SECURED TRANSACTIONS OUTLINE

Part I: The Creditor-Debtor Relationship

§ 1: CREDITOR’S REMEDIES UNDER STATE LAW

§ 1.1: REMEDIES OF UNSECURED CREDITORS UNDER STATE LAW

A. G/R: Secured Transactions Definition: a secured transaction within the scope of Article 9 is any transaction which is intended to create, in favor of one person, a security interest in the personal property of someone else.
   1. In other words, it is the use of personal property to get loan.
   2. Secured transactions are essentially the use of personal property as collateral for a loan.
      a. The lender will want security in exchange for its loan and it will seek to secure collateral for the loan before it gives any credit to the debtor.

B. UCC 9-101 cmt. 1: Article 9 provides a comprehensive scheme for the regulation of security interests in personal property and fixtures.

C. G/R: Personal Property: is any chattel, good, license other property that is not real property, which secured parties can reach. Security interests are property.

D. G/R: Real Property: is the land and all improvements or attachments to the land.

I. WHO IS AN UNSECURED CREDITOR?

A. G/R: Creditor: anyone who is owed a legal obligation that can be reduced to a money judgment is a creditor of the party owing the obligation (debtor).

B. G/R: Debtor/Creditor Relationship: the debtor creditor relationship can be formed in many ways; the archetypical debtor-creditor relationship is that between lender and borrower of money.
   1. Voluntary Relationship: most debtor-creditor relationships are entered into voluntarily; such as, when the creditor lends money to the debtor.
   2. Involuntary Relationship: the debtor-creditor relationship can also be entered into involuntarily; such as with judgment creditors.

C. G/R: Unsecured Creditors: unless a creditor contracts with the debtor for secured status or is granted secured status by statute, the creditor will be unsecured.
   1. Unsecured creditors are general creditors that populate state collection proceedings.
   2. Judgment Creditor: if the unsecured creditor has already obtained a court judgment to establish liability, the creditor is a judgment creditor; however, the mere grant of a judgment does not alter the creditor’s unsecured status.

II. HOW UNSECURED CREDITOR’S COMPEL PAYMENT
A. **G/R:** **Prohibited Remedies for an Unsecured Creditor:** among the remedies prohibited to unsecured is:

1. **Self Help Seizure:** of the debtor’s property, which in most cases will result in the tort of conversion.
   a. Conversion is the wrongful exercise of dominion and control over another’s property in denial with his rights.
2. **Larceny:** the creditor that wrongfully takes possession of property of the debtor may be charged with larceny;
3. **Wrongful Collection Practices:** if the creditor demands payment from the debtor in an unreasonable manner, it may incur liability for wrongful collection practices.

B. **G/R:** **Remedies Available:** the creditor is entitled to coerce payment of the debt only through judicial processes specified by the state (which are fundamentally the same in all states). Under most state law, an unsecured creditor who wishes to enforce its rights following a breach must proceed through judicial action.

1. The unsecured creditor first has to get a judgment against the creditor in court;
2. to execute the judgment it must then must procure a writ of execution;
3. then the sheriff will attempt to execute the writ by levying (getting the property) on the property of the debtor, if the property is not subject to an exemption statute.
   a. the unsecured creditor (and his lawyer) must be very specific in instructing the Sheriff what property to obtain, which requires knowledge of what property the debtor has unsecured.

C. **G/R:** **Execution Procedure:** a successful plaintiff who obtains a judgment against a defendant may: (1) cause the personal property of the defendant/judgment debtor to be seized and sold; with (2) the proceeds applied to the judgment and costs by way of execution.

1. To do this, plaintiff obtains a writ of execution, directing the sheriff to levy and make a return within a statutory time limit (3-months) after the date of issuance.
   *[Vitale v. Hotel California]*

D. **G/R:** **Successive Levies under One Writ:** further levies under one writ are authorized under the same before the return day (physical return of original writ to clerk of court) if the initial levy does not satisfy the judgment *[Vitale v. Hotel California]*

E. **G/R:** **Physical Force in Making a Levy:** an officer may force an entry into any enclosure except the dwelling house of the judgment creditor in order to levy on the debtor’s goods.

F. **G/R:** **Writs of Garnishment:** [another way to compel payment of a debt]: if a third party is in possession of property of the debtor or woes money to the debtor, the creditor can cause the sheriff to serve a writ of garnishment on the third party.

G. **G/R:** **Preference Payment:** it is not fraudulent for a debtor to pay one of its creditors, even if the effect is to leave nothing for the others, so long as the debtor does not make payment for the purpose of defrauding the others.
H. G/R: Exemption Statutes: exemption statutes, which exist in all fifty states, prevent the sheriff from seizing certain property under a writ of execution and the property is exempt from the remedies available to unsecured creditors.

1. For example, some of the common statutory exemptions are:
   a. provisions for burial;
   b. business and farm property;
   c. consumer goods;
   d. motor vehicles;
   e. net incomes (up to a certain amount);
   f. depository accounts (up to a certain amount).

2. Homestead exemptions (usually with some dollar amount) are also common.
3. In short,
   a. exemption statutes prevent creditors from taking many of the most valuable and easy-to-locate assets that debtor’s own; and
   b. protect debtors by keeping households intact and by preventing some debtors from becoming wards of the state.

I. 15 U.S.C. § 1671: protects debtor’s wages by providing that a minimum of 75% of the debtor’s earnings from personal service will generally be exempt in all states.

§ 1.2: SECURITY AND FORECLOSURE

I. THE NATURE OF SECURITY

A. Liens: a lien is a charge against or an interest in property to secure payment of a debt or performance of an obligation. The lien is like a charge against an interest in property to secure payment of a debt.

1. A lien is a relationship between a particular property (the collateral) and a particular debt or obligation.
2. The general nature of the relationship is that if the debt is not paid when due, the creditor can compel the application of the value of the collateral to payment of the debt.
   a. The process by which the creditor does this is foreclosure.
3. Nonconsensual Liens: there are two types of nonconsensual liens:
   a. liens granted by statute, such as mechanic’s liens (statutory liens); and
   b. liens obtained by unsecured creditors through the judicial process (judicial liens).
4. Common Types of Liens: there are three main types of liens:
   a. security interests—liens created by contract;
   b. statutory liens—liens imposed by law; and
   c. liens obtained by unsecured creditors.

B. Security Interest: the security interest is the most common type of lien. A security interest is any lien created by contract between a debtor and creditor.

1. It includes, inter alia, real estate mortgages, deeds of trust, and security interests in personal property created under Article 9 of the UCC.
C. **G/R:** A transaction is in the nature of security if the effect is to provide one party with an interest in the property of another, which interest is contingent upon the nonpayment of debt.

D. **G/R:** A deed conveying real property, although absolute on its face, will be considered to be a mortgage when the instrument is executed as security for a debt [*Basile v. Erhal Holding Corp.*].

E. **G/R:** Intended as Security Doctrine: the intended as security doctrine applies to personal property transactions as well as those involving real property.

   1. Article 9 applies to any transaction regardless of its form, that creates a security interest in personal property [UCC § 9-109(a)(1)].
      a. When a security interest is created, Article 9 applies regardless of the form of the transaction or the name that the parties have given to it.

II. **FORECLOSURE PROCEDURE**

A. **Generally:** 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 the collateral.

   1. This change in ownership is typically accompanied by a transfer of possession, which can occur before, after, or during foreclosure.

B. **Judicial Foreclosure:** a foreclosure process is referred to as judicial if it is accomplished by the entry of a court order.

   1. In a judicial foreclosure, a creditor holding a mortgage or security interest typically files a civil action against the debtor.

C. **G/R:** U.C.C. Foreclosure by Sale: Article 9 of the UCC governs the foreclosure of security interests in personal property. It provides that after default the secured party may sell, lease, license, or otherwise dispose of any or all of the collateral. [U.C.C. § 9-610(c)]

   1. That sale or disposition itself forecloses the debtor’s right to redeem the property [§ 9-623(e)(2)].
   2. It extinguishes the creditor’s security interest in the collateral and transfers to the purchaser all of the debtor’s rights in the collateral (by cutting off the juniors) [9-617(a)].
   3. Alternatively, if the creditor so chooses, it may foreclose by any available judicial procedure [§9-601(a)].

§ 1.3: **REPOSESSION OF COLLATERAL**

I. **THE IMPORTANCE OF POSSESSION PENDING FORECLOSURE**

A. **Generally:** the essence of security is the right to repossess; foreclosure only works if the creditor can take possession of the property. The question then becomes how the creditor obtains possession of the property

II. **THE RIGHT TO POSSESSION PENDING FORECLOSURE—PERSONAL PROPERTY**
A. Generally: Article 9 of the UCC governs nearly all security interests in personal property, unless it is otherwise spelled out in the security agreement
   1. The UCC favors the secured creditor in the strongest terms on the issue of possession pending foreclosure.

B. UCC § 9-609: gives the secured party the right to take possession immediately on default by the debtor.
   1. The secured party need not involve courts or public officials if the secured party can get repossession without a breach of the peace.
   2. If the debtor resists repossession, the secured party must obtain a court order for possession and have a sheriff take possession from the debtor.
   3. The easiest way this is done is by filing an action replevin.

C. G/R: Writ of Replevin: any person entitled to possession of tangible personal property is entitled to a writ of replevin. The writ directs the sheriff to possession of the property from the defendant and give it to the plaintiff.
   1. The most common users of the writ are secured creditors entitled to possession of collateral pursuant to UCC § 9-609.
   2. A secured creditor, after getting the writ, can then obtain possession of the collateral that is tangible personal property through judicial procedure within two or three weeks.
   3. The creditor can then complete the foreclosure by selling the collateral in a commercially reasonable manner [§9-610].

D. G/R: Due Process Requirements: in creditor repossession (such as writs of replevin) or garnishment cases, the Due Process Clause of the 14th Amendment requires either:
   1. that the debtor be provided a hearing (and hence an opportunity to be heard) before his property is taken; OR
   2. that the debtor be provided certain pre-seizure procedural safeguards, coupled with a prompt post-deprivation hearing before final judgment.
   *[Del’s Big Saver Foods, Inc. v. Carpenter Cook, Inc.]*.

III. ARTICLE 9 RIGHT TO SELF HELP REPOSSESSION AND ITS LIMITS

A. G/R: Self-Help: a creditor with an Article 9 Security interest in tangible, personal property can bypass the courts and the sheriff and do its own work. The creditor’s reason for doing so is usually to save time, effort, and money.
   1. The right to self-help repossession is derived from UCC 9-609, which provides that after a default a secured party may take possession of the collateral.
   2. Caveat: courts generally hold the duty to refrain from breach of the peace during repossession is non-delegable making secured creditors liable for the consequences of illegal repossessions by independent contractors.

B. G/R: Breach of the Peace: the UCC permits self-help repossession only if the secured creditor can repossess without breach of the peace [UCC §9-609(b)(2)]; however, the UCC does not
define breach of the peace. Thus, here some of the following standards for breach of peace from various jurisdictions:

1. **Definition:** A civil breach is “a public offense done by violence, or one causing or likely to cause an immediate disturbance of public order [Restatement Torts (second) § 116];

2. **Factors:** There are two main factors courts will consider in determining whether there has been a breach of the peace:

   a. the potential for **immediate violence**; and
   
      i. most commonly used.

   b. the nature of the premises intruded upon.

   *These factors are interrelated in that the potential for violence increases as the creditor’s trespass comes closer to a dwelling

   c. it is also necessary to determine the facts of each case in order to determine if a breach occurred.

   *[Salisbury Livestock Co. v. Colorado Credit Union].

C. **G/R: Per Se Breaches:** A creditor’s entry into a residence without permission is breach of the peace.

   1. A trespass is a breach of the peace only if certain types of premises are invaded (e.g. residential) or immediate violence is likely.

D. **G/R: Privileged Right to Repossess:** If there is no confrontation and the timing and manner, including notice or lack of notice, are found reasonable, the entry is privileged by the self-help statute (UCC § 9-609) [Salisbury Livestock Co. v. Colorado Credit Union].

   1. **Notice:** is a common law element which helps determine the reasonableness of the repossession’s actions.

E. **Generally:** Various jurisdictions have considered what constitutes a breach of the peace under the UCC:

   1. In the following circumstances courts held there **was** a breach of the peace in a repossession cases:
      
      a. when creditor brought uniformed police officer to the debtor’s home in a repossession attempt;
      
      b. when the creditor’s agents physically confront the debtor or his representative;
      
      c. when the creditor’s agents cut a chain to gain admission to the property.

   2. In the following circumstances courts held there **was not** a breach of the peace in a repossession cases:
      
      a. when the repossession agents took a car in the middle of the night;
      
      b. when repossession agents took a car with a tow truck in the middle of the night;
      
      c. when the creditor snuck in and obtained a car even after being threatened with violence;
      
      d. when a creditor used a locksmith gain entry to the debtor’s business premises and then he changed to lock;
      
      e. when the repossession agent used misrepresentations in order to gain possession of the property; and
f. when a creditor gained entrance to a business premise by a friend who worked in the debtor’s building.

