perfection in certificate of title systems (assignment 25)

A) Certificate of title system is used for some types of personal property, mainly automobiles. Cars are used as collateral many more times than other personal property.

1) For most kinds of property covered by certificate of title systems, the face of the certificate is the proper place to record any security interest.

B) Process

1) The lender gets the certificate of title from the county clerk with security agreement.

a) The clerk puts a lien on the certificate: both the original and the courthouse copy.

b) In Wyo, also have to file a financing statement with the county clerk.

2) The UCC does not apply to certificate of title systems except when deciding the choice of law.

C) § 9-311 says file the financing statement where the state says to file it; in Wyo, § 31-2-801 says file the statement with the county clerk and on the title.

1) § 9-311: (a) [Security interest subject to other law.] Except as otherwise provided in subsection (d), the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to:
   a) (1) a statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt Section 9-310(a);
   b) (2) [list any certificate-of-title statute covering automobiles, trailers, mobile homes, boats, farm tractors, or the like, which provides for a security interest to be indicated on the certificate as a condition or result of perfection, and any non-Uniform Commercial Code central filing statute]; or
   c) (3) a certificate-of-title statute of another jurisdiction which provides for a security interest to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the property.

D) What a certificate of title does
   1) Lists who owns the property and who the lien holders are.
   2) List the vehicle VIN# so the property is identifiable.
   3) Disadvantages
      a) Questions about who might have a security interest in additions to the car: such as an engine.
      b) The certificate of title system and the UCC say that the person with an interest in the whole car prevails over these smaller part creditors [§9-355(d): accessions].
   4) Advantages
      a) Contains title as well as lien information. Only have to look in one place for this information.
      b) Identification of the collateral through the vehicle license plate # and the VIN #. Conducting a search under a unique number eliminates the complexity and uncertainty of using the debtor's name. In order to use this advantage, each item of collateral has to be marked with a unique number, so it probably will not be used for other types of collateral.

E) Accessions: § 9-102 (a)(1): (1) "Accession" means goods that are physically united with other goods in such a manner that the identity of the original goods is not lost.
   1) Basically, when one item of property is affixed to another. Affixed property is divided into three categories:
      a) That which is not sufficiently related to the whole to be considered part of it and therefore not an accession (spare tire).
      b) That which is so integrated into the whole that it is part of the whole for financing purposes (mixer on the back of a cement truck)
      c) Accessions, the property in between that that is sufficiently affixed to be reached by the security interest in the whole, but not sufficiently integrated that it can no longer be the subject of separate financing (automobile tires).
   2) A security interest in the whole has priority over a security interest in an accession to the whole—regardless of the order in which the two security interests were perfected.

a) § 9-335(d): [Compliance with certificate-of-title statute.] A security interest in an accession is subordinate to a security interest in the whole which is perfected by compliance with the requirements of a certificate-of-title statute under Section 9-311(b).

F) Where is the certificate of title located

1) Depends on the law of the state, but, there should only ever be one certificate of title.
2) Usually, the vehicle has to be registered in the state where the owner is located, but hat does not always mean the title has to be in that state. Most of he time, the title will be in the state where the vehicle is located. When the owner moves to another state then he will have to get a new title in that state.
3) Registration in a new state does not affect certificate of title perfection

G) **Moving between states**

1) The owner of the vehicle should get a new certificate of title from that state transferring any lien holders from the old title to the new title.
2) If the new title does not list the old creditors then they lose priority or interest in the collateral against a good faith purchaser after four months.
   a) The notation on the first certificate remains perfected against lien creditors and he trustee permanently.
3) Movement between certificate and non-certificate states (boats). Covered by §9-303.
   a) **Certificate to non-certificate moves**: The certificate of the original state remains effective until the collateral becomes covered by a certificate in another state. Since the new state does not have certificate's for the item (boats) the original certificate continues to cover the collateral.
   b) **Non-certificate to certificate moves**: In the original state the item was covered by a financing statement. In the new state it is covered by a certificate of title. The creditor **has <u>four</u> months** to remain continuously perfected by noting its security interest on the new state's certificate. (§ 9-316(e)). Otherwise, its interest will be defeated by a purchaser who buys or takes a security interest during or after the four month period. Still prevails over a lien creditor and trustee.
      i) § 9-316 describes when the property becomes unperfected.

# Priority

## I) The Concept of Priority: State Law (Assignment 26)

A) Priority in Foreclosure

1) Absent an agreement to the contrary, any lien holder may foreclose while the debtor is in default to that lien holder. The existence of a prior lien generally does not block the exercise of rights under a subordinate one.
2) No lien holder is compelled to foreclose
3) Governing Principles:

a) Foreclosure sale discharges from the collateral the lien under which the sale is held and all subordinate liens § 9-617(a)). The sale does not discharge prior liens.
b) Sale transfers debtor's interest in the collateral to purchaser, subject to all prior liens 9-617(a). The **buyer takes subject to all senior liens**.
c) Following foreclosure sale, if new purchaser does not pay the lien, senior creditor can foreclose.

d) Proceeds of sale are applied in this order (§ 9-615(a))
   i) Expenses of sale
   ii) Payment of the lien under which the sale was held.
   iii) Payment of subordinate liens in the order of priority.
   iv) Any surplus goes to debtor--- unsecured creditors do not share in the proceeds; their remedy is to levy on the surplus in the hands of the debtor (unless a distribution in BR).
e) Debt underlying each lien is reduced by the amount paid to the lien holder from the sale; but the balance remains owing. 9-615(d)(2). The unpaid creditors can get judgment for deficiency if the state allows (anti-deficiency statutes).
f) Buyer cannot rescind on unilateral mistake because *caveat emptor* still applies to foreclosure sales.

B) **Reconciling Inconsistent Priorities**

1) Any creditor whose liens are discharged by the sale shares in the proceeds of the sale in the order in which their loans have priority. Difficulty is determining priority between liens and security interest that arise in different systems.
2) G/R: Mortgages usually have priority over judgment liens for the simple reason that when a debtor has a judgment lien against his property, no one will make the mortgage loan to the debtor.

3) **Bank Leumi Trust Co. v. Liggett**
   a) Judgment creditor #1 had secured interest in 1974. Bank then gave mortgages on same property in 1980 and 1981. In 1982, Judgment creditor #2 finalized its claim.
   b) The issue was whether state law regarding priority between judgment creditors establishes a priority of JC#2 over mortgages that were recorded prior to JC#2.
   c) Court found that it would be inequitable to discharge mortgages w/o making any payment on it. THUS, Bank participates in foreclosure disbursement before JC#2.
   d) Even though there was a statute that said that all judgment creditors will be paid first, the court relied on the general system and said that first in time is paid first.

C) The Right to Possession Between Lien holders

1) **Grocers Supply Co. v. Intercity Inv't Prop**
   a) The first lien has a security interest in the inventory. The second lien has an interest through a judgment. The second lien creditor tired to foreclose so it took possession of the collateral. It Did not inform Grocers Supply (who held the senior lien)

b) Issue: whether GS may recover its collateral after subordinate judgment creditor has obtained possession.

i) GS's right, as a prior secured creditor, to take possession of the collateral was superior to the right of a mere judgment creditor. GS could regain possession from sheriff. Judgment creditor was required to pay GS's costs to repossess b/c it did not inform GS beforehand.