F. G/R: Waiver: the debtor or creditor may not waive the breach of peace provision in UCC § 9-609(b)(2) [UCC 9-602(6)].

1. However, the debtor and creditor can define the term “breach of peace” in the security agreement so long as it is not manifestly unreasonable [UCC 9-603].

§ 1.4: JUDICIAL SALE AND DEFICIENCY

A. Generally: after a judgment has been entered in a judicial foreclosure, the collateral is sold at a public sale.

B. UCC § 9-601(a): after default, a secured party has the right to reduce a claim to judgment, foreclose, or otherwise enforce the claim or security interest by judicial process.

1. Foreclosure on personal property is rarely done, most of the time the personal property is simply reposed and disposed of under 9-610(a), (b).

I. STRICT FORECLOSURE

A. G/R: Strict Foreclosure: a foreclosure procedure or situation that does not require a sale of collateral.

1. EX: the foreclosure of a contract fore deed (where if the purchaser does not make timely payments, the seller must foreclose through the court process), or installment land contract

II. FORECLOSURE BY SALE PROCEDURE

A. Generally: in most states, statutes specify the manner in which a foreclosure sale must be held. The typical statute might provide that all foreclosure sales within the county are to be held by auction at the courthouse at a certain date and time.

1. The bidder, if successful, must immediately make a deposit of a portion of the purchase price in cash or by cashier’s check.
   a. The secured creditor has a statutory right to bid at the sale; practically, the secured creditor is usually the only one to bid at the sale.
   b. Secured creditors will bid the lowest amount possible, which is usually less than the fair market value of the property
2. A court usually must review the circumstances under which the sale was held and confirm that the sale before the sale can be consummated.
3. Once the sale has been confirmed, the official (sheriff or clerk) disburses the sale proceeds.
   a. The money first goes to reimburse the foreclosing creditor for the expenses of the sale;
   b. Next the proceeds are distributed to the foreclosing creditor up to the amount of the debt secured by the foreclosed lien;
   c. assuming there are no other liens, any remaining surplus goes to the debtor.
B. **G/R: Deficiency Judgment:** if the proceeds of the sale are insufficient to pay the full amount of the debt secured by the foreclosed lien, the foreclosing creditor may ask the court to enter a judgment for the deficiency.

1. If the deficiency judgment is granted, the foreclosing creditor can it in the same manner as any other judgment on an unsecured debt.

C. **G/R: Right of Redemption:**

1. **Common Law Right of Redemption:** while the foreclosure is in progress, the mortgage debtor has the right to redeem the property from the mortgage by paying the full amount due under the mortgage, including interest and attorney’s fees.
   a. The common law right to redeem is typically foreclose as of the time of the sale.

2. **Statutory Right of Redemption:** in more than half the states, the debtor has a statutory right to redeem the collateral from the buyer after the sale (with one year being the most common period).
   a. Redemption is accomplished by paying the purchaser the amount the purchaser paid at the sale; that is, the statutory redemption is for the amount of the sale price of the property
      i. A debtor who has the right to redeem the property after sale usually remains entitled to possession;
      ii. the high bidder at the sale may have to wait months or even years for possession;
      iii. even if the bidder can obtain possession, if the right to redeem is later exercised, the bidder may be unable to recover money spent to preserve the property during the bidder’s time of possession.
   b. In some states, the redemption price will also include interest on the sale price and other expenses incurred by the purchaser in connection with the sale; however, the redemption price typically does not include the purchaser’s costs of maintaining or improving property during the period (if any) it was in the purchaser’s possession.
   c. Statutory rights of redemption are freely transferable.

III. **Problems with Foreclosure Sale Procedure**

A. **Generally:** several factors of foreclosure sale procedure contribute to is failure to bring reasonable prices for the property that is sold:

1. sales are poorly advertised;
2. prospective buyers are given little opportunity to inspect the property before the bidding and must accept the property “as is”;
3. the rule of caveat emptor applies with regard to the state of the title;
4. the sale often takes place in a hostile environment making it difficult for the prospective bidder to get information about the property; and
5. the buyer may be unable to use the property until the statutory redemption period expires.
B. G/R: **Inadequacy of Price at Foreclosure Sale:** it is well settled that a judicial sale will not be set aside for inadequacy of price unless it be so gross as to shock the conscience or there are additional circumstances which would make it inequitable to allow the sale to stand.

1. Courts will, however, set aside a judicial sale when circumstances impeaching the fairness of the transaction exist.
2. There are two instances when equity will intervene to set aside a judicial sale where the price, compared with the value of the property, is inadequate:
   a. when the disparity is so great as to shock the court’s conscience (i.e. the inadequacy is sufficiently gross to warrant the courts intervention); and
   i. sale prices less than 10% of value are generally held grossly inadequate whereas those above 40% are held not grossly inadequate.
   
   b. when circumstances exist which would make it inequitable to allow the sale to stand.
   *[Armstrong v. Csurilla]*.

C. G/R: **Advertising:** the way a foreclosure sale is advertised may be fixed by statute or the judgment of foreclosure.

1. Ex: the real estate being sold must be advertised in three public places, 3-weeks prior to the sale and advertised in the newspaper in the county where the sale is held for 6-weeks (Wis. Stat. Ann. § 815.31(1)-(2)).

D. G/R: **Inspection:** generally, the debtor is entitled to remain in possession of the property until after the sale is held; however, the mortgage contract usually grants the foreclosing creditor the right to inspect the collateral in preparation for bidding at the sale.

1. Others who wish to bid at the sale can observe the property from adjacent public places, but they have no right to enter in order to inspect.

E. G/R: **Title and Condition:** judicial sales are one of the few situations in which the rule of caveat emptor still applies—buyers take subject to any defects in the title that they could have discovered through a search of the public records or an inspection of the property.

1. In other words, the risk of mistake or defect of title is to be borne by the purchaser;
2. exception: the rule of caveat emptor does not apply in judicial sales if there is fraud, misrepresentation, or mistake of fact.
   *[Marino v. United Bank of Ill.]*

F. G/R: **Elements of Fraudulent Misrepresentation:** to set aside a judicial sale for fraudulent misrepresentation the plaintiff must satisfy five elements:

1. a false statement of material fact made by the defendant;
2. defendant’s knowledge or belief that the statement was false;
3. defendant’s intent to induce plaintiff to act;
4. an action by plaintiff in justifiable reliance on the statement; and
5. damage to plaintiff resulting from such reliance.
   *[Marino v. United Bank of Ill.]*
G. **G/R: Hostile Situation:** many foreclosure sales take place in a hostile environment because often there is no one with either a motive or an obligation to furnish information to prospective purchasers.
   1. In fact, the debtor’s strategy for retaining the property often calls for preventing third parties from obtaining the information they need to bid.
   2. Foreclosing creditors may not be able to furnish information because they do not themselves have access to it.

H. **G/R: Anti-deficiency Statutes:** because foreclosure sales rarely yield the “market value” of the property, many states have enacted anti-deficiency statutes.
   1. These statutes 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. The most common type of anti-deficiency statute credits the debtor for the fair market value of the property even if the property brings a lower price at the foreclosure sale.

I. **G/R: Credit Bidding at Judicial Sales:** the creditor who forces the sale is permitted to bid at it and will usually do so.
   1. **Credit Bids:** foreclosure sale procedures generally allow the creditor to bid on credit up to the amount of the debt (as opposed to having the creditor pay the sheriff the cash and then get it from him after the sale a few days later).

§ 1.5: **ARTICLE 9 SALE AND DEFICIENCY**

A. **Generally:** sales under Article 9 of the UCC serve essentially the same purpose as judicial sales—they determine the value of the collateral and covert it into cash.

B. **G/R: Waiver:** the requirement that the collateral be offered for sale as part of the personal property foreclosure process under §9-620 cannot be waived or varied in the initial lending contract [UCC §9-602(10)].

I. **STRICT FORECLOSURE UNDER ARTICLE 9**

A. **G/R: Strict Foreclosure:** is a procedure by which the secured party acquires the debtor’s interest in the collateral without the need for a sale or other disposition under 9-610 [9-620 cmt. 2].
   1. In other words, strict foreclosure is essentially a trade under which the secured party becomes the owner of the collateral without having to go through the normal foreclosure sale process. In exchange, the full or part of the debtor’s obligation is forgiven.

B. **G/R: Partial Satisfaction:** after default has occurred, the debtor can consent to the secured party retaining the collateral in full or partial satisfaction of the obligation it secures.
   1. **Partial Satisfaction:** means that the debtor receives credit against the debt in some amount but continues to owe the remainder.
C. **G/R: Consent:** In most cases, consent to partial or full satisfaction will not be “real.” § 9-620(c)(2) implies consent if the secured party sends the debtor a proposal for retention of the collateral in full satisfaction of the debtor and does not receive notification of objection to the proposal within 20-days. [9-620(c)(2)(A)-(C)].
   1. An oral objection is insufficient, therefore, debtors who do nothing because of confusion or otherwise, are deemed to have consented.
   2. Consent is subject to three conditions:
      a. there must be no objection from others holding liens against the collateral [9-620(a)(2)];
      b. if the collateral is consumer goods, the debtor can consent, in writing or by silence, to strict foreclosure only after repossession [9-620(a)]; and
         i. consumer goods are goods that are used or bought primarily for personal, family, or household purposes [9-102(a)(23)]
      c. strict foreclosure is not permitted if the debtor has paid 60% of the cash price of consumer goods purchased on credit or 60% of the loan against other consumer goods [9-620(e)].
         i. In other words, 9-620(e) protects debtor’s equity in the property; however, it is not too much protection because it provides to protections to consumers who have paid less than 60% and not protection to non-consumers at all.

II. **SALE PROCEDURE UNDER ARTICLE 9**

A. **Generally:** When Article 9 applies, 9-610 governs the procedure for sale of the collateral. Unlike real estate sales, which are conducted by a public official, the secured creditor conducts the sale and distributes the proceeds.
   1. Sales under Article are governed by the following procedures even if the creditor obtained possession of the collateral by filing a replevin case rather than the self help remedies under 9-609.

B. **G/R: Disposition of Collateral:** 9-610 gives the creditor broad latitude to determine the method and timing of the sale, which can be done by selling the property by auction, setting a fixed price and finding a buyer who will pay that price, or by negotiating with interested parties..

C. **G/R: Commercial Reasonableness:** the foreclosing creditor has a duty to the debtor to choose a procedure for sale that is commercially reasonable in “every aspect of the disposition, including the method, manner, time, place and terms.” [9-610(b)].

D. **G/R: Notice:** the foreclosing creditor is required to give the debtor prior notice of the sale [9-611(c)(1)].
   1. “Debtor” means an person having an interest in the collateral (other than security interest) [9-102(a)(28)].
   2. **Purpose:** the purpose of notice is to enable the debtor to observe the sale, participate in it, or otherwise protect its rights (like seeking out additional persons to bid).
E. **G/R: Right of Redemption:** the debtor has the common law right to redeem by paying the full amount of the debt, including the secured creditor’s attorney’s fees expenses of sale; however, the right to redeem only exists before the sale. No statutory right to redeem exists after an Article 9 sale [9-623(b)-(c)].

F. **G/R: Defective or Irregular Sales:** the debtor’s right to set aside an irregular or defective sale is constricted under Article 9. If the only defect in the sale was that it was commercially unreasonable, the debtor probably only has the right to sue the creditor for damages [9-625]

1. If the collateral is consumer goods, however, the debtor may be able to collect a statutory penalty [9-625(c)(2)].
2. **Good Faith Purchasers:** at UCC sales can buy with confidence that it will not lose its bargain because the sale is set aside [9-617(b)].

III. **PROBLEMS WITH ARTICLE 9 SALE PROCEDURES**

A. **G/R: Failure to Sell the Collateral:** UCC 9-610(a) provides that a secured party may sell the collateral after default, but there is no specific provision that the secured party must sell the collateral after default and not time fixed within which any sale must occur.

1. 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 left owing if the sale had been commercially reasonable [9-626(a)].

B. **G/R: Notice of Sale:** 9-611 requires that the secured party send notice to the debtor, guarantors, and some lienors. To identify lienors, the secured party may have to conduct a search of the public records.

1. §9-611(b) requires that the creditor give the debtor reasonable notification of the time after which any private sale or other intended disposition is to be made.
   a. The purpose of this notification is to give the debtor an opportunity to discharge the debt, arrange for a friendly purchaser, or to oversee the sale to see if it was conducted in a commercially reasonable manner.
2. The failure to give this notice does not invalidate the sale [9-617]; however it can have the effect of reducing the amount of deficiency the secured party can recover.

C. **G/R: Requirements of Notice:** there are 5-main rules for notice under Article 9:

C(1). **Those entitled to Notice:** Article 9 requires that the secured party given pre-disposition notice to the debtor, which is limited to a person holding an interest in the collateral [9-102(a)(28)(A)].

C(2). **Amount of Notice Necessary:** Article 9 requires that the secured party send a “reasonable notification” of the foreclosure sale, which means that the secured party must send the notice so that a party receiving it in due course would have a reasonable opportunity prior to the sale to exercise its redemption rights or take other steps reasonably calculated to protect its interests [9-612 cmt. 2].
1. A requirement of reasonable notification is timeliness. 9-612(b) provides the foreclosing secured party with an express “safe harbor” in non-consumer transactions if the secured party sends the notice no later than 10-days prior to the sale.
   a. In other words, 10-days should be sufficient, and anything less than 10-days is a question of fact for the court.

C(3). Form and Content of Notice:
1. Form: Article 9 requires the secured party to send an “authenticated” notification [9-102(a)(7); 9-611(c)], which effectively requires the secured party to send notice in a “record” (i.e. writing or electronically); hence, oral notification will not suffice under the secured party’s responsibility to provide presale notice.
2. Content: a secured party’s notice will be deemed sufficient if it:
   a. describes the debtor and the secured party;
   b. describes the collateral that is the subject of the intended disposition;
   c. states the method of intended disposition;
   d. states that the debtor is entitled to an accounting (and cost of it) of unpaid indebtedness; and
   e. states the time and place of the sale (for a public sale) or the time after which the secured party may sell the collateral (for a private sale). [9-613(1)]
3. In a consumer goods transaction, the above 5-requirements are mandatory, plus the secured creditor must also provide in its notice:
   a. a description of any liability that the recipient may have for a deficiency judgment following the sale;
   b. telephone number where recipient can obtain information about redemption; and
   c. telephone number or mailing address where recipient can obtain information concerning disposition of the collateral and obligation secured. [9-614(1)]

C(4). When Notice is Excused: the secured party need not give notice in the following situations:
1. when the collateral is perishable;
2. when it threatens to decline speedily in value;
3. when it is of a type that is customarily sold on a recognized market; and
4. when the debtor makes an effective waiver of the right to notice after default. [9-611(d); 9-624(a)].

C(5). Whether Secured Party Can Purchase at Sale: the secured party can purchase the collateral at a public sale, but it may not purchase the collateral at a private sale unless it is of a type customarily sold on a recognized market or is the subject of widely distributed standard price quotations [9-610(c)].

D. G/R: Disposition of Proceeds of Sale: Article 9 establishes a 4-step process to govern the manner in which the foreclosing secured party must distribute the proceeds of its foreclosure sale:
1. the secured party can reimburse itself for the reasonable expenses incurred to repossess the collateral and to dispose of the collateral (and reasonable attorney’s fees if in the security agreement) [9-615(a)(1)];
2. the secured party then reimburses itself for the balance of the secured indebtedness being foreclosed upon [9-615(a)(2)];
3. if there remains additional proceeds after the satisfaction of its claim, it must distribute those proceeds to junior secured parties who have provided the foreclosing secured party with a timely demand for payment [9-615(a)(3)]; and
4. the secured party must return any surplus remaining to the debtor [9-615(a)(3)].

E. **G/R: Commercially Reasonable Sale:** 9-610(b) requires that every aspect of the disposition of collateral, including the method, manner, time, place and other terms must be commercially reasonable.

1. **Test:** ordinarily, a commercially reasonable method would be a method that a reasonable owner of the particular type of property would use when their own money is at stake.
2. To make a determination of commercial reasonableness, the court will look at the facts and circumstances of the sale.
3. **Sale Price:** although failure to procure the best price for collateral does not in and of itself make a sale commercially unreasonable and reasonableness is primarily assessed by the procedure employed, a sufficient resale price is the logical focus of the protection given debtors.

E(1). **G/R: Requirements for Commercial Reasonableness:**

1. **Duty to Publicize:** one of the most important elements of a commercially reasonable sale (and not directly mentioned in the UCC) is the duty to publicize adequately; compliance with this duty requires the secured party to ensure that
   a. advertisement of the sale is sufficient to reach the proper audience for the type of asset being sold;
   b. that sufficient time is allowed between the advertising and the sale for potential buyers to respond;
   c. that the information contained in the advertising is adequate and accurate; and
   d. that the collateral is made available prior to the sale for inspection by potential buyers.
2. **Disposition within Reasonable Time:** the UCC does not specify a timeframe within which the secured party must dispose of the collateral after default; however, the secured party (to meet its commercially reasonableness duty) must:
   a. not act hasty, such as disposing of the collateral as a matter of convenience before its advertising has had time to be effect; and
   b. not delay so long that the collateral depreciates significantly in value.
   i. These inquiries are highly fact specific (i.e. perishable food must be sold sooner than a car);
   ii. the court will also look to the conduct of the creditor during the delay (i.e. was it sitting around or fixing up the car and seeking ads, etc…).
3. **Public v. Private Sale**: the secure party can sell the collateral either at a public or private sale so long as the method is commercially reasonable. A public sale is an auction, any other type of sale is a private sale.
   a. The distinction between private and public sales is relevant to the following issues:
      i. whether the method chosen is commercially reasonable;
      ii. what information the required notice should contain; and
      iii. whether the secured party may purchase the collateral at the sale.

4. **Duty to Fix-Up Collateral**: the secured party is under a clear duty to use reasonable care in the “custody and preservation” of the collateral in its possession [9-207(a)]; however, the secured party can sell the collateral in its existing condition of after any commercially reasonable preparation or processing [9-610(a)]. The secured party may make use of the collateral for the purpose of preserving its value [9-207(b)(4)(A)].
   a. In other words, there probably is not a “duty” to fix the collateral but the secured creditor can do so in his discretion.

5. **Price as an Indicator of Commercial Reasonableness**: a low price obtained at a foreclosure sale certainly provides a warning that there may have been something wrong with the sale. It may suggest that the sale was improperly advertised, that the secured party’s method of sale was unreasonable, that the sale was held at an unreasonable time, or some other problem.
   a. A low price standing alone, however, absent any procedural flaws, is not enough to invalidate the sale [9-627(a)].
   b. The standard of commercial reasonableness requires that the secured party adopt procedures designed—not guaranteed—to produce a reasonable price.
   c. **But note**: an exceptionally low price generally increases the likelihood that a court will find that the secured party employed flawed procedures—low prices cause courts to scrutinize closely the secured party’s disposition efforts.

*Chavers v. Frazier*.

F. **G/R**: Absent of Notice/Commercially Unreasonable Sales: if the secured party fails to give notice of sale or to conduct the sale in a commercially reasonable manner, there is a rebuttable presumption that the value of the collateral was at least equal to the amount of the debt.
   1. As a result, the secured creditor can recover a deficiency only by rebutting the presumption, which it can do by proving the collateral was worth some amount less than the amount of the debt.
   2. The secured creditor is entitled to a deficiency in an amount equal to the amount by which the debt exceeds the value of the collateral.

G. **G/R**: Absent of Notice/Commercially Unreasonable Sales in Consumer Contracts: the jurisdictions are split as to the appropriate remedy for failing to conduct a commercially reasonable sale of consumer or for failing to give notice of consumer goods:
   1. **Majority**: hold that there is a rebuttable presumption that the value of the collateral was at least equal to the amount of the debt, with the consequence that, if the consumer debtor objects, the court ends up determining what the sale price should have been;
2. Minority: hold that any significant irregularity in the sale procedure is sufficient to deny the deficiency altogether, a view that relieves the court of the necessity to guess what the price would have been absent the defect.

§ 2: CREDITORS’ REMEDIES IN BANKRUPTCY

§ 2.1: BANKRUPTCY AND THE AUTOMATIC STAY

I. THE FEDERAL BANKRUPTCY SYSTEM

A. Generally: the Constitution gives Congress the power to establish uniform bankruptcy law, U.S. Const. Art. I, § 8, which Congress has done in Title 11 of the United States Code. Under the Supremacy Clause, federal bankruptcy law supercedes state collection law—i.e. Article 9 and state law remedies.

II. FILING A BANKRUPTCY CASE

A. Generally: a bankruptcy case can be filed initiated by either a debtor or a creditor, however, over 99% are initiated by the debtor.

1. The Bankruptcy Reform Act of 1978 (Bankruptcy Code, Code or BC) is divided into several chapters, any of which a given debtor may choose to file under:
   a. Chapter 7, liquidation;
   b. Chapter 11, reorganization (typically for businesses);
   c. Chapter 12, reorganization (only for owners of family farms), or
   d. Chapter 13, reorganization for individuals

2. Bankruptcy Estate: upon the filing of a bankruptcy petition a bankruptcy estate is created, which consists of all the property of the debtor [BC § 541(a)].

3. Automatic Stay: at the instant the bankruptcy estate is created a stay against any collection activities is automatically imposed [BC § 362(a)].

**Both the estate and stay go into effect by operation of the law without any additional action of the court.

4. Bankruptcy Trustees: are appointed to administer the estate in most cases.

**Bankruptcy cases may be resolved through liquidation, reorganization, or some combination of the two.

B. G/R: Chapter 7 Liquidation: in a Chapter 7 liquidation, the trustee liquidates all of the property of the estate. To liquidate the property is to covert it into cash—usually by selling it. The trustee makes distributions to unsecured creditors only in money.

1. The property available for liquidation differs depending on whether the debtor is an individual or a corporation.
   a. Individual Debtors: are entitled to exempt certain property from the estate. Every Chapter 7 debtor is entitled to keep the property of the bankruptcy estate that would have been exempt from creditor’s remedies on a judgment under state law [BC § 522(b)].
i. EX: a debtor living in a state that would not permit a judgment creditor to claim the debtor’s household goods can keep those same goods if the debtor declares bankruptcy.

ii. In addition, some states give the debtor the option to exempt the property listed in BC § 522(d) instead of the property exempt from execution under state law.

b. Corporate Debtors: are not entitled to exemptions under either state or bankruptcy law; in a Chapter 7 case all corporate assets are either abandoned or liquidated.

2. Following liquidation of the non-exempt property of a Chapter 7 estate, the trustee distributes the money pro rata to the general (unsecured) creditors.

   a. If the debtor is an individual, it is discharged of all his debts, if a corporation, it has been stripped of all its assets, but the corporation still owes all its debts [BC §727(a)(1)].

C. G/R: Reorganization Cases: bankruptcy reorganization cases, whether under Chapter 11, 13, or 12 proceed differently then liquidation cases. The debtor proposes a plan to pay its creditors all or part of the debts owing to them from currently available assets or future income.

   1. Reorganization bankruptcy performs different functions than liquidation bankruptcy under Chapter 7, which is more akin to state collection procedures, because the law encourages and sometimes compels creditors to accept a modification of the debtor’s obligations sufficiently so that the debtor can meet them thereby encouraging the debtor to pay what it can rather than nothing at all.

III. STOPPING CREDITORS’ COLLECTION ACTIVITIES

A. G/R: Unsecured Creditors’ Rights: after the debtor has filed for bankruptcy, unsecured (general) creditors can file their claims and have disputes regarding them resolved in the bankruptcy case, but they have few other specific rights as the case moves toward resolution.

   1. If the debtor violates the provisions of the Code, the unsecured creditor can complain in court, however, than that, it is mostly a passive procedure for the unsecured creditor.

   2. Benefits are then shared pro rata with all other unsecured creditors.

B. G/R: Violation of the Automatic Stay: if a creditor violates the automatic stay the bankruptcy courts will usually hold deliberate violators in contempt of court and impose a fine, sometimes a substantial one.

   1. In some instances, a party injured by the stay violation can sue for damages [BC § 362(h)].

   2. Actions take in violation of the stay are either void or voidable, and many courts impose on even the innocent violator of the stay the obligation to undo the violation by returning property or correcting public records.

C. G/R: Automatic Stay: the filing of a bankruptcy petition automatically triggers the stay authorized by § 362, which enjoins creditors from exercising their ordinary remedies to enforce or collect debts that arose prior to bankruptcy.
1. Under § 362(a), the filing of a bankruptcy petition means that a creditor legally may not engage in any of the following customary collection activities:
   a. filing suit to collect a pre-petition debt;
   b. prosecuting a previously filed suit to collect a pre-petition debt;
   c. enforcing judgment obtained prior to bankruptcy;
   d. attaching, levying upon, or reposing property of the bankruptcy estate;
   e. obtaining, perfecting, or enforcing a lien or security interest in property of the bankruptcy estate; or
   f. taking any other action to collect, assess, or recover a pre-petition debt; *[BC § 362(a)(1)-(7)].

2. The Code describes the stay broadly and provides that it is applicable to all entities against any act to collect a pre-petition debt.

3. **Policy:** by stopping payment and collections, bankruptcy provides an opportunity to account for all the assets in the estate and all the charges against the estate.

3. **Duration:** with regard to unsecured creditors, the automatic stay remains in effect until the conclusion of the bankruptcy case. Unsecured creditors generally do not have the grounds to seek relief from the stay and must rely on operation of the bankruptcy process to collect the debts owed to them.