2) **Frierson v. United Farm Agency** (Limit to what the senior party can do)

a) Bank cannot refuse to exercise its rights under a security agreement and thus impair the status of other creditors by preventing them from exercising valid liens.

b) Senior lien holder must foreclose, or stand aside so junior creditors can do so.

## II) The concept of priority: Bankruptcy Law (assignment 27).

A) Collateral may be sold by the trustee subject to the liens of secured creditors.

B) Abandonment removes the property from the estate, re-vests the property in the debtor, terminates the automatic stay, and opens the way for the lien holders to foreclose. BR §362(c)

C) Bankruptcy can weaken priority

1) In certain circumstances, the debtor can borrow from a new creditor and make that new security interest senior [BR § 364(d)].

a) Only if all of the secured parties are covered and only if that is the only way to get the loan.

2) Creditor's cannot always decide when to foreclose. The trustee can force a foreclosure even if the creditors do not want to. [§ 363(f)].

3) In Re Oneida Lake Development.

a) 363(f): the trustee may sell the property free and clear of all of the liens only if one of the five provisions of this section is met.

i) (3) is the greater aggregate value of all of the liens on the property.

b) The debate in this case was whether the price of the collateral would be enough to pay all of the liens on the property. There are two options in determining the value of the liens to see if they are satisfied:

i) The face amount of the liens, or

ii) The value of the collateral (this could be less than the face value of the liens). This is the majority view and was adopted by this court.

c) The aggregate value of all of the liens equals the total value of the collateral. The value of the collateral equals the sales price at the sale (but still get an independent appraisal and compare it to the sales price).

d) Subsection (4): Can sell when the interest is in a bona fide (good faith) dispute.

e) The main point is that someone else has to decide to sell the property besides the mortgagee.

4) **In re 495 Central Park Ave.** (Ability to grant senior liens)

a) Debtor in bankruptcy moved to borrow funds to make changes so the building would

attract new tenants.

b) §364 requires

i) Requires the debtor to show that alternative financing is unavailable (expert testimony); and

ii) Requires the debtor to show that the interests of the holders of an existing lien on the property are adequately protected (as long as the value of the collateral goes up as much as the existing loan).

c) This whole thing probably turns into a battle of the experts and then turns to the court's subjective decision.

D) Protection of Subordinate Creditors: the main effect of going into bankruptcy is that it works to protect junior creditors much more than non-bankruptcy does. Bankruptcy focuses its attention to the unsecured creditors and junior creditors who would be less likely to recover outside of bankruptcy.

# Competitions for Collateral

## I) Lien Creditors Against Secured Creditors: The Basics (assignment 28)

A) Principal issues

1) **Future advances**: the principle issue will be whether the priority date of a later advance should be the date of that advance or the date of the earlier transaction in which the future advance was contemplated.

2) **Purchase money status**: what steps a later purchase money lender must take to have priority over competing liens perfected earlier.

B) How Creditors Become "Lien Creditors"

1) Define: "any creditor who has acquired a lien on the property involved by attachment, levy or the like" (§ 9-102 (a)(53)).

a) Basically, a person who has obtained a judgment against the debtor who has proceeded to get some kind of lien against the property. Liens depend on the state court rule—like when the lien begins.

b) BR § 544 (a): the trustee is a lien creditor at the commencement of the bankruptcy case: that is their date of priority.

c) CA Civ Pro. Code: recording a judgment creates the lien—either in the county recorder's office for real property or with the secretary of state for personal property.

2) May become Lien Creditor (dates of priority options)

a) By levying on property and attachment.

b) When the writ of garnishment is served on the third party.

c) Recordation of a judgment for money damages in the real property recording system (creates and perfects).

i) Reaches all property owned by the debtor in the county where the judgment was recorded.

ii) Even applies to property acquired later, provided that the judgment remains perfected

3) Trustee in Ch. 11 BR has the rights of a hypothetical lien creditor; "ideal lien creditor".

C) Priority Among Lien Creditors

1) Depends on the state because it is defined by state statute. First come First served but it depends on the date used.

2) Typically defined on the basis of one of these four:

a) Date of levy (majority rule): date that the sheriff or officer took possession of the particular property. Sometimes constructive or symbolic possession is enough (post a notice).

b) Date of deliverance of the writ of execution is delivered to the sheriff (minority rule)

c) Date of service of writ of garnishment: date the writ is delivered to the garnishee—bank.

d) Date of recordation of judgment: the date delivered to the recording officer.

3) In a competition between writs of execution, the majority rule gives priority to the first to levy on the particular property. Under minority rule, priority depends on the order in which the writs were delivered to the sheriff.

D) Priority Between Lien Creditors and Secured Creditors

1) § 9-317(b) & (a)(2): Priority between lien creditor and secured creditor depends on whether the lien creditor "becomes a lien creditor" before the secured creditor either:

a) Perfects its security interest

b) Files a financing statement and complies with 9-203(b)(3)

c) § 902(b)(3): (b) [Enforceability.] Except as otherwise provided in subsections (c) through (i), a security interest is enforceable against the debtor and third parties with respect to the collateral only if:

i) (1) value has been given;

ii) (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and

iii) **(3) one of the following conditions is met**:

- (A) the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;
- (B) the collateral is not a certificated security and is in the possession of the secured party under Section 9-313 pursuant to the debtor's security agreement;
- (C) the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under Section 8- 301 pursuant to the debtor's security agreement; or
- (D) the collateral is deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights, and the secured party has control under

Section 9-104, 9-105, 9-106, or 9-107 pursuant to the debtor's security agreement.

2) Perfection is defined by 9-308(a)
   a) An interest is perfected only after it has attached and the applicable steps required for perfection have been taken.
   b) The issue is often between trustee in BR and secured creditor: The argument is that secured creditor isn't perfected at all

E) Purchase Money Priority: PMSI's are an exception to the first in time theory, but still has limitations.
   1) **§ 9-317(e)**: A PMSI can achieve priority a lien creditor's interest only if the PMSI comes into existence and attaches to the collateral before the creditor obtains a lien on it.
      a) If PMSI attaches first the holder of the APMSI has a 20-day grace period in which it can perfect and defeat lien creditors.
      b) Purchase money secured creditor that went public later can defeat a lien creditor who went public up to 20 days earlier.
      c) Purpose to facilitate sales of personal property on secured credit

## II) Lien Creditors Against Secured Creditors: Future Advances (assignment 29)

A) The Priority of Future Advances: Personal Property
   1) **§ 9-323(b)** Exceptions in favor of secured party continuing to make advances after the lien creditor's levy:
      a) Gives future advances priority over the lien in situations that the creditor making the advance didn't have knowledge of the lien.
      b) Every secured advance made within 45 days after the levy is entitled to priority over the lien, even when the secured party has actual knowledge of the lien creditor's levy.
      c) Every advance made "pursuant to a commitment entered into without knowledge of the lien" gets priority over the lien.
   2) All future advances still must be **pursuant to a future advance clause** in the original security agreement.

B) Priority of **non-advances**: personal property
   1) Non-advances: most security agreements provide that in the event of default, the debtor will pay the secured creditor's reasonable costs of collection, including attorney's fees. These are non-advances. Issue is whether these non-advances qualify for priority over lien creditors even if they come into existence after the lien creditor has perfected.
   2) As long as the non-advances can be tied to the original loan that has priority (as clause in the agreement calling for them), then the non-advances also have priority.