IV. **LIFTING THE STAY FOR SECURED CREDITORS**

(A. **Generally:** for secured creditors, the consequences of bankruptcy are significantly different than for unsecured creditors. While bankruptcy alters the secured creditors’ rights in many respects, the bankruptcy system recognizes their most important state created rights and gives these creditors much better treatment.

1. Bankruptcy may delay enforcement of secured creditor’s rights, however, it still promises it eventual access to either their collateral or to property or money of equivalent value.
   a. In most cases, bankruptcy gives neither the secured creditor nor unsecured creditor the right to full payment of the outstanding debt, but in all cases bankruptcy gives the secured creditor the right to be paid at least the value of its collateral.

B. **G/R: Relief from Stay:** the Code sets forth two standards for relief from stay that are relevant to Article 9 secured creditors:

1. Section 361(d)(1), which entitles a creditor to relief for “cause”; and
2. Section 361(d)(2), which entitles a creditor to relief in the debtor has no equity in the collateral and the collateral is not necessary for the debtor’s effective reorganization. *[BC § 361(d)(1)-(2)].

C. **G/R: Relief for Cause:** section 361(d)(1) provides that the court shall grant a creditor relief from the stay if that creditor demonstrates cause, including a lack of adequate protection of an interest in property held by that creditor.

1. Relief for adequate protection is limited to creditors, such as Article 9 secured parties, with valid and enforceable interests in specific assets of the debtor under non-bankruptcy law.
2. Generally, a secured creditor’s interest is adequately protected when provisions that the court considers adequate have been made to protect the secured creditor from loss as a result of a decline in the value of the secured creditor’s collateral during the time the creditor was immobilized by the automatic stay.
   a. adequate protection for a secured creditor means that the creditor must receive the same measure of protection in bankruptcy that he could have had outside bankruptcy although the type of protection may differ from the bargain initially struck by the parties.,
   b. If the debtor cannot provide what the court considers adequate protection, the court must lift the stay and allow the creditor to foreclose.
      i. EX: car that would depreciate in value because of time and use during bankruptcy — if debtor does not give adequate protection that it won’t depreciate in value, stay is lifted and secured party can foreclose on car.
      ii. The bankruptcy court determines what is adequate protection.
   *[In Re Craddock Terry Shoe Corp.]*

D. G/R: Relief under § 362(d)(2): under section 362(d)(2) a secured party can obtain relief from the stay in order to repossess and foreclosure upon its collateral if the debtor does not have an equity in the collateral and the collateral is not necessary to an effective reorganization.
   1. For purposes of § 362(d)(2), the debtor has no equity in an asset if the sum of all encumbrances on that asset exceed the value of the asset.
      i. To make this determination the bankruptcy court must determine the value of the collateral.
   2. If the valuation reflects that the debtor has no equity in the collateral, the court must grant relief from the stay, unless the debtor can prove that the collateral is necessary for an effective reorganization of the debtor. To prove this, the debtor must demonstrate two things:
      a. the particular piece of collateral is necessary to the debtor’s reorganization efforts; and
      b. that an “effective reorganization” is possible, which means that there must be a reasonable possibility of successful reorganization within a reasonable time.
   *[In Re Craddock Terry Shoe Corp.]*

§ 2.2: THE TREATMENT OF SECURED CREDITORS IN BANKRUPTCY

I. THE VOCABULARY OF BANKRUPTCY CLAIMS

A. Definitions: terminology in bankruptcy law is sometimes different that in non-bankruptcy law:
   1. Debt: the sum of money owing (in both bankruptcy and non-bankruptcy law):
      a. the amount of the debt is determined under non-bankruptcy law, typically by application of contract law, tort law, antitrust law, or some other substantive law that determines the rights and liabilities of disputing parties.
   2. Discharge: debts can be discharged in bankruptcy. A discharged debt still exists, but the discharge permanently enjoins the creditor from attempting to collect it [BC § 524(a)(2)].
a. In other words, once the debt is discharged, the debtor does not owe it.

3. **Non-recourse**: both secured and unsecured debts can be discharged; in either case, the discharged debt is described as a non-recourse, meaning that it cannot be enforced against the debtor.

   a. This really has no effect on unsecured debts;
   
   b. with secured debt, although no one owes the non-recourse secured debt, failure to pay the debt has important consequences:
   
      i. if the lien has not been removed during the bankruptcy case, it continues to encumber the collateral afterward;
      
      b. if the underlying debt is not paid, the creditor can foreclose on the property after bankruptcy, which will transfer ownership of the collateral to the purchaser and the proceeds of the sale will be applied to pay the non-recourse debt.

      i. if those proceeds are sufficient to satisfy the non-recourse debt, the debt will paid in full with the excess being distributed to junior lien holders;
      
      ii. if the proceeds are not enough to satisfy the debt, the secured creditor cannot obtain a deficiency judgment against the debtor because he does not “owe” the debt.

4. **Security Interest**: the bankruptcy groups Article 9 security interests together with other types of security interests (such as mortgages, deeds of trust, etc.) [BC §101(51)]. Thus, an Article 9 security interest, a real estate mortgage, a deed of trust, and the rights of lien creditors are all liens under the Code.

   a. **note**: under Article 9 a security interest is defined much more narrowly, as the special collection rights of a personal property secured creditor [9-102(a)(52)] (defining lien creditor as a creditor that has acquired a lien on the property involved by attachment, levy, or the like);

      i. a mortgage is defined under Article 9 as the special collection rights of a creditor consensually secured by an interest in real estate [9-102(a)(55)].

5. **Claim**: a creditor’s claim in bankruptcy is the amount owed to the creditor under non-bankruptcy law at the time the bankruptcy case is filed [BC §101(5), (12)]—a claim in bankruptcy is the amount that is actually owed.

   a. Only claims that are **allowed** are eligible to share in the distributions made in the bankruptcy case.

II. **THE CLAIMS PROCESS**

A. **G/R: Three Bankruptcy Variables**: how much creditors are paid from a bankruptcy estate depends on (1) how much the various creditors are owed, (2) the creditors’ relative priorities in the estate, and (3) the value with which to pay them.

B. **G/R: Bankruptcy Procedure**: the general bankruptcy procedure through the claims process:

   1. begins with the determination of the amount of all the creditors’ claims; that is, the amounts those creditors were owed under non-bankruptcy law as of the date of the bankruptcy [BC § 502(a)];
2. the creditor’s claims are established by the creditor filing a proof of claim, describing the debt and stating that it remains outstanding [BC § 501(a)], and the claim is allowed, unless it is objected to (however, objections to claims in bankruptcy are relatively rare);
   a. most claims are simply filed by the creditors and deemed allowed by operation of the law.
3. Claims against the estate are accelerated as a consequence of the bankruptcy filing, e.g., the entire amount becomes due, not just the monthly payment [BC § 502(b)(1)].
4. then the amount of the claim in calculated,
5. the collateral is sold,
6. the trustee is paid, and
7. finally the creditors are paid

III. CALCULATING THE AMOUNT OF AN UNSECURED CLAIM AND PAYMENTS ON UNSECURED CLAIMS

A. Generally: most debts scheduled in bankruptcy are undisputed—the debtor owes the money and has no defense; however, the amount in which the various claims should be allowed must still be calculated. From that, the amounts appropriate for distribution on each can require considerable knowledge of bankruptcy law.

B. G/R: Amount of Unsecured Claim: the amount of an unsecured claim in bankruptcy is essentially the amount owed on the debt under non-bankruptcy law as of the moment the bankruptcy petition is filed, including attorney’s fees in they were in the contract [BC § 502].
   1. The amount of the unsecured claim does not grow with the accrual of interest during the bankruptcy case because the unsecured creditors claim may not include “unmatured interest.” [BC §502(b)(1)].

C. G/R: Payments of Unsecured Claims: if there is an money left over after the everyone else is paid, the unsecured creditors take pro rata with the other unsecured creditors.
   1. However, the prospect of recovery for unsecured creditors in bankruptcy is usually not good—the vast majority fact discharge of all or a substantial portion of their outstanding debt without payment, or nominal payment.

IV. CALCULATING THE AMOUNT OF A SECURED CLAIM

A. G/R: Amount of Secured Claim: calculating the amount of a creditor’s secured claim begins with a determination of the amount owing under non-bankruptcy law, this step is the same for a claim secured by a lien as an unsecured claim [BC § 502].
   1. Then the claim is bifurcated under BC §506, which provides that the claim of a secured creditor can be a secured claim ONLY to the extent of the collateral.
      a. The remainder of the creditors claim is then unsecured (i.e. the amount over the amount of the collateral).
      b. effect: if the value of the collateral is less than the amount of the secured creditor’s claim, the effect will to be divide the secured creditor’s claim into tow claims:
         i. one will be secured in an amount equal to the value of the collateral; and
ii. the other will be an unsecured claim for the deficiency.

*[BC § 506(a)].

2. The next step is to determine whether the creditor is entitled to accrue post-petition interest, attorney’s fees, or costs on it claim. BC §506(b) allows the holder of a secured claim to accrue post-filing interest, attorney’s fees, and costs on its claims when three conditions are met:

a. attorney’s fees and costs must be reasonable;

b. payment of the attorney’s fees and costs by the debtor must be provided for under the agreement under which the claim arose; and

c. interest, attorney’s fees, and costs can be accrued only to the extent that the value of the collateral exceeds the amount of the claim secured by it.

**note:** the rules that prevent interest, attorney’s fees, and costs accruing on a claim do NOT prevent them from accruing on the underlying debt.

*[BC § 506(b)].

V. SELLING THE COLLATERAL

A. G/R: Bankruptcy Sale: Chapter 7 of the Code provides a sale procedure for the collateral which is generally more effective than a typical judicial sale because Chapter 7 provides that the trustee may sell the property in whatever manner the trustee thinks will maximize the net proceeds.

1. The broader leeway given to the trustee permits alternative forms of sale, such as, going out-of-business sales at the business site, sales in already established markets, sales through brokers, etc. . . .

2. The trustee liquidates the property of the estate and sells only the debtor’s equity in property subject to a security interest because that is all the estate has succeeded to under BC §541(a).

B. G/R: Abandonment: the trustee is authorized to abandon the property of the estate that is burdensome or of inconsequential value to the estate [BC § 554(a)]

1. When the trustee abandons property, it ceases to be property of the estate and ownership reverts to the debtor;

2. Abandonment, like sale, terminates the automatic stay;

3. if the debt has not been paid, once the property has been abandoned, the secured creditor can foreclose without interference from the bankruptcy court.

C. G/R: Sale Free and Clear of Liens; another disposition of collateral that is common in Chapter 7 is when the trustee, under appropriate circumstances, sells the collateral “free and clear” of liens [BC § 363(f)].

VI. PAYMENT OF THE TRUSTEE

A. G/R: Payment of the Trustee: a trustee who has incurred reasonable, necessary costs and expenses of preserving, or disposing of, property securing an allowed secured is authorized to recover those costs from the property [BC § 506(c)].
1. This provision results in: a trustee’s sale of an undersecured creditor’s collateral will ordinarily benefit the creditor and be deducted from its recovery; however, if the trustee’s sale of property is oversecured it will not be deducted from the trustee’s recovery.

§ 3: CREATION OF SECURITY INTERESTS

§ 3.1: FORMALITIES FOR ATTACHMENT

I. THE PROTOTYPICAL SECURED TRANSACTION

A. Generally: creditors taking a security interest either under Article 9 or real estate law have one key feature in common: they obtain their status by contract with the debtor. Article 9 secured creditors or real estate mortgagees are, by definition, consensual creditors.

1. Most security interests are created as part of a transaction in which money is lent or property is sold.

B. G/R: Security Agreement: a security agreement is a specialized type of contract entered into between the secured party and the debtor. Through this contract, the debtor creates a security interest in personal property or fixtures that runs in favor of the secured party.

1. The consensual nature of the transaction, which is necessary to bring it within the scope of Article 9, is satisfied through the voluntary association of the parties that underlies any contract [9-109(a)(1)].

C. G/R: Effectiveness of Security Agreement: unless another provision of Article 9 yields a contrary result, the terms of a security agreement are effective:

1. between the parties to the agreement,
2. against purchasers of the collateral, and
3. against creditors who acquire an interest in the collateral *[9-201].

D. G/R: Perfection/Attachment Distinction: differentiate between the concepts of perfection and attachment.

1. Attachment: once a security agreement attaches, it is enforceable against the debtor, 9-203(a), this means a secured party may proceed to foreclose upon the collateral in the event of default.

   a. That a security interest is enforceable against the debtor means that, in the event of default, the secured party can foreclose on the collateral.