   3) **Uni Imports, Inc. v. Exchg. Nat'l Bank** (non-advances)

a) Bank had SA with debtor, establishing a revolving line of credit up to $7.2 million. Nov 18, 1988, Uni obtained a judgment against debtor. Jan 13, 1989, served writ of execution on bank, which refused to turn over any of debtor's assets, claiming priority. Continued to advance $ to debtor (beyond 45 days).

b) Issue: Whether monies paid on behalf of debtor (taxes, credit draws, etc) were advance payments and thus had priority of original date.

c) 9-323(b) applies when there is a perfected security interest in existence when the judgment lien attaches. Court held that they were not advance monies, but were entitled to the priority date of the agreement requiring that they be paid.

i) Interest, attorneys' fees, and costs accruing on the prior liens will eat away at the lien creditor's potential for recovery: these are non-advances.

ii) The non-advances must have been considered for in the original security agreement. The reasoning is that later creditors could look for them in the security agreement.

C) The Priority of Future Advances and non-advances: **Real Property**

1) **Shutze v. Credithrift of Am.**

a) Creditor had a mortgage in Debtor's property. Documents contained a future advance clause ("**dragnet clause**") and was properly perfected on the original mtg in 1981. In 1984, S. obtained a judgment against debtor, properly filed. In 1985, C renewed the mortgage and advanced $2700.

b) Issue: Whether the 1985 advance had priority over the 1984 lien.

c) Dragnet clause is valid. Thus, Mtg. was properly perfected 3½years prior to S's judgment lien. 1985 advance dates back to the 1981 perfection.

d) Gave creditor priority over the lien creditor even though the creditor was not obligated to make the future advance.

2) Other jurisdictions refuse priority t optional future advance clauses made by the mortgagee who has knowledge of the lien, but give priority to obligatory advances.

D) How does another potential secured party find out if there is a future advance clause in the prior security agreement?

1) § 9-210: the secured has to provide information to the debtor when the debtor asks for it, not another creditor.

a) The second creditor will have to convince the debtor to get the other security agreement.

2) Make sure the other creditor knows of your lien to get around the without knowledge exceptions.

## III) Trustees in Bankruptcy Against Secured Creditors: The Strong Arm Clause (assignment 30)

A) §544(a) a bankruptcy trustee in possession has the power to avoid most kinds of security interest that remain unperfected as of the time of filing of the bankruptcy case.

B) The Purpose of BR Code § 544(a): **Strong Arm Powers**

1) Policy against secret liens (if secured creditors have not posted notice about their liens by the date of BR, they are unperfected, and trustee can avoid their security interest)
2) If so, then the interest is preserved for the benefit of the estate. §551

C) The Text of the BR § 544(a)(1)
1) Trustee has a lien as of the date of the BR petition: without regard to the trustee's knowledge.
2) Gave the trustee the right to step into the shoes of the one who would have the greatest rights against the particular competitor: either;
a) Hypothetical lien creditor
b) Fraudulent conveyance
c) Bona fide purchaser of real property

3) BR § 544(a) allows trustee to avoid the security interest if any one of these three options could avoid it. This is the ideal lien creditor.

D) The Judicial Lien Creditor of § 544(a)(1):
1) Trustee can step into the shoes of a hypothetical "creditor that extends credit to the debtor at the time of the commencement of the case. The date of perfection is the date of the filing of the bankruptcy regardless if state law provides an earlier time for a lien creditor.
2) The trustee has the status of a Creditor with an Execution Returned Unsatisfied: this allows the trustee to reach fraudulent conveyances.

E) The Bona Fide Purchaser of Real Property
1) This is the most powerful designation.
2) This allows the trustee to prevail only where (1) the competing creditor was supposed to do something to perfect its lien (that is "applicable law permits perfection" against a later bona fide purchaser) and (2) the competing creditor failed to do it.
a) If the competing creditor was supposed to perfect and did, he prevails over the trustee.
b) Regarding fixtures: trustee only has the powers of a judicial lien creditor, not a bona fide purchaser.

3) **Midlantic Nat'l Bank v. Bridge**
a) BR trustee sought to avoid Midlantic's unrecorded refinanced real estate mortgage as a bona fide purchaser. The bank argues that there is equitable subordination where the second mtg. Relates back to the first mtg. The trustee argues that it—as a bona fide purchaser—would step in front.
b) Under this states law, a bona fide purchaser would have priority at common law so the trustee gets priority—the lien creditor loses to the bona fide purchaser. (The creditor only had an equitable lien). BFP acquiring title when there was no recorded mortgage would have taken clear of the mortgages. THUS, the trustee may also take free and clear of the mortgages.
c) UCC has not displaced the doctrine of equitable subrogation.

F) The Implementation of BR Code § 544(a)
1) This section makes certain transfers avoidable, but does not require the trustee to avoid them.

2) Exercise of § 544(a) Discretion by Chapter 7 Trustees:
   a) There is strong encouragement to avoid the creditors interest because then they might get paid. The collateral ill become part of the unsecured eatate and that is where the trusttte gets paid from.
   b) Secured creditors can file proofs of claims in BR cases, but do not have to.
   c) Unless someone sues the secured party, they have the right to ignore their debtor's bankruptcies.
      i) If they ignore them and no one comes after their security interests, they pass through the BR unaffected

3) Exercise of § 544(a) Discretion by Chapter 11 Debtors in Possession (DIP's):
   a) Typically have reasons not to avoid security interests: transfer of security interest may have been to themselves or their friends or to persons with whom they have ongoing business relationships.
   b) Debtors in possession fiduciary duty to act in the interest of the estate.
   c) But these bankruptcies may end up in chapter 7.

G) Recognition of Grace Periods: when the secured party has a grace period:
   1) Grace period that the secured party would ordinarily have when bankruptcy is filed do not disappear.
   2) BR Code § 546 (b) allows these grace periods to continue on. Also does not violate the automatic stay because §362 (d) says that the creditor can finish perfection under the grace period.
      a) Example: 9-317(e) gives the holder of a purchase money security interest 20 days from the debtor's receipt.

## IV) The trustee in bankruptcy against secured creditors: preferences (assignment 31)

A) Priority among unsecured creditors
   1) Under state law, priority among unsecured creditors was always the first to perfect. That depended on what the state law was (levy, writ attachment, record judgment, serve the writ of garnishment).
   2) Under bankruptcy, unsecured creditors must stop collection practices at the time of the filing of the bankruptcy. Then, the unsecured creditors are paid pro rata, in proportion to their claims.
   3) Preference period: Bankruptcy also imposes a policy of equal treatment of general unsecured creditors retroactively for a period of one year against creditors who are "insiders" of the debtor and for 90 days against those who are not. This is the "preference period."

a) §547 (b) authorizes the trustee or the debtor in possession to "avoid" any transfer made during the preference period that would have the effect of preferring one unsecured creditor over others.

b) The policy is that it prevents debtors from defeating the bankruptcy policy of pro rata distribution by liquidating their own estates on the eve of the bankruptcy.

B) What security interests can be avoided as **preferential**

1) Generally

a) BR § 547 (b) states what transfers can be avoided as preferences. To be avoidable, the transfer must satisfy each element. Even if it does, it may be excepted from avoidance by § 547 (c).

b) Elements:

i) Transfer: only a transfer of an interest of the debtor in property can be avoided. "Disposing or parting with property or with an interest in property."

- The trustee most commonly seeks o avoid payments.
- The creation and perfection of a security interest is also a transfer.

ii) § 547 (b)(1): to or for the benefit of the creditor, and (b)(2) for or on account of an **antecedent debt**. The transfer must have been made to a party who was already a creditor. The debt must have already been in existence when the security interest was made (the transfer). Brand new debts are not avoidable.

iii) Insolvency: If the debtor was insolvent at the time of the transfer, the transfer is not avoidable as a preference for that reason lone. Thee is a presumption of insolvency that extends 90 days before the filing of the bankruptcy.

iv) The preference period. 90 days for most creditors and one year for insiders.

v) The improvement test: To be avoidable, the transfer must have **improved the creditor's position.** The transfer must have enabled the creditor who received I to recover more than the creditor would have if the debtor had been liquidated under chapt. 7 without making the transfer. Did the creditor get more than it's pro rata share. This requirement is usually met.

c) **Timing**: when did the transfer take place (need to know if it fell in the grace period and some transfers relate back to an earlier period)

i) § 547(e): the transfer of a security interest is made when it is perfected. Does not matter when the security interest attached.

ii) The date of perfection is referred to state law. The security interest in real property is perfected when it is too late for a bona fide purchaser to gain a superior interest. A security interest in personal property and fixtures is perfected when it is too late for a lien creditor to gain a superior interest.

- 9-317(a)(2) and 9-323(b) say when it is too late for a lien creditor: when the security interest is perfected within he article 9 meaning of the term or at such earlier time that a security agreement is executed and a financing statement is filed.

d) The transfer of a security interest in after-acquired property is not made until the debtor has acquired rights in the property. This could bring after acquired property within the preference period even though the security interest was made before it.

2) BR § 547(c)(5): exception for accounts receivable and inventory. (Addresses the after-acquired property problem above).
   a) This is a safe harbor for security interests in accounts receivable. This section treats receivables and inventory as a single item of collateral, instead of separate transfers. Only the overall increases are vulnerable to avoidance.

3) Relation-back rules
   **a)** If a secured party perfects its security interest within **ten days** after the interest takes effect between the debtor and the creditor (ten days after attachment) the interest is deemed perfected as of the time of the attachment. [§ 547 (e)(2)]. **Substantially contemporaneous.**
   b) Exempts purchase money security interests from avoidance provided that the secured creditor disburses the loan proceeds at or after the signing of the security agreement and perfects the interest within twenty days after the debtor receives possession of the collateral.

## V) Secured Creditors Against Secured Creditors: The Basics (assignment 32)

A) **The Basic Rule: First to File or Perfect** § 9-322(a)(1)

1) Priority of a security interest is the earlier of date on which the secured party files with respect to the interest, **or** perfected it.
   a) First to file or perfect rule of 9-322(1)(a). Added "or perfect" as an afterthought to protect those secured parties who perfected automatically or by taking possession (exception is PMSI).
   b) Exception to the first to file or perfect rule: § 9-325: Subordinates security interests perfected against a transferee to those perfected against a transferor. This exception covers transfers where one debtor transfers to another debtor whose after acquired property is cover by an earlier security agreement.

**2) Priority of Future Advances**
   a) All advances made by the secured creditor to the debtor have priority as of the filing of the financing statement 9-322(a)(1).
   b) An important function of Article 9 is to put searchers on notice of present and future interests that may prime the only one they intend to take.
   c) A single financing statement is adequate to perfect any number of security interests, to the limit of the description of collateral in the financing statement.

**3) Priority of After-Acquired Property**
   a) Debtors who grant security interests in after-acquired property often do not even contemplate acquiring any property of the kind described.

b) If the debtor later acquires property that fits that description in the SA, then the security interest attaches 9-203(b).

c) After-acquired lender's priority dates from the time of the filing of the original financing statement. 9-322(a)(1).

B) **Priority of PMSIs**

1) PMSIs Generally

a) **§ 9-324(e)** a PMSI in collateral other than inventory has priority over conflicting security interest in same collateral if:

i) PMSI is perfected not more than 20 days after debtor receives possession of the collateral.

ii) PMSI perfects by filing a financing statement. 9-324(e).

b) Reason: PMSI lender has relationship with the collateral earlier than any other secured party because it actually sold the property to debtor. Enables companies to sell and deliver immediately without having to check the public record and worry about the in-box

c) 9-324(g)(1) gives the seller's purchase-money security interest priority over cash lender.

2) PMSIs in Inventory

a) Twenty day grace period does not apply when it's going to be inventory in the hands of the buyer 9-324(e). Must perfect before the debtor take possession.

b) Designed to accommodate customs and practices in inventory financing (rolling). Prior security interest holders could just put into their security agreements that if the debtor gives a PMSI there is default.

c) **§ 9-324(a)** permit PMSIs in inventory ONLY when:

i) PMSI lender must perfect no later than the time the debtor receives possession of the collateral; and

ii) PMSI lender must give advance notice to inventory lender that it expects to acquire a PMSI in inventory. Notice expires after 5 years.

3) Purchase Money Priority in Proceeds: After PMSI, if debtor exchanges the collateral for proceeds.

a) The seller must take whatever action is required under § 9-306(3) to continue its perfection.

b) Generally, PM priority extends to collateral or its proceeds (§ 9-324(e).

c) Exception in 324(a): PM status in inventory flows only into chattel paper, instruments, and cash proceeds.

d) Doesn't follow proceeds of accounts.

C) Priority in **Commingled Collateral**

1) Collateral is commingled when it is mixed with other property.

2) When the identity of the collateral is lost by commingling and the collateral becomes part of a product or mass (eg., potassium nitrate in fertilizer)

a) § 9-336(c) security interest continues in the product or mass.

3) Where the identity is not lost (eg., replacement part in a machine)

a) § 9-335 allows security interest in full machine provided that the secured party files a financing statement that covers the replacement part but also the machine.

4) If more than one security interest in the mass, they rank and are in proportion to the share the total cost of the product or mass.

D) Liens: § 9-317(a): the security interest is subordinate to alien when the lien is perfected first.

1) If the secured party also satisfies § 9-203(b), then the secured party has priority.

## VI) Secured Creditors against Secured Creditors: land and fixtures (assignment 33)

A) Mortgage against mortgage

1) G/R: The first Mtg. Has priority. In most cases a mortgagee contracts with the debtor for its priority. Only when there is an inconsistency in the mortgages do these rules apply.

2) There are 3 types of recording Statutes:

a) Notice: if the creditor has notice of the prior mtg., recording the second does not get priority.

b) Race: The first to record has priority.

c) Race-notice: If the second mtgee. Does not have notice, and files first, it has priority.

3) Good Faith purchaser for value

a) Most recording statutes only protect good faith purchasers for value. Generally must be more than nominal consideration to be considered a good faith purchaser. To be a purchaser, one must take in a voluntary transaction (not judgment lien creditors).