2. Perfection: is irrelevant to a dispute between the secured party and the debtor. Perfection, which is a method of giving public notice of a security interest, becomes important only in the context of a dispute between the secured party and a third party asserting rights in the collateral.

   a. For the security interest to have priority over some other creditors, such as another secured party who lends against the same collateral, the creditor must perfect the interest by having the debtor authenticate a financing statement and filing that statement in the public records.
II. FORMALITIES FOR ARTICLE 9 SECURITY INTERESTS

A. G/R: Prerequisites for Creation of Enforceable Security Interest: there are three prerequisites for the creation of a security interest, which all must be satisfied before a security interest “attaches”:
   1. a security agreement;
      a. either the collateral must be in possession of the secured creditor or the debtor must have authenticated a security agreement which contains a description of the collateral;
      b. the authentication requirement, see 9-102(a)(7), serves to satisfy the statute of frauds, which must be met in order for the security interest to be enforceable.
   2. value given by the secured party; and
   3. the debtor having rights in the collateral.
**[9-203(a)-(b)].

   ELEMENT 1: SECURITY AGREEMENT AND DESCRIPTION OF COLLATERAL: 9-203(b)(3)(A)

B. G/R: Security Agreement by Possession: the secured creditor may create a security agreement without a writing if the creditor takes possession of the goods pursuant to an oral agreement to create a security interest [9-203(b)(3)(B)].
   1. EX: pawnshops
   2. note: a description of the collateral is not necessary when the creditor has possession of the collateral

C. G/R: Security Agreement by Writing: the prototypical secured transaction is based on a writing.
   1. The debtor signs an agreement called a security agreement, which contains:
      a. a description of the collateral;
      b. a description of the obligations secured; and
      c. provisions defining default, specifying the rights of the secured creditor on default, requiring the debtor to care for the collateral and keep it insured, and imposing other obligations on the debtor.
   2. When the debtor signs the security agreement the requirement for authentication in 9-203(b)(3)(A) is fulfilled.
   3. All that is required to create a security agreement is that the parties enter into a contractual relationship that falls within the scope of Article 9 (it is not necessary that they contract with reference to Article 9) [9-102(a)(73) (defining security agreement as a agreement that creates or provides for a security interest); 9-109(a)(1) (Article 9 governs transactions regardless of their form that create security interests)].

C(1). G/R: Authenticated Requirement: authentication by the debtor (a person having an interest other than a security interest or lien) includes signing, or authentication may be printed, stamped, written, initials, or by thumbprint. It may be on any part of the document and in some cases may be found on the letterhead on the “record.”
   1. Record is a media neutral term which includes writings and electronic documents, 9-102(69).
D. **G/R:** Test for whether a Security Interest has been Created: there is a two part test used for determining whether a security interest has been created:

1. first, the court must determine as a question of law, whether the language embodied in the writing objectively indicates that the parties may have intended to create or provide for a security agreement;
   a. parol evidence is not admissible on this inquiry
   b. if this element is satisfied, that is, the writing evidences a possible secured transaction and satisfies the statute of frauds requirement; **then**
2. second, the fact finder must inquire into whether the parties actually **intended** to create a security interest.
   a. parol evidence is admissible on this inquiry.

* [Ace Lumber Supply]

E. **G/R:** Composite Document Rule: when the parties have neglected to sign a separate security agreement, some courts look at the transaction as a whole in order to determine if there is a writing, or writings, signed by the debtor describing the collateral which demonstrates an intent to create a security interest in collateral.

1. In other words, the composite document rule allows the formal requirements of 9-203(b)(3)(A) to be met by the financing statement, the promissory note, and the course of dealings between the parties to indicate whether a security agreement was created.
2. The rule is available to provide evidentiary support to create a security interest in collateral.
3. **Test:** while there are no magic words which create a security interest there must be language in the instrument which leads to the logical conclusion that the it was the intention of the parties that a security interest be created.

* [Ace Lumber Supply]

E(1). **G/R:** Additional Collateral: when more than document may qualify as a security agreement (under the composite document rule) and one document contains the debtor’s signature and possibly a description of additional collateral, the jurisdictions are split as to what result:

1. **Majority Rule:** holds that so long as the documents express some internal connection with one another, they may be read together for purposes of including the collateral described in the second document with the security agreement’s umbrella;
2. **Minority Rule:** requires more than an internal consistency between the documents; instead, demanding that there be a reference within one document to another.

F. **G/R:** Absence of an Authenticated Security Agreement: if a court determines that a security agreement has not been authenticated, the creditor has no security interest and therefore is an unsecured creditor * [Ace Lumber Supply].

G. **G/R:** Policy Reasons for Authenticated Security Agreements: there are 5-main policy reasons for an authenticated security agreement:

1. **Preventing Fraud:** requires, in effect, that the writing be in the nature of the statute of frauds;
2. **Reduces Litigation:** parties agree and document is signed reduces factual disputes;
3. **Cautions Debtor:** debtors will make better decisions if they have to sign something rather than just agree orally;

4. **Channeling Transactions:** parties should put the security agreement in writing anyway because it is good business practice; and

5. **Discouraging Secured Credit:** secured creditors are sophisticated parties so burden should be on them to do it right and if they don’t the harsh result is justified.

### H. **G/R: Description of Collateral:**

the authenticated security agreement must provide a description of the collateral [9-203(b)(3)(A)].

1. The description of the collateral is the means by which to identify the property to which the security interest attaches. Because a security interest cannot attach indiscriminately to a debtor’s assets, the specific property that is affected must be identified.

2. The description in a security agreement delineates the assets of the debtor that are subject to the security interest.

3. **Sufficiency of Description:** a description of personal property is sufficient, whether or not it is specific, if it reasonably identifies what is described [9-108(a)]. This is a functional standard which requires that the collateral be described with a reasonable degree of certainty.
   
   a. A description of collateral reasonably identifies the collateral if it identifies it by:
      
      i. specific listing;
      
      ii. category;
      
      (A) EX: machinery or furniture (something not defined in the UCC) or something defined in the code like equipment, but with a different definition
      
      iii. a type of collateral defined in the UCC;
          
          (A) for example: accounts, equipment, inventory, instruments, consumer goods, and general intangibles.
      
      iv. quantity;
      
      v. computational or allocational formula or procedure; or
      
      vi. any other method that is objectively determinable.

   *[9-108(b)]*

   b. A description of collateral does not reasonably identify it when the description is supergeneric, such as, “all the debtor’s assets” or “all the debtor’s personal property” [9-108(c)].
      
      i. note: the secured creditor can achieve virtually the same result by listing separately each Code type.

### Element 2: **Value Has Been Given:** 9-203(b)(1)

I. **G/R: Value:** a security interest is not enforceable until “value has been given” [9-203(b)(1)].

1. **Value:** a person gives value for rights if he acquires them in return for a binding commitment to extend credit or if he acquires them generally in return for any consideration sufficient to support a simple contract [1-201(44)]. Hence, value is given when a party provides consideration, even past consideration.
a. This definition is so broad that the definition is nearly always met in commercial transactions (i.e., the creditor almost always loans money or has sold property on credit to the debtor).
b. Although the section does not say who has to give “value” the assumption is the creditor.

2. note: a situation in which the secured creditor did not give value at all is unlikely to lead to litigation for the simple reason that the secured creditor won’t be injured by whatever happened.

**ELEMENT 3: DEBTOR RIGHTS IN THE COLLATERAL: 9-203(b)(2)**

**J. G/R: Debtor Rights in Collateral:** the debtor must have rights in the collateral before a security interest can attach; this right is inherent because in all enforceable secured transactions the debtor transfers a property interest in a specific asset to a secured party. In other words, a person cannot grant a security interest in someone else’s property. [9-203(b)(2)].

1. The courts have read three requirements into this rule:
   a. if the debtor owns a limited interest in the property and grants a security interest in that property, the security interest will generally only attach to that limited interest [9-203 cmt. 6];
   b. some “owners” who acquired their property rights by fraud have the power transfer (or grant security interests) to bona fide purchasers (debtors) ownership rights they do not have [2-403]; and
   c. some security interests can arise at the instant their debtor’s acquire collateral.

**§3.2: WHAT COLLATERAL AND OBLIGATIONS ARE COVERED?**

A. **Generally:** a security interest is, in effect, the right to apply the value of the collateral to the holder’s debt. It follows the value of the security interest can be no greater than the value of the collateral covered by it.

I. **INTERPRETING SECURITY AGREEMENTS**

A. **G/R: Debtor Against Creditor:** a security agreement is, among other things, a contract between the debtor and creditor; hence, the rules that govern the interpretation of contracts generally apply to security agreements as well. [9-201(a); 1-201(3), 1-205].

   1. A court will generally try and determine the intention of the parties as objectively expressed in the written security agreement.
   2. Where the agreement is ambiguous, parol evidence may be introduced;
   3. Where the writing results in a mutual mistake, the security agreement can be reformed.

B. **G/R: Creditor Against Third Party:** although a security agreement is a contract between the debtor and creditor, in most circumstances, it binds third parties as well [9-201(a)]

   1. When a security agreement affects the rights of third parties, the courts are more likely to interpret them more literally than in accord with the intention of the debtor and secured party.
2. This rule also applies to the provisions of the security agreement that state what collateral is covered by the agreement.

C. G/R: Interpreting Descriptions of Collateral: when parties use one of the terms defined in Article 9 in their security agreement the court will usually, but not always, give the term its Article 9 meaning rather than its common meaning.

1. Ex: Article 9 defines many types of collateral including account, 9-102(a)(2); equipment, 9-102(a)(33); inventory, 9-102(a)(48); instruments, 9-102(a)(47); consumer goods, 9-102(a)(23); and general intangibles, 9-102(a)(42).

2. However, there is strong argument that the words used in the security agreement, like words used in any other agreement, should be assigned the meaning that the parties intended in using them.

II. SUFFICIENCY OF DESCRIPTION: ARTICLE 9 SECURITY AGREEMENTS

A. G/R: Primary Function of Description: the primary function of the description of collateral in a security agreement is to enable interested parties to identify the collateral.

1. Interested parties certainly include the debtor and creditor, and may also include other creditors disadvantaged by the grant of security, trustees in bankruptcy, or courts that must decide case that use them.

2. Identification: to “identify” the collateral means to determine that a particular time of property is, or is not, included in the security agreement.

B. G/R: Description of Collateral: a description of collateral is sufficient if it reasonably identifies the collateral.

1. Collateral must be described in one of two ways: by (a) type of assets or (b) individual items.

2. Test: individual items are sufficiently specified if the description meets a two part test:

   a. if the collateral is such that the debtor may own other similar items (regardless of whether the debtor in fact has more than one) the description must enable a third party to distinguish the collateral from other property;

      i. community standard test: in determining whether a debtor may own other similar items, for consumer purchases, the standard is whether a person is likely to own more than one item of the particular type (such as fridge, baseball glove, or socks) if an ordinary consumer in the community would have more than one item of this type.

   b. if the collateral is such that the debtor is not likely to own more than one such item, or more general description is sufficient.

*In Re Carlos*.

**Remember:** whether a description enables interested parties to identify collateral depends on: (a) who the interested parties are; (b) what information they start with; and (c) what obligations can be placed on them to gather additional information.

B(1). G/R: in order for a description of collateral in a security agreement to be sufficient it must make possible the identification of the item in which the security interest is claimed.
1. The description of the collateral in the security agreement must be more specific than that required in a financing statement.
2. The security agreement should describe the collateral with details sufficient for third parties to be able to reasonably identify the particular assets covered.
   a. Cases interpreting the reasonably identified provision have been fairly strict. *[In Re Ziluck].

B(2). G/R: Supergeneric Description: a description of collateral as “all the debtor’s assets” or “all the debtor’s property” does not reasonably identify collateral [9-108(c)].

III. DESCRIBING AFTER ACQUIRED PROPERTY

A. G/R: After Acquired Property: is a term used to refer to property that a debtor acquires after the security interest is created; that is, things such as accounts receivable or inventory that is acquired by the debtor after the debtor has signed a security agreement [9-204(a)].
   1. Most descriptions use the terms “after acquired property” but descriptions can use other words and the inclusion of after acquired property can even be compelled in some circumstances.

B. G/R: Implied After Acquired Property Clauses: there is substantial support for the proposition that, where a financing statement or security agreement provides for an interest in “all inventory” (or uses similar broad language) the document incorporates after acquired inventory.
   1. Policy: inventory is constantly turning over and no creditor could reasonably agree to be secured by an asset that would vanish in short time in the normal course of business.
      a. The utility of after acquired property clauses is that they enable the security interest to “float” on collateral, the precise components of which are constantly changing but which as whole remains relatively stable in identity and value.
      b. Sometimes these are called floating liens.
   2. Minority View: the UCC contemplates that a security agreement should clearly spell out any claims to after acquired collateral and a broad description such as “all inventory” is not sufficient.
      *[Stoumbos v. Kilmnik].

IV. SUFFICIENCY OF DESCRIPTION: REAL ESTATE MORTGAGES

A. G/R: Description of Mortgages: are governed by a separate body of law, however they rules are similar to Article 9: the description in a mortgage must describe the land sufficiently to identify it. However the description may refer to separate documents, such as maps, plats, or landmarks.
   1. A description may be so vague as to render a mortgage void; however, if the description is merely ambiguous, parol evidence may be used to explain its meaning.
   2. After Acquired Title: real estate law recognizes the doctrine of after acquired title that applies to mortgages and permits an earlier mortgage document to convey a security interest in land later acquired by the mortgagor.
B. **G/R: Fixtures:** permanent buildings and other structures permanently affixed to the land (known as fixtures) become part of the real estate and are automatically included in a description that refers only to land.
   
   1. The rule applies whether the fixtures are affixed to the real estate before or after the mortgage is executed.

V. **WHAT OBLIGATIONS ARE SECURED?**

A. **G/R: Obligations:** the general rules regarding interpretation of security agreements apply to provisions specifying what obligations are secured. Virtually any obligation can be secured if the parties make their intention clear.

B. **G/R: Future Obligations:** a security interest can also secure a debt that does not yet exist but which the parties contemplate will come into existence in the future.
   
   1. **Future Advance:** if the future obligation will come into existence as the result of an additional extension of credit by the secured creditor it is referred to as a future advance [9-204(c)].

C. **G/R: Dragnet Clauses:** debtors often execute agreements that purport to secure every obligation to the secured creditor of any kind that may come into existence in the future.
   
   1. If the creditor later lends additional money, a security agreement with such a future advance clause will assure that the subsequent loan is secured from its inception.
   2. Dragnet clauses are only valid when they are contained in Article 9 security agreements.

D. **G/R: Attorney’s Fees and Other Obligations:** [Nonadvance Provisions] security agreements (and mortgages) usually provide that, in the event of default, the debtor will pay the creditor’s attorney’s fees and other expenses of collection.
   
   1. They authorize the creditor to add these amounts to the secured indebtedness.
   2. These provisions are considered valid and effective in both personal property and real estate security agreements, and in bankruptcy.
   3. These are referred to as “nonadvance” provisions because the creditor does not advance the amount secured by them to the debtor.

§ 3.3: **PROCEEDS, PRODUCTS, AND OTHER VALUE TRACING CONCEPTS**

A. **Overview:** when a debtor and creditor contract for a security interest, they must describe the collateral, once that is done the security agreements and other documents are typically put away until a dispute arises.
   
   1. When the debtor and creditor anticipate that the collateral may go through a transformation that take its outside the description of collateral in the security agreement, the parties usually choose to have the security interest continue into the collateral as it changes form, or if the debtor disposes of it to a third party, to have the security interest attach to whatever the debtor receives in return.
a. One way to assure that a security interest will follow the value is to include express language in the description of collateral in the security agreement that covers all forms the value is likely to take.
   i. EX: bank that lends against inventory can anticipate that the inventory will be sold, resulting in accounts, negotiable instruments, or money.
b. Value Tracing Concepts: the most common way to ensure that the security interest follows the collateral is to employ value tracing concepts; the most commonly employed value tracing concepts are:
   i. proceeds,
   ii. rents,
   iii. profits, and
   iv. offspring
   *In theory each of these terms (terms of art) identifies a particular set of tracing rules, although sometimes those rules are not agreed upon.

I. PROCEEDS

A. G/R: Definition: proceeds means the following property:
   1. whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;
   2. whatever is collected on, or distributed on account of, collateral;
   3. rights arising out of collateral (i.e. rents);
   4. claims arising out of the loss, use, or rights in the collateral; or
   5. insurance payable by reason of the loss, defects, or infringement of rights, or damage in/to the collateral.
   [9-102(a)(64)(A)-(E)]

A(1). Under this definition, a security interest will follow the value of the collateral through some transformations, but not others.
   1. If the debtor sells the collateral, the security interest will attach to the price paid, whether it is in the form of an account, a promissory note, or cash.
   2. note: proceeds are collateral within the definition of collateral in 9-102(a)(12)(A). As a result, when proceeds are disposed of or rights arise out of them, whatever is received is “proceeds.” Thus, the proceeds of proceeds, are proceeds.
      a. In other words: when collateral is disposed of in any manner, whatever replaces it is a proceed. If a proceed is later disposed of, any asset that is then acquired also qualifies as a proceed. This secondary disposition results in “proceeds of proceeds.”
   3. Proceeds can take almost any form, cases have found proceeds to consist of:
      a. cash;
      b. checks;
      c. promissory notes;
      d. all payments of principal and interest on promissory notes;
      e. used cars accepted as trade ins;
      f. shares of stock received in the sale of a partnership assets, etc . . . .
A(2). **G/R: Attachment to Proceeds:** even if the security agreement makes not mention of proceeds, a security agreement automatically covers them [9-203(f); 9-315(a)(2)].

1. In other words, the attachment concept applies automatically to proceeds pursuant to 9-203(f); then
2. 9-315(a) limits attachment to proceeds that are identifiable.
   a. Identification means that the proceeds can be traced back to the collateral from which they came.
      i. The secured party has the burden of tracing the proceeds.

B. **G/R: Termination of the Security Interest in the Collateral After Authorized Disposition:** a secured party who consents to the disposition of the collateral free from its security interest is limited to the identifiable proceeds from the disposition; that is, the buyer takes free of the security interest and the secured creditor can only look to the debtor for proceeds [9-315(a)(1)].

1. Ex: the authorization to dispose of collateral might be contained in the security agreement, as when the inventory lender to a department store agrees that the store can sell inventory to customers; alternatively, it might be expressed by the secured creditor at some later time (such as when financed automobile lender approves of owner’s plan to sell it). It can also be implied from the course of dealings of the parties.

C. **G/R: Continuation of Security Interest in Collateral After Unauthorized Disposition:** when the disposition occurs without consent of the secured party, the secured parties interest attaches to the identifiable proceeds and, unless a provision of Article 9 provides otherwise, continues in the collateral (hence, the secured party can look to sources for satisfaction) [9-315(a)(1)].

1. Some states have made the unauthorized selling of collateral under a security agreement contract criminal when the debtor willfully and wrongfully fails to pay the proceeds to the secured party. *See, e.g.*, Illinois and NY.

C(1). **G/R: Multiplication of Collateral:** even if the security agreement expressly prohibits the sale of the collateral, the debtor has the power to transfer ownership to a buyer (even if the transfer is a breach of the security agreement or criminal) [9-401(b)].

1. However, as noted above, the security interest continues in the collateral notwithstanding the sale; hence, after an unauthorized sale the buyer will own the collateral subject to the security interest.
   a. The buyer may, or may not, know of the security interest.
2. Unless the secured party has authorized the debtor to sell the collateral free of the security interest, the security interest continues in the original collateral and also in the proceeds under 9-315(a)—this is *not* tracing, it is a multiplication of value for the secured party.

C(2). **G/R: Implied Waiver:** secured creditors who insist in the security agreement on provisions restricting the sale of their collateral often intend to enforce the restriction only if their relationship with the debtor sours.

1. However, if the secured creditor allows the debtor sells portions of the collateral and ignore the restrictions (in good times) many courts hold that the creditor waived the conditions on sale by its course of dealing with the debtor and that the sale to the third party was therefore impliedly authorized.
D. G/R: Limitations on the Secured Creditor’s Ability to Trace Collateral: a security interest continues to encumber proceeds only so long as they remain “identifiable”; that is, upon the sale of collateral, a secured interest in the collateral continues in any identifiable proceeds from the sale or disposition of the secured party’s collateral. [9-315(a)(2)].

1. **Tracing:** to do this the secured party must “trace” the claimed proceeds back to the original collateral; that is, the secured party must establish that the alleged proceeds arose directly from the sale or other disposition of the collateral and that these alleged proceeds cannot have arisen from any other source [In Re Oriental Rug].

D(1). G/R: **Commingling Goods:** to commingle collateral is to put it together in one mass with identical non-collateral so that no one can tell which is actually which.

1. Commingled goods are goods that are physically united with other goods in such a manner that their identity is lost in a product or mass [9-336(a)].
2. **EX:** secured oats in a silo with unsecured oats.
   i. Nevertheless, commingled grain may be legally identifiable: the law may provide a rule that arbitrarily assigns a particular part of the mass as collateral. Such a tracing rule enables the court to tell which grain is legally which [9-336(f)].

D(2). G/R: **Commingling Cash:** tracing is most often required when the debtor commingles cash proceeds with other money; that is, depositing proceeds from the disposition of collateral into a deposit account that contains other funds.

1. The secured party can prevail by identifying the funds remaining in the bank account as its collateral by a method of tracing, including the application of equitable principles that is permitted under non-UCC law (e.g., trust law), which is generally the lowest intermediate balance rule [9-315(b)(2) & cmt. 3].
2. **Lowest Intermediate Balance Rule:** the amount of the secured creditor’s collateral remaining in a bank 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 rule was applied.
   a. This rule is based on the following assumptions:
      i. as the debtor spends funds from an account, it spends the proceeds of a security interest **last**; and
      ii. the amount that can constitute identifiable proceeds is not increased by a later deposit of non-proceed funds in the account, **unless**
         (A) the parties intend that the later deposit restore the proceeds balance.
      iii. once the balance of the commingled account drops below the amount of the deposited proceeds, the secured creditor’s interest in the proceeds abates accordingly.
3. **note:** a transferee of funds (the dude paid out of the bank account) from a deposit account takes the funds free of a security interest in the deposit account **unless** the transferee acted in collusion with the debtor in violating the rights of the secured party [9-332(b)(2)].
D(3). **G/R: Specificity Requirement:** one limit on the ability of a security interest to follow the value of its collateral is that the secured creditor must be able to trace that value with specificity [*In Re Oriental Rug*].

II. **OTHER VALUE TRACING CONCEPTS**

A. **G/R: Product:** the product of collateral is something the collateral produces. The term is most commonly used in the context of agriculture (e.g., wool is a product of sheep, milk is the product of cows, babies are the product of women, just kidding).
   1. Secured creditor’s can take a security interest in “products.”

B. **G/R: Profits:** another value the secured creditor may take a security interest in (or as collateral) is the profit from collateral. Profit (a term of art with more than one meaning) generally describes the excess revenues of a business over the expenses where the business itself is collateral.

C. **G/R: Rents:** are money paid for the temporary use of collateral, which a secured party can take an interest in.

D. **G/R: Offspring:** the offspring of collateral is a term most often used with regard to animals (well, I’ll be dipped in shit), a calf is the offspring of a cow; however, it could also be considered a product of the cow.

**Note:** products, profits, rents, and offspring of collateral are all arguable “rights arising out of collateral and hence are arguable proceeds. Assuming they are, adding these terms to the description of collateral in a security agreement adds nothing under Article 9.

III. **NON-VALUE TRACING CONCEPTS**

A. **G/R:** concepts such as “after acquired property”, “replacements”, “additions” and “substitutions” in a description of collateral are non-value tracing in that they can pick up property acquired by the debtor with value not derived from the previously existing collateral.
   1. In practice, the security agreement usually provides that the collateral includes both after acquired property and proceeds, making this fine distinction irrelevant.

§ 3.4: **TRACING COLLATERAL VALUE DURING BANKRUPTCY**

I. **DISTINGUISHING PROCEEDS FROM AFTER-ACQUIRED PROPERTY**

A. **Generally:** Article 9 permits a secured creditor to trace the value of its collateral through concepts such as proceeds or products and also to pick up additional collateral by means of an after-acquired property clause.
   1. Often, the distinction between proceeds and after acquired property is not significant under Article 9, as long as one of the concepts cover the property in question.
   2. However, once the debtor files bankruptcy, the distinction becomes critical because of **BC § 552.**
B. BC §552(a): provides that property acquired by the bankruptcy estate or by the debtor after the commencement of the bankruptcy case (e.g., the petition date) is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the bankruptcy case.
   1. In other words, once the debtor is in bankruptcy, the secured creditor can no longer pick up additional collateral by means of an after acquired property clause.

C. BC §552(b): provides that if a pre-petition security interest encumbers both pre-petition collateral and its proceeds, any proceeds of that pre-petition collateral remain subject to the security interest even if they are not received until after the petition date.
   1. §552(b)(1) applies to proceeds, product, offspring, or profits; whereas, § 552(b)(2) provides a similar remedy for post-petition “rents” or pre-petition collateral.
   2. In other words, §552(b) limits value tracing to five concepts: proceeds, product, offspring, profits, and rents.

D. G/R: Effect of §552(a)-(b): generally, the result is that the secured creditor can keep what collateral value it has as of the filing of the bankruptcy case, even if that collateral value is transformed, but cannot it cannot acquire additional collateral value during bankruptcy.
   1. Policy: to safeguard the secured creditor’s entitlements after imposing the automatic stay.
   2. Thus, to permit debtors to use unencumbered property of the bankruptcy estate to buy property that would then be collateral for preexisting debts would enable debtors to apply the unencumbered values of their estates for the benefit of particular secured creditors thereby depriving their unsecured creditors of their expectancies in those unencumbered values.
      a. To prevent this the Code protects proceeds, products, offspring, rents, and profits for the secured creditors, but does not honor after acquired property clauses.