4) Purchase-Money Mortgage: most states give purchase money mortgages priority over some liens created and perfected before.

B) Judgment liens against mortgages

1) Unsecured creditor can obtain a lien against the debtor's real property by suing the debtor, obtaining a judgment, and recording the judgment in the real estate recording system where real property is located. Priority depends on which was created first, unless the recording statute gives a different priority.

C) Construction Liens against mortgages

1) Construction liens are statutory liens -- purpose is to protect those who supply labor or material incorporated in a building.

2) Priority of construction liens

a) Usually distinguish the obvious construction of buildings from the not-so-obvious casual repair.

b) **Lien will date from the commencement of construction**. Can record the construction lien initiated by the lender before the date of commencement of construction.

3) Priority between construction lien and mtg. Will depend on the first to perfect. If the mtg is perfected before the beginning of construction, it will have priority.

D) Priority of **Article 9 Fixture Filings**

1) Priority achieved by fixture filings is governed by § 9-334. But the contractor has the choice of doing a fixture filing or a mechanics lien.
2) Fixture filings incorporated during construction: construction lien encumbers the entire building property, while the fixture filing encumbers only the fixture described
3) Priority in Fixtures incorporated without construction
   a) Non-purchase-money fixture financier will be subordinate to whatever mortgages exist at the time of the fixture filing. Except:
      i) The fixture filing will have priority over the mortgages if the debtor has the right under the mortgages to remove the fixtures. Can just go after the fixture itself without having to foreclose on the entire property.
      ii) The fixture filing will have priority over the mortgages if the security interest is a purchase money security interest in goods affixed after the mortgage, and is filed no later that 20 days. 9-334(d)

E) Priority of real Property Based on Personal Property Filing

1) A normal UCC filing is ineffective against a later mortgagee or fixture filer who perfects by filing in the real estate recording system. 9-334(e)(1)
2) However, a fixture filing is sufficient against a later mortgagee or fixture filer who perfects by filing in the real estate recording system. 9-334(e)(3). Such a filing is fully effective against certain kinds of fixtures. It permits earlier filing in the UCC personal property system to defeat mortgages and fixtures filings later recorded in the real estate system.

## VII) Competition involving Cross-Collateralization and Marshaling (assignment 34)

A) **Cross-collateralization** -- more than one item of collateral can secure a single debt. The debt is either over secured or the collateral is not valuable enough.

1) A Creditor secured by more than one item of collateral generally has the right to choose when it will foreclose against each.
2) Single action rule
   a) A creditor who forecloses against one parcel of real estate omitting another may find that it has lost the omitted parcel as collateral. These rules do not apply to personal property 9-604(a)(1).
3) Release of Collateral
   a) Debtors do not need release clauses for collateral that is inventory. 9-320(a).
   b) Sale of inventory automatically releases the property sold from any security interest created by the seller

B) **Marshalling**

1) Marshalling is an equitable doctrine developed to limit the senior secured creditor's choice of which collateral to pursue.
   a) Requires the recovery to be limited first to the non encumbered property, so that the holders of the junior liens can recover from the only collateral available to them.
   b) Usually to the detriment of the debtor's unsecured creditors.

2) Must have two creditors, two pieces of collateral, and one of the creditors can go after both (senior). The junior can only go after one.
   a) If the senior goes after the one where the junior has the interest and not the other, the junior will lose the amount of its interest.
   b) Have to show that the senior will no be harmed.

3) **In re Robert Derecktor**
   a) Both FDIC and Port Authority had security interest in some of the same collateral. FDIC had the senior secured position on Dry Dock. Without marshalling Port Authority would recover little of its claim.
   b) Court held to apply Marshaling **three elements** must be present.
      i) The existence of two creditors of the Debtor
      ii) The existence of two funds owned by the Debtor
      iii) The ability of one creditor to satisfy its claim from either or both of the funds, while the other creditor can only look to one of the funds.
   c) Further, the fact that it could hurt the recovery of unsecured creditor does not matter. The court held that these parties are not on equal footing. Secured creditors are legally superior.

4) Equitable Assignment as an Alternative to Marshaling
   a) Deny marshaling and let the senior creditor recover from the most convenient source. But as a condition of doing so, they require the senior creditor to assign its security interest in the unforeclosed collateral to the junior creditor.

5) Other marshalling rules
   a) Marshalling cannot be used by one junior lienor to the detriment of another.
   b) Bankruptcy trustee cannot marshal against unsecured creditors because it already represents all of the unsecured creditors; it cannot marshal against the debtor because the debtor has no interest.
   c) Courts are split on whether to allow marshalling where a leinor seeks to compel marshaling against the assets of a third party.

C) Cross-Collateralization on Purchase Money Security
   1) 9-103(f) places the burden of establishing what part of the balance is the purchase price on the secured creditor.
   2) 9-103(b)(2) sets forth an even more liberal rule for purchase money security interests in inventory.
      a) An inventory lender can have a purchase-money security interest in an item of inventory that secures an obligation that is not even arguably the purchase price of the item.

## VIII) Sellers Against Secured Creditors (assignment 35)

A) How the disputes arise: Where the debtor buys from someone who has less than full ownership of the collateral. Or, where the debtor induces the sale through questionable conduct, such as fraud, and then fails to pay for the collateral. In either case, the secured creditor of the buyer (through an after-acquired property clause) may have better rights to the collateral than its debtor transferor.

B) Limits of the After-Acquired Property Clause

1) § 9-203(b)(2) does not require that debtor be the owner of the collateral to effectively grant a security interest in it: Just needs to have "rights" in the collateral.

2) Rules Governing Title to Personal Property

a) Stolen property: true owner prevails because no intermediate seller had full title to car

i) Can only sell what you own

ii) Outright thief obtains no title ("void title") to the property he or she steals

iii) Thus, purchaser can obtain no title

iv) One who has no title cannot convey title "nemo dat."

b) If true owner lost his car to a car dealer who agreed to repair it for the true owner but sold it instead, true owner could not have recovered it from taxi cab company § 2-403(2) & (3)

3) Rules Governing Security Interests in Personal Property

a) Purchaser is a person who takes by purchase, and defined "purchase" as including taking by "mortgage, pledge … or any other voluntary transaction creating an interest in property. 1-201(32), (33).

b) Good faith means only honesty in fact in the conduct or transaction concerned. 1-201(19)

i) A secured creditor can be in good faith even if it does not observe "reasonable commercial standards of fair dealing in the trade." § 2-103(1)(b).

ii) Secured creditor can be good faith purchaser even if it doesn't purchase the collateral, has bad intentions, and pays nothing for it. Only requirement is they cannot lie.

c) Secured creditor obtains rights of good faith purchaser under § 2-403: can prevail over true owner of goods even if the title of the transferor was voidable because of fraud.