II. CASH COLLATERAL IN BANKRUPTCY

A. G/R: Use of Secured Party’s Collateral: the debtor or trustee in a bankruptcy case is generally permitted to use the secured creditor’s collateral [BC §§ 363(c)(1), (b)(1)].
   1. EX: if the secured creditor’s collateral is a factory, the bankruptcy estate can operate the factory while it remains in bankruptcy.

B. G/R: Cash Collateral: the debtor or creditor may use the secured creditor’s highly liquid collateral, such as the money in the bank account or the rents paid by the tenants of an apartment building. [BC §363(a)].

C. G/R: Adequate Protection: regardless of whether collateral is cash collateral, or regular collateral, the debtor or trustee who uses it must provide adequate protection to the secured creditor against its loss or decline in value.
   1. The debtor or trustee’s use of collateral, such as a factor or apartment building, generally do not present an immediate threat to the interest of the secured creditor
because significant decline is not likely to occur quickly, and in the meantime the secured party can seek appropriate orders from the bankruptcy court for adequate protection [BC § 361].

2. The use of cash collateral (such as to pay employees or bills) presents a more immediate threat to the secured creditor because it has the potential of being permanently lost. Hence, the usual solution is for the trustee to provide adequate protection in the form of a lien on other property of the estate.
   a. The secured party is entitled to notice and a hearing before the debtor or trustee can use its cash collateral [BC § 363(c)(2)].

§ 3.5: THE LEGAL LIMITS ON WHAT MAY BE COLLATERAL

A. Generally: Article 9 places no express limits on what may serve as collateral; in addition, although the secured cannot say it encumbers all the debtor’s property, 9-108(c), it can string together a list of descriptions (such as equipment, inventory, accounts, chattel paper, instruments, money and general intangibles) which will in effect cover everything the [business] debtor has.

B. G/R: Property Limit: the UCC defines a “security interest” as an interest in personal property or fixtures, 9-102(a)(37), and state law defines fixtures in a way that only property can be fixtures; hence, only items that are property can have a security interest taken in them.

I. PROPERTY THAT CANNOT BE COLLATERAL

A. G/R: Property of a Personal Nature: there has been growing consensus that it is inappropriate for creditors to take and enforce non-possession, non-purchase money security interests in property that is highly personal in nature and has little resale value.
   1. Ex: artificial limbs, personal clothing, some furniture or household furnishings, etc…

B. BC § 552(f)(1)(B)(i)-(iii), (f)(2): permits debtors who file bankruptcy to avoid non-possession, non-purchase money security interests in certain property (such as: household furnishings or goods, wearing apparel, books, animals, crops, musical instruments, personal jewelry, etc…) if the security interest prevents the debtor from taking advantage of an exemption otherwise available.
   1. §552 only authorized avoidance of a lien if the lien “impairs an exemption to which the debtor would have been entitled” were the lien not in existence, which restricts its protection to the categories of property exempt from the claims of unsecured creditors under state of federal law (i.e. exemption statutes).
      a. The bid difference is that exemption laws protect typically protect homes and automobiles, but §552 protects neither.
      b. note: if the debtor is not in bankruptcy, he is not protected under §552; however the FTC prohibits such action (see below)
   1. Exception: security interests in possession of the secured creditor are exempted from §552 avoidance.
      a. Ex: a bank good take possession of jewelry or a coin collection and then take possession by keeping it in the vault.
2. **Exception**: purchase money security interests in personal items are also excepted from §552 avoidance.

C. **FTC Rule §444.2**: Unfair Credit Practices: it is an unfair act or practice for a lender or retail installment seller directly or indirectly to take or receive from a consumer an obligation (agreement between lender and seller) that:

1. contains an assignment of wages *unless*:
   a. it is revocable at will by the debtor;
   b. the assignment is a payroll deduction plan in which consumer authorizes a series of wage deductions as a method of making payment; or
   c. the assignment applies only to wages already earned at the time of the assignment.

2. contains a non-possessory security interest in household goods other than a purchase money security interest.
   a. household goods means clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects (including wedding rings).

**The FTC can enforce these regulations by bringing actions for civil penalties or for cease and desist orders against violators.**

**Note:** most states have enacted similar statutes that allow private actions against lenders involved in unfair trade practices.

D. **G/R**: Future Income of Individuals: a direct attempt to create a security interest in the debtor’s ability to earn future income (an *assignment of wages*) is not covered by Article 9 [9-109(d)(3)].

1. The UCC excludes coverage of assignment of wages because the assignments present important social issues that other law addresses [9-109(d) cmt. 11 citing FTC §444].
2. **State Law:** when states do permit wage assignments they frequently limit them by:
   a. assignments of wages cannot be made in consumer transactions;
   b. wages can only be assigned after they are earned; or
   c. assignment of wages cannot exceed a certain percentage of the debtor’s income.

E. **G/R**: Pension Rights: under ERISA, pension plans cannot be assigned or alienated; hence, there is a general rule against taking a security interest in a pension plan or the use of pension rights as collateral [ERISA §206(d); *In Re Green*].

1. Note, however, that although federal law prohibits taking an interest in pension plans there is nothing in Article 9, which expressly prohibits it; however, in my personal opinion 9-109(c)(1) does expressly prohibit it.

II. **Future Property as Collateral**

A. **G/R**: Future Property as Collateral: under both real property law and the UCC, a debtor can grant a security interest in property the debtor does not yet own (i.e. after acquired property) then when the property comes into existence or into the hands of the debtor, the security interest attaches.
1. *Individual Debtors:* an individual debtor ordinarily cannot effectively encumber his future earnings from personal services;

2. *Business Debtors:* a business debtor, on the other hand, may encumber future earnings of the business by encumbering accounts, chattel paper, money, and bank accounts—the income the business will receive over time.
   
a. **note:** a business that has encumbered its future income can escape the encumbrance by filing bankruptcy because an after acquired property clause ceases to be effective once the debtor files, BC §552(a); hence, the creditor is entitled only to the proceeds, product, offspring, rents, or profits of the collateral existing at the time of filing, BC §552(b).

### III. VALUABLE NON-PROPERTY AS COLLATERAL

A. **Generally:** Article 9 only applies to transactions intended to create a security interest in personal property, 9-109(a)(1); hence, if the subject of the transaction is not property the debtor and creditor cannot create a security interest in it.
   
   1. This is often used to place limits on what may be used as collateral.

B. **G/R:** Valuable Non-property: generally, any non-property cannot have a security interest taken in it and such valuable things as franchises, licenses, and pension rights are unencumberable. However, some courts have taken an expansive view property, pragmatically equating it with almost anything of value and valuable non-property’s potential to produce property is encumberable *In Re SRJ Enterprises*.
   
   1. In other words, a license or franchise is not property but a secured creditor can take an interest in the value that is produced (or proceeds) of the license; hence, the creditor would be taking a lien in the market share value or general intangibles of the license.

### IV. DEFEATING LIMITS ON WHAT MAY BE COLLATERAL

A. **G/R:** Licenses and Franchise Agreements: assuming that debtors cannot create security interests in licenses and franchises, they may nevertheless create security interests in:
   
   1. the proceeds that come into existence when debtor’s sell those licenses or franchises; and
   
   2. revenues that debtor’s derive from the sue of their licenses or franchises.
   
   **Debtors can grant security interests in both kinds of collateral long before they come into existence.

### § 4: DEFAULT: THE GATEWAY TO REMEDIES

#### § 4.1: DEFAULT, ACCELERATION, AND CURE UNDER STATE LAW

I. **Default**

A. **G/R:** Debtor in Default: creditors only have remedies available to the them under state law if the debtor is in default. [9-609(a)].
B. G/R: Default: is the debtor’s failure to pay the debt when due or otherwise perform the agreement between the debtor and creditor.
   1. Creditor’s usually define precisely what constitutes default in the security agreement. Those acts or failures which constitute default are usually defined broadly, so that the creditor is sure to collect upon non-payment.
   2. Some of the common examples, or standard reasons for default are:
      a. non-payment of an obligation;
      b. debtor breaches any warranty or note with the creditor in this transaction (and sometimes even other transactions);
      c. debtor becomes insolvent or dies;
      d. gave secured party materially misleading information;
      e. the collateral is lost or destroyed;
      f. debtor petitions for bankruptcy or admits cannot pay debts;
      g. property of debtor attached to;
      h. whenever secured party believes in good faith that the prospect of payment or performance is impaired (insecurity clause);
   3. In other words, virtually any breach of contract puts the debtor in default.

II. WHEN IS PAYMENT DUE

A. G/R: Installment Loans: a loan is an installment loan if the parties contemplate that the debtor will repay in a series of payments; ordinarily, most of these payments will be at regular intervals (monthly, quarterly, or annually)

B. G/R: Single Payment Loans: many secured loans are made payable on a particular day; often, this is because the parties except the debtor to have the money that day.
   1. Rollover: the debtor cannot pay on that given day, the bank may rollover the debt until the next quarter or time when it is due; however, the bank has not legally binding obligation to do so.
   2. Payable on Demand Loans: some loans are payable “on demand”; that is, whenever the bank demands payment, or calls its note, the debtor must pay.

C. G/R: Lines of Credit: with a line of credit loan, the bank contracts to lend up to a certain fixed amount of money (the line limit) and then loans the money as the debtor needs it.
   1. Under most line arrangements, the debtor borrows the money simply by writing a check on its bank account.
   2. The bank covers all overdrafts up to the limit of the line of credit by drawing against the line, and charges the debtor interest on the money only from the time it pays the money out.
   3. As the debtor receives revenues from its operations, it uses the money to pay down on the line of credit obligation, thereby stopping the accrual of interest.

III. ACCELERATION AND CURE

A. G/R: Common Law Default Rule: at common law, a debtor who defaults on a loan payment, is only in default on that one “obligation”; that is, the entire amount of the loan does not become
due because the debtor missed one payment, this is the result because absent a contract provision to the contrary, the entire debt is not due after the missing of payment.

1. This put creditor’s in a precarious situation because they would have to choose whether to bring suit after each missed payment, incurring substantial litigation costs, or wait until the entire debt came due, at which time the debtor may be insolvent or destroyed the value of the collateral.

2. As a result, most secured creditors contract out of the “common law” rule.

B. G/R: Acceleration Clauses: most creditors require that an acceleration clause be part of an installment loan agreement. An acceleration clause typically states 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.

1. The creditor can then enforce the obligation in a single lawsuit.

2. The practical effect of an acceleration clause is often to eliminate the debtor’s ability to cure the default.

C. G/R: Insecurity Clauses: if an acceleration clause contains a provision which states that the creditor can consider the debtor in default when it deems itself “insecure”, the creditor has the right to accelerate only if it in good faith believes that prospect of payment or performance is impaired [1-208].

1. “Good faith” means honesty in fact in the conduct or transaction concerned [1-201(19)] or

2. “Good faith” means honesty in fact and the observance of reasonable commercial standards of fair dealing [9-102(a)(43)].

D. G/R: Implied Waiver: waiver is the intentional relinquishment or abandonment of a known right. The intent to waive contractual obligations or conditions may be implied from a party’s representations that are short of an express declaration of waiver; however, these voluntary “implied in fact” waivers still represent a voluntary act whose effect is intended [JR Hale v. United N.M Bank].

1. Waiver, in the context of acceleration clauses, presents an issue when a creditor demands payment when it usually has not done so, or the exercises its rights under an insecurity clause. The debtor usually argues that the Bank cannot call its debt because it waived the debtor’s transgressions that were in violation of the contract.

E. G/R: Waiver by Estoppel: when one party honestly believes that other party intended to make a waiver, a waiver might be presumed or implied contrary to the intention of the party waiving certain rights.

1. To prove waiver by estoppel, the party need only show that he was misled to his prejudice by the conduct of the other party into the honest and reasonable belief that such waiver was intended.

2. The estoppel is justified because the estopped party (i.e. bank) reasonably could expect that his actions would induce reliance of the other party. [JR Hale v. United NM Bank].
F. **G/R:** **Debtor’s Right to Cure:** a debtor has the right to cure a default by paying the amount due. If the debtor cures before the creditor accelerates, the necessary sum may be small.
   1. Some debtors, particularly those who get remainders from their creditors, make up payments in time and get out of jeopardy.
   3. However, once acceleration has occurred, a debtor can cure, or redeem, only by paying the **entire** amount of the accelerated debt [*Old Republic Ins. Co.*].

G. **G/R:** **Reinstatement Statutes:** statutes in some states permit cure and reinstatement of the original loan terms by payment of only the arrearages (money overdue and underpaid) even after the secured creditor has exercised its contract right to accelerate.
   1. State legislatures that enact such statutes usually limit their application to home mortgages, to consumer borrowers, or to some other circumstances that the legislators’ believe most require this form of regulation.