4) The Filing System as an Exception to *Nemo Dat*

a) Concept of filing system is also contrary to *nemo dat*

i) If B records in real estate system without knowledge that A is true owner, B becomes the true owner.

b) Title springs from A to B, enabling O to transfer what O did not have

C) Suppliers Against Inventory-Secured Lenders

1) Because these inventory suppliers do not take a PMSI in the goods they sell, they cannot win against a secured creditor: would have won had they obtained a PMSI.

a) Bank will have the right to take possession of the inventory and sell it 9-609(a)

D) **Seller' Weapons** Against the After-Acquired Property Clause

**1) Retention of Title**

a) Seller's first reaction is to contract to sell, with title to pass to buyer only when the buyer pays for the goods.
b) Such a contract is an immediate sale with the seller retaining a security interest

**2) Consignment**

a) Consignment is an arrangement in which a manufacturer or wholesaler of goods entrusts the goods to an agent for sale. This only works if the seller goes to the extra step to make a perfected purchase $ security interest.
b) 9-109(a)(4) governs consignments
c) 1-201(37) deems a consignment, even if it is a true consignment, to be a security interest.
d) 9-103(d) states that the security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.
e) Consignor will have priority over the inventory lender only if the consignor complies with the perfection and notice requirements of 9-324(b). Have to give notice to the secured to the secured inventory lender.
f) This usually does not work because secured inventory lenders have a provision in their security agreement where if the debtor takes another security interest, without its consent, the debtor is in default.

3) The Seller's UCC § 2-702 Right of **Reclamation**

a) § 2-702(2) grants unpaid sellers the right to reclaim the goods they have sold. The buyers must have received the goods while insolvent and the seller must make a demand for reclamation within 10 days of receipt.
b) § 2-702(3) effectively nullifies this right: makes the right subject to the rights of a buyer in the ordinary course of business or other good faith purchaser (a secured party is one).
    i) The courts have uniformly held that seller's right of reclamation (2-702) was subject to the security interest of the inventory lender.
c) BR § 546(c) recognizes the seller's right of reclamation as superior to the rights and avoiding powers of the trustee.
    i) 546(c) expressly provides that the demand for reclamation must be written.
    ii) It provides that the demand must be made within ten days after receipt of the goods.
    iii) It permits the Bank.Court to substitute an administrative expense priority or a lien for the right to reclaim the particular goods.
d) Existence of a good faith purchaser for value (the Bank) *extinguished* the right of reclamation.

4) **Express or Implied Agreement** with the Secured Creditor

a) The most direct means for a seller to protect itself against the buyer's inventory secured lender is by agreement.
b) The secured lender will have to agree to subordinate its interest.
c) The debtor may not like this arrangement because it doesn't allow for additional financing.
d) Problem for the seller because the secured party may not want to subordinate but it may be the only way to keep the debtor going and t=it is the most solid solution for the seller.

5) Equitable Subordination
   a) This is an equitable tool court's use where out of fairness the seller gets priority. This is the last thing the court will turn to. Usually requires conduct that is gross or egregious on the part of the secured party. Doctrine exists under both state and bankruptcy law, but only the bankruptcy courts seem to have taken to it.
   b) In re M. Paolella
      i) This court adopted a three part test for equitable subordination:
         - Claimant must have engaged in some type of inequitable conduct (fraud, illegality, undercapitalization)
         - The misconduct must have resulted in injury to the creditor
         - Equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy act.
      ii) Has seldom been invoked in cases involving non-insiders

6) Unjust enrichment
   a) Courts have only slightly been receptive to unjust enrichment claims. They are usually not allowed because they are in direct contravention of the UCC.
   b) The claim is that the inventory lender is unjustly enriched because they the collateral from he seller.

## IX) Buyers Against Secured Creditors (assignment 36)

A) Debtor has the right to sell the collateral. Security does not interfere with the free alienability of the property 9-401 but the secured creditor expects to be protected as to the value of its interest.

B) Buyers of Real Property
   1) If the mortgage was created before the debtor sold the property, the buyer takes subject to the mortgage.
   2) If sale takes place first, it will be free of a later mortgage granted by the debtor-seller.
   3) All purchasers of real property are expected to search the public record, are deemed to have notice (constructive notice) of duly recorded mortgages and take subject to them.
   4) No exceptions for sales in the ordinary course of business or even sales to consumers.
   5) A bona fide purchaser of real estate for value will take free of a prior unrecorded mortgage, if they record first.

C) Buyers of Personal Property (question is whether the buyer takes subject to prior security interests).
   1) G/R**: Buyers take subject to encumbrances of record** §§ 9-201, **9-315(a)**. This means the buyer will have to check for perfected security interests. There are **exceptions**:

   2) The **Authorized Disposition Exception**: § 9-315(a)(1)
      a) Security interest does not continue in the collateral if the disposition was authorized by the secured party free of the security interest.
      b) Does not depend for its operation on equities in favor of the buyer.

c) Authorization to sell need not be express: a secured creditor who knew that the debtor was making sales of collateral in violation of provisions of the security agreement "waived" the provisions and authorized the sale so that the buyer took free of the security interest.

d) The secured party still has an interest in the proceeds of the sale.

3) The **Buyer-in-the-Ordinary-Course-of-Business Exception**: § 9-320(a

a) *The ordinary course of whose business*

i) System does not require those who by and sell most kinds of personal property in the ordinary course of business to search and file.

**ii)** Buyer in the ordinary course of business is defined in 201(9): **must be in the ordinary course of the <u>seller's</u> business, not the buyers.**

b) *The buyer's knowledge*

i) § 9-320(a) protects a buyer in the ordinary course even if they knew of the security interest's existence.

ii) Many business that sell goods from inventory have granted security interests in their inventories. THUS, buyer takes free of SI only if he merely knows that there is a security interest in those goods. BUT, doesn't know that the sale is in violation of the security agreement.

c) *"Created by the seller"*

i) Neiman Marcus issue

- if Linda, not realizing the light is encumbered, sells the lamp to NM in the ordinary course of her business, Neiman Marcus takes **<u>subject to</u>** original security interest (because not created by Linda, their seller)

ii) Buyer does not take free of security interests created by her predecessors in title.

d) *Farm products exception:* § 9-320(a) not much of an exception

e) *When does a buyer become a buyer:* buyer defined in 9-320(a)

i) **Daniel v. Bank of Hayward**

- Customers bought a van from dealer, using their existing motor home as a down-payment. Executed a contract, transferred title on the old motor home, set the contract price, but did not list the VIN of the van. Van delivered to dealer. Bank called all the loans and secured the lot, preventing the customers from picking up their van.
- Issue: Do purchasers who make a down payment under contract for sale & have not taken title to the vehicle achieve status of buyer in the ordinary course of business. Simply, are they a buyer.
- Transfer of title not required. Instead, **they are buyers in the ordinary course when the merchandise listed in the contract is identified** (whether that means upon site notice sent to Bank listing VIN number) was sent back for factual determination.

ii) **Revised UCC 1-201(9)** codifies this case. The person is a buyer when the merchandise is identifiable because that is when the buyer has a right to recover from the seller.

f) *Sale of goods in possession of the secured party*

i) Can put buyer on notice that security interest exists, but not necessarily that the sale is in violation of the security agreement.

4) The Buyer-**Not**-in-the-Ordinary-Course-of-Business **Exception**: § 9-323(d) and (e) and 9-317(b)[this is not very powerful].

a) Result: buyer not in the ordinary course in an unauthorized sale takes subject to any **perfected** security interests, but is senior to **unperfected** security interests.

5) The **Consumer-to-Consumer-Sale Exception**: § 9-320(b): "garage sale exception" absent a filing.

a) Buyer here is protected from an automatically perfected PMSI in consumer goods but not perfected security interests.

b) Required:

i) Goods that are held for personal, family, or household purposes of the seller prior to the sale.

ii) Be held for personal, family, or household purposes of the buyer after the sale.

## X) Statutory Lien Creditors against Secured Creditors **(assignment 37)**

A) The Variety of Statutory Liens in Personal Property

1) Artisans' Lien - person skilled in some kind of trade, crafts, or art requiring manual dexterity such as carpenter, plumber, tailor, or mechanic. These are usually called mechanics liens. They have a pro rata interest once they arise with the same priority date: this is for real property.

2) Garage Keepers' Lien -- person who repair motor vehicles are in most states entitled to common law artisans' liens, but

a) Minority of states have enacted a statute specifically entitling garage keepers and mechanics liens.

b) These liens usually have priority over secured creditors: this is the majority rule.

3) Attorney's liens -- attorneys are granted statutory liens to secure the payment of at least some kinds of fees.

a) Charging liens -- lien that attaches to the clients recovery in an action against a third person.

b) Retaining lien -- a lien that attaches to documents and records that the client has delivered to the lawyer for use in connection with representation

4) Hospital Lien -- persons who are hospitalized

5) Landlord's Lien -- majority of states recognize a landlord's lien in at least some landlord-tenant contexts:
   a) Tenant-farmer who is growing crops
   b) Shopping center leases

6) Dry Cleaners' and Launderers' liens -- some states specifically provide liens in favor of cleaners and launderers. If you don't pay, then cleaners can sell the clothes.

7) Agricultural Liens -- 9-109(a)(2) applies to agricultural liens. Continue to come into existence by operation of the statute granting them, but by being within the scope of Article 9 the procedure for perfection and enforcement is more uniform.
   a) Agricultural lien holder who files a financing statement will enjoy priority as of the filing (9-322(a))

B) Statutory Liens in Bankruptcy

1) In general bankruptcy gives effect to prior statutory liens.

2) Three types that are avoidable by the trustee
   a) When lien becomes effective after the debtor is in financial difficulty. BR § 545(1)
   b) Can avoid liens that at the time of the bankruptcy filing, the lien was not sufficiently perfected to be effective in the absence of bankruptcy. §545(2).
   c) Can avoid a statutory lien that was not sufficiently perfected to be effective in the absence of bankruptcy against a hypothetical bona fide purchaser.

C) **Priority of Statutory Liens**

1) A statutory lien has the priority specified in the law that creates it (state law). Three types of rules governing priority
   a) Gives priority to either based on which was first in time. (majority)
   b) Gives priority to statutory liens regardless of which was first.
   c) Gives priority to security interests regardless of which was first.

2) Date of the lien: may be dated as of the time the lien holder gives value, contracts to give value, files the claim of lien, or takes some other action.

3) § 9-333 addresses the issue of priority between security interests and lien arising by operation of law. The section determines the relative priority of a statutory lien only if the law creating the lien does not. The default rule is that a statutory lien has priority over an article 9 security interest. Qualifying liens are narrowly defined: the lien must be
   a) In favor of the person who furnishes services or materials in the ordinary course of her business
   b) For the purchase price of the services or materials, and
   c) On goods in possession of the lienholder.

D) Statutory liens as a challenge to the first in time rule

1) To the extent that statutory liens are allowed to take priority over prior perfected liens, the system allowing first-in-time first-in-right is upset. And the purpose of that system, to

place later creditors on notice of a party's interest, is also upset.
2) This could deter some lenders from lending money; they don't know if their interest will later be trumped by a statutory lien.
3) Advocates of giving priority to the statutory liens say that the lien is for the value added by services or materials, so the secured party is not affected.
a) But, nearly all debts result from the creditor furnishing new value, some statutory lien holders do not add value (tax, towing), the debtor does not always get the value the lienor is giving (bad idea to get the car fixed).
4) Some states still give priority to statutory lien holders on the idea that the value they give will not exceed the value added to the collateral.

E) Secured creditor responses to statutory lien priority
1) Secured creditor can do things to protect themselves from statutory liens, such as;
a) Covenants: most secured lenders require, as a condition of the loan, that the debtor agree not to do anything that would give rise to a statutory lien. These covenants are rarely effective, could still be a statutory lien.
b) Payment: Most statutory liens are small in amount (such as property tax). The mortgagee can prevent foreclosure on these small amounts by paying them and add the amount to the mortgage.
c) Waiver: Some statutory lien laws permit the lienholder to waive its rights. Require the debtor to get a lien waiver before construction or the service begins.
d) Monitoring: For things like environmental cleanup. Monitor the debtor's activities to make sure that the need for clean up does not arise. This extra effort makes lending more costly.

## XI) Competitions involving federal tax liens: the basics (assignment 38)

A) Federal tax liens do not have super priority. The government was afraid that doing that would chill consumer lending. Canada does give these liens super priority.

B) Creating a federal tax lien and perfection
1) Create the lien :IRC § 6321 & 6322
a) The IRS determines the tax owing and the lien starts from the day the tax is assessed. It assess by recording the amount on its own records. When it notifies the taxpayer of the assessment, that notice constitutes demand, the lien comes into existence and relates back to the date of assessment.
b) Then the IRS perfects or "validates" the lien where the state says to. Liens against the individual in the county. Liens against a corporation with the secretary of state.
i) If the tax lien has not been filed when a debtor sells its property, grants a security interest in it, the tax lien will not be valid against that competitor.
ii) This means that he govt. plays in the priority game along with everyone else. First in time, first in right.
c) The lien attaches to "all property and rights to property, whether real or personal" belonging to the taxpayer.

C) Remedies if a taxpayer that doesn't pay: enforcement
1) If the taxpayer does not pay the tax within ten days after notice and demand, the IRS can levy on the property of the debtor.
a) The IRS can just seize the property and sell it: doesn't need the sheriff or the court.
b) The IRS can garnish: can get money belonging to the debtor from third parties (this is more common).
2) State exemption laws do not apply to the IRS but has its own exemptions.

3) Tax liens are most common against small businesses for delinquent payroll taxes.

D) Maintaining perfection
1) The IRS must refile within 9 years and one month after the origination of the lien (for a total of 10 years and 1 month).

E) Name Changes and sale of collateral
1) US v. LMS Holding Co.
a) The IRS filed a lien against MAKO. MAKOP sold the property to RMC. RMC later files bankruptcy but the IRS does not have a lien against RMC
b) The court analogizes to debtor name change cases. Because later creditors would have never known the IRS had a lien against RMC, the lien is voided against the property and the IRS is relegated to an unsecured creditor.

2) The federal tax lien act contains no provisions where the IRS has a certain amount of time, like four months, to file the lien against the purchaser or when there is a name change. This leaves it to courts to decide the time period.
3) The IRS does not have a duty to discover name changes, only to file under the new name when it knows about name changes.

F) Competitions involving Federal Tax liens
1) IRC § 6323(a): the tax lien shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until the IRS files a notice of tax lien.
a) The tax lien is valid against those competitors after it is filed. This is the idea of first in time, first in right.

2) What must the holder's of other interest's do to be senior over the tax lien:
a) Security interest: The security interest will prevail over the tax lien if the security interest satisfies the following test before the government files notice of the tax lien.
i) The property is in existence has become protected against a judgment lien under the local law, and
ii) The holder has parted with the money or other value, the repayment of which is secured.

b) Purchaser: to prevail over a tax lien, a purchaser must acquire its status as such before

the government files notice of the tax lien. [IRC § 6323(a)].

i) Purchaser is defined as a person who "for adequate and full consideration in money or money's worth," acquires an interest valid under local law (state) against subsequent purchaser without actual notice of the interest. (would do whatever it takes to be perfected under state law against subsequent purchasers: file mostly but problem arises with notice statutes).

ii) If local law requires filing or recording, the purchaser must do that to be protected.

c) Judgment lien creditor: the tax lien act does not define a judgment lien creditor but the supreme court has.

i) U.S. v. Mcdermot

- The debtor's property had both a judgment lien and a federal tax lien against it. The issue was which of the liens had priority.
- The judgment lies does not perfect until it attaches. The lien attaches to after acquired property on the date that the debtor acquires he property.
- The IRS tax lien also attaches to after acquired property, but on the same day as the judgment lien came into existence: date of assessment.
- The court says that the IRS wins because the date of the tax lien is the date of filing, not the date of attachment.
- The IRC section pointed out by the court does not necessarily require the court's conclusion, but that is the interpretation.

## XII) Competitions involving federal tax liens: advanced problems (assignment 39)

A) This assignment focuses on a number of exceptions to the general rule of first in time, first in right when it comes to federal tax liens. All of the exceptions cut against the government. The motivation for these exceptions is the protection of commerce.

B) The strange metaphysics of the Internal Revenue Code

1) The federal government can enter into the priority game with any priority it likes, but it cannot alter the priority of other interests. It therefore recognizes the types of interests usual to secured credit.

2) IRC § 6323 (a)(d) &(h) govern the priority between the federal tax lien and an Article 9 security interest.

a) The federal tax lien has priority if the IRS files a notice of tax lien before the security interest comes into existence; otherwise, the security interest has priority over the federal tax lien.

b) A security interest comes into existence when it is protected by state law against a subsequent judgment lien, but it only comes into existence to the extent that the secured

creditor has parted with money or money's worth.

i) The first part of the test is reference to 9-317(a) and 9-323(b).

ii) The second part, unlike article 9, only covers the secured creditor who has made the loan. Although different in form, the results are the same as under article 9.

C) Protection of those who lend after the tax lien is filed

1) Provision regarding future advances: IRC § 6323(d) protects advances to the extent the security interest would be "protected under local law against a judgment lien arising, as of the time of the tax lien filing, out of an unsecured obligation."

a) Banks and creditors can still make future advances for 45 days after the filing of the tax lien and have priority (because that is how they are protected against lien creditors under article 9).

b) This requires the creditor to check the record for the filing of a tax lien.

c) The security agreement itself must still contemplate future advances.

2) Commercial Transactions financing agreements

a) IRC § 6323 (c): Like the protection for future advances, extends only to transaction occurring within 45 days after the tax lien filing. The 45-day period is an opportunity for the creditor to learn of the tax lien.

b) The protection in subsection (c) also extends to after acquired property of the debtor during the 45 days.

c) Commercial financing security is accounts, inventory, chattel paper, and mortgage paper.

3) Real property construction financing

a) IRC§6323(c) protects construction lenders against a tax lien filed during construction.

b) The construction lender must have entered into a contract to finance the construction prior to the filing of the tax lien. The protection offered only extends to he real property improved.

c) This protection extends past 45 days. Advances are protected as long as they would be protected against a judgment lien arising at the time of the tax lien.

d) The purpose of this protection is to protect construction.

4) Obligatory disbursement agreements

a) IRC § 6323 (c)(4) protects lenders who have agreed before the tax lien is filed to make disbursements that the lenders then make after the lien is filed.

b) This is not the same general protection as that offered by article 9 for obligatory disbursements. It has to be a genuine obligation, not merely an option.

c) In reality, this will not often happen because security agreements with obligatory clauses will also often have clauses that there is no longer an obligation once the tax lien is filed.

5) Statutory liens

a) IRC § 6323(b) grants some statutory liens priority over the federal tax lien, even when those statutory liens arise after the federal tax lien is filed.

b) Covered are artisan's liens in favor of those who repair or make improvements to personal property and retain possession of the property; real property tax and special assessment liens; mechanic's liens for improvements made to real property [up to $1,000]; and attorney's liens.

c) The other types of statutory lies not recognized are subordinate to tax liens if they arise after the tax lien is filed.

6) PMSI

a) There is no provision of the IRC that protects PMSI's.

b) Courts have read such a provision into the IRC and the IRS has acquiesced. The reasoning is that these creditors are providing new value.

c) Elements of PMSI

i) The lender must have given value by making advances or incurring an obligation.

ii) The value must have been to enable the debtor to acquire rights in or the use of collateral.

iii) Such value must have been in fact so used

d) This requirement excludes any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt.

e) First bank of Utah v. IRS

i) The bank, after the IRS had filed its tax lien, provided financing to the debtor so it could fulfill its contracts. The bank called it a purchase money security interest in order to get priority over the IRS.

ii) The court said that it was not a purchase money security interest because it did not allow the debtor to gain rights in the collateral. Because the debtor already had rights to the contracts, the financing just allowed the debtor to operate its business.

f) The distinction made by the case is recognized under article 9 as well. Protection is afforded to the lender who assists with the purchase of an asset; there is no protection of a lender who assists by financing continuing operations.

g) Under bankruptcy, the court would have probably allowed the loan to be made with priority over the tax lien.

D) Non-advances

1) Non-advances include interest, attorney's fees, and other expenses that may be incurred by a secured creditor in protecting and recovering its collateral and collecting the amount owing from the debtor.

2) IRC § 6323(e) gives non-advances the same protection as article 9 gives them. The value of these non-advances will have the same priority date as the security agreement that they arise from, and therefore, have priority over the tax lien if the original security agreement does.

3) The security agreement must contemplate the application of non-advances: a "costs and reasonable attorney fees" clause.

## XIII) Why secured credit: theory (assignment 40)

A) The question posed by this chapter is what system would be best:

1) Security first: protection for secured parties. This is the system that is set up now

2) Tort-first by way of federal legislation. This type of system would have the effect of giving tort victims, and their judgment lies, priority to compensate them for their loss.

3) 20% carve out for torts through federal legislation. Would just expose a portion of the secured party's collateral to tort victim priority.

4) (2) or (3) above through state legislation.

B) Arguments

1) The current state, protecting secured parties, encourages excessive lending. The bank will make out no matter what.
   a) But the excessiveness is probably due in large part to unsecured credit that does not have priority anyway.

2) The current state may facilitate judgment proofing. The secured creditor actually owns the property so the tort victim cannot collect.
   d) But the lending keeps commerce going so it benefits everyone. Even tort victims because it makes the pool of resources available to satisfy judgments larger.

3) The current state of secured credit is deceptive. Normal people do not understand how the system works. But, the normal tort victim will not take into consideration the financial well being of the tortfeasor before being injured anyway.

4) The tort first system would have the effect of slowing down the lending system because secured parties will lend a lot less.
   a) But, insurance plays a major role. This is probably just another expense the creditor could pass on to the debtor who would than pass it on to consumers.