IV. **ENFORCEABILITY OF PAYMENT TERMS**

A. **G/R:** **Lender Liability:** some courts have determined that harsh payment terms, even if properly administered and worded, are not enforceable because implied in every contract is an obligation of good faith, which means that the parties must act reasonable and in fairness.
   1. The Circuits are split on whether such a defense is available to the debtor [*KMC v. Irving Trust* (defense available in 6th Cir); *Kham & Nate’s Shoes v. 1st Bank* (defense not available in 7th circuit)].
   2. Under the revised Article 9, it may appear from the definition of good faith, 9-102(a)(43), that the drafter’s followed the sixth circuit approach; however, the definition only applies when it is used in the Article.

V. **PROCEDURES AFTER DEFAULT**

A. **G/R:** **Secured Creditor Remedies:** once the debtor is in default, the secured creditor has a choice of remedies.
   1. Those remedies fall into two basic categories:
      a. judicial remedies, such as, foreclosure and replevin, which are administered by the courts; and
      b. self-help remedies such as repossession without judicial process, the notification of account debtors, or the refusal to make further advances to the debtor under a line creditor.
   2. If the debtor is an account debtor, the creditor can notify any person obligated to make their payment directly to the bank [9-607(a)(1)].

§ 4.2: **DEFAULT ACCELERATION AND CURE UNDER BANKRUPTCY LAW**

A. **Generally:** state law generally enforces the contract between a debtor and secured creditor regarding default, acceleration, and the possibility of cure. Because, except in a few limited circumstances, once acceleration under state law occurs it is irreversible, thus, debtors are usually in deep shit and cannot recover from their defaults—hence, here we are back in bankruptcy.
B. G/R: Bankruptcy Protection for Defaulting Debtor: bankruptcy protection of the debtor who has suffered an acceleration of installment debt occurs in two stages:
   1. in the first stage, which extends from filing to confirmation, the automatic stay protects the debtor from foreclosure while the debtor attempts to formulate a plan;
   2. in the second stage, confirmation of the debtor’s plan reverses the acceleration, the debtor cures its default, and the installment payment contract between the debtor and creditor is reinstated.

I. STAGE I: PROTECTION OF THE DEFAULTING DEBTOR PENDING REORGANIZATION

A. G/R: Automatic Stay: when the debtor files bankruptcy the automatic stay against collection and foreclosure is instantly imposed by operation of law. Unless lifted pursuant to BC § 362(d) the stay of an act against property (e.g., foreclosure) remains effective until the property is discharged from bankruptcy.
   1. The stay of any other act continues until the case is closed or dismissed, or the debtor is granted or denied discharge [BC § 362(c)(2)(A)-(B)].
   2. A debtor who provides adequate protection to its secured creditor typically will be permitted to use the collateral while the case remains pending [BC §§ 363(b)(3); 363(c)(2)].
   3. EX: all this simply means, if the collateral is a house the debtor can live in it, if the collateral is a hotel, the company can run it, until the debtor can cure.

II. STAGE II: REINSTATEMENT AND CURE

A. G/R: Reinstatement and Cure: is a process accomplished through the confirmation of a plan of reorganization in either Chapter 13 or 11; however, this must be distinguished from modification (see “B” below).
   1. Reinstatement and cure is always a return, as opposed to modification, to the repayment terms agreed to between the debtor and creditor.
   2. When a default is cured and terms of payment are reinstated the debtor takes on two obligations:
      a. any payment that, by the contract between the parties, was due on a date after the reinstatement remains payable on its original due date;
      b. any payment that, by the contract between the parties, is overdue as of the reinstatement date is part of the obligation to cure.

A(1). G/R: Reinstatement and Cure under Chapter 11: to cure and restate under Chapter 11 the debtor must:
   1. cure any default that occurred before or after the commencement of the bankruptcy case, in a slump sum on the effective date of the plan;
   2. future payments must remain due at the times specified in the original contract;
   3. debtor must compensate creditor for any damages incurred through reasonable reliance on the breached repayment contract; and
   4. the plan must not otherwise alter the legal, equitable, or contractual rights to which the claim entitles the holder.
A(2). **G/R: Reinstatement and Cure under Chapter 13:** A Chapter 13 plan may provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any secured claim on which the last payment is due after the date on which the final payment is due. This requires:

1. the debtor cure any default that occurred before or after the commencement of bankruptcy, within a reasonable time (interpreted to mean months and in some cases years with the ceiling being that it cannot extend longer than the plan);
2. future payments remain due at times specified in original contract; and
3. cannot otherwise alter the legal, equitable, or contractual rights to which the holder is entitled.

*Chapter 13 does not expressly require compensation for damages incurred by the creditor as a result of the breach, but it directs the court to apply applicable state law—some states have provisions requiring payment, some don’t.*

**B. G/R: Modification:** modification is sometimes referred to as “rewriting” the loan. Modification is accomplished through confirmation of a plan that provides for it.

1. The minimum amount debtor must pay on a modified secured claim is determined in two steps:
   a. determine the amount of the allowed secured claim; and
   b. formulate a schedule for payments that will have value, as of the effective date of the plan, not less than the amount of the allowed secured claim.
      i. the accepted method for meeting this test is that the payments must be at least equal to the amount of the claim plus interest at the “market rate” from the effective date of the plan until the payments are made.
         (A) In other words, if the debtor is going to “modify” he must pay the secured lender the full amount of the claim plus interest at the market rate.
      ii. in Chapter 11, payments can extend of a period of time that is fair and equitable [BC § 1129(b)(1)].

C. **G/R: Deadline for File for Reinstatement and Cure:** a debtor can reinstate and cure a default and acceleration even though the deadline for doing so under state law has passed before the debtor invokes bankruptcy procedure.

1. Notwithstanding applicable state law, a default with respect to a lien on the debtor’s principle residence may be cured until such residence is sold at a foreclosure sale [BC §1322(c)(1)].

§ 5: **THE PROTOTYPICAL SECURED TRANSACTION**


**Part II: Creditor-Third Party Relationship**
§ 6: **PERFECTION**

A. **Analytical Framework:** when dealing with perfection, the general filing rule and its exceptions, there are essentially three things that must be done:

1. categorize the collateral;
2. determine whether perfection will be governed by Article 9, real estate recording statutes, or other law; and
3. examine that law to determine what, if anything, it requires of the creditor to perfect the security interest.

§6.1: **THE PERSONAL PROPERTY FILING SYSTEMS**

A. **G/R:** Perfection: are the steps that a secured creditor takes to enhance its position with respect to other potential competing claimants.

1. Competing claims can be asserted by an array of potential claimants, including a purchaser (other than a secured party), another secured party, or lien creditor (e.g., bankruptcy trustee).

2. **Attachment:** of a security interest simply established the relationship between the debtor and secured party and gives the creditor a special property interest in the collateral.
   a. Perfection is only relevant to the secured party’s position to a third party who claims an interest in the same collateral—perfection has no bearing on the debtor or secured party.
   b. Perfecting simply allows the secured party to reduce the risk that a third party claimant can successfully assert a superior claim to the collateral.

3. Perfection generally requires that the secured party take designated steps that are deemed sufficient to publicize its interest to other parties that might have an interest in the same property.

B. **UCC § 9-310:** Article 9 identifies eight methods by which secured parties can perfect their security interests. The various alternatives are all described, with applicable cross-references, in §9-310. The availability of any given method of perfect depends upon the kind of property used for the collateral and sometimes upon the nature the transaction.

C. **G/R:** Eight General Ways to Perfect: there are eight general ways to perfect a security interest:

1. **Filing a Financing Statement:** Article 9’s default rule requires that a financing statement be filed to perfect all security interest and agricultural liens [9-310(a)]. All other methods are considered exceptions to this general rule [9-310 cmt. 2].
   a. A financing statement is a simple form that is filed in the appropriate public filing office (usually the secretary of state’s office) to enable interested parties to obtain sufficient information concerning a security interest in personal property of the debtor.

2. **Possession:** a secured party generally is entitled to perfect a security interest in goods or in any form of indispensable paper by taking actual, or constructive, possession of the collateral [9-310(b)(6), 9-313].
3. *Automatic Perfection*: in some circumstances, a secured party will not be required to take any steps beyond attachment of the security interest to be deemed perfected because perfection occurs automatically (e.g., purchase money security interest in consumer goods) [9-310(b)(2), 9-309];

4. *Temporary Perfection*: Article 9 also allows automatic perfection in certain additional, specified circumstances, but perfection is only for a limited time [9-310(b)(5), (9)];

5. *Perfection under Federal Law*: if federal law preempts state law and requires filing in a federal filing system then perfection must be done at the federal level [9-310(b)(3)];

6. *State Certificate of Title Statutes*: all states have enacted separate certificate of title systems that cover motor vehicles, and related goods such as, trailers, boats, and tractors. These statutes generally provide that a security interest in the property can be noted on the title itself. Hence, with these goods it is neither required nor effective to file a financing statement [9-310(b)(3), 9-311(a)(2)-(3)];

7. *Control*: the primary method for perfecting a security interest in investment property, deposit accounts, letter of credit rights, and electronic chattel paper is control;

8. *Delivery*: a security interest in a certified security is perfected by delivery to the secured party even though an endorsement for control is not present [9-313(a)].

**D. G/R: When Perfection Occurs:** a security interest becomes perfected when it has attached and when any additional steps set out in the code have been taken [9-308(a)]. The security interest must also attach (i.e. it would be fucking stupid to perfect something that did not exist).

1. The **general rule** is that perfection occurs at the first instance when all the requirements for both attachment and perfection are satisfied.

**I. COMPETITION FOR THE SECURED CREDITOR’S COLLATERAL**

A. **Generally**: the focus in perfection and priority is the relationship between the secured creditor and others who may claim the same collateral; that is, the issue now becomes the rights a secured creditor against others who also have rights superior to those of the debtor.

1. *Priority*: the law treats many contests over right to collateral as question of priority.

2. *First Time, First in Right*: is the general principle that drives the system of lien priority.

**II. PRIORITY**

A. **G/R: Lien and Priority**: a lien is a relationship between a debt and property that serves as collateral.

1. *Remedy*: if the debtor fails to pay the debt, the secured party can foreclose the lien, force a sale of the collateral, and have the proceeds of the sale applied to payment of the debt.

   a. This is the secured creditor’s “remedy.”

2. *Priority*: if there is more than one lien against collateral, each will have a priority (labeled first, second, third, etc…).

   a. Lien with priority higher than another is referred to as a prior lien or *senior lien* and the other is referred to as a *junior lien* or subordinate lien.
b. If the value of collateral is insufficient to pay all of the liens against an item of collateral, the junior liens yield to the senior ones.

B. G/R: Unjust Enrichment: the rule of equitable unjust enrichment can be asserted in cases under Article 9 because it would substantially impair the effectiveness of the UCC if interested created in compliance with the UCC could be defeated through an unjust enrichment claim [Peerless Packing Co. v. Malone & Hyde].

III. HOW DO CREDITORS GET PRIORITY

A. G/R: First in Time: central to the system of lien priority is the idea that liens rank in the chronological order in which they were created, subject to a few small exceptions for property tax liens.

1. The rationale of the lien priority system depends heavily on the fact that once the priority of a lien is established, any lien created thereafter will be subordinate.
   a. Policy: this allows a creditor to know, at the time it makes the loan, how it will fare in later competitions over the collateral.

B. G/R: Perfecting the Lien: the laws under which liens are created almost invariably condition priority on the holder taking steps to make the existence of the lien public and easily discoverable (for subsequent creditors).

1. The steps that must be taken differ with the type of lien, but nearly all include acts in one of four categories:
   a. filing notice in a public records system established for that purpose;
   b. taking possession of the collateral;
   c. taking control of the collateral by means of the stake holder’s agreement to hold for the secured creditor; or
   d. posting notice on the property or where it will be seen by persons dealing with the property.

2. The taking of whatever steps are necessary is perfection.
   a. Perfection is a series of steps that the holder of lien must take to give public notice and thereby establish priority. Because priority is based on the time these steps were taken, it is important to document that time, which is usually done by filing officers that receive notices of filing.
   b. In a large majority of cases, the dates and times of perfection will determine the priorities of the liens.

IV. THEORY OF THE FILING SYSTEM

A. Filing System Generally: the filing system is the principle means used to communicate the possible existence of a lien form a creditor who has one to a creditor who is thinking of acquiring one.

1. Constructive Notice: the filing system gives constructive notice but is intended to also give actual notice to a later creditor.

2. Financing Statements: financing statements, see Form UCC-1, are the way creditors put other creditors on notice of the its security interest.
V. MULTIPlicity OF Filing SYSTEMS:

A. G/R: Nelson’s General Rule: a secured creditor should file financing statement everywhere that someone potentially might look—at the federal level, and at the state level, if necessary. If applicable, file one in the real estate filing system too. If anything has come from the worthless class notes, it is that rule.

B. Generally: there are several filing systems throughout the country, with a few exceptions, each county in the United States maintains a real estate recording system in which not only real estate mortgages are filed, but Article 9 fixture filings are also filed [UCC 9-501(a)(1)].
   1. Many counties maintain separate systems for property liens, tax liens, and money judgments.
   2. All states except two have UCC filing systems (usually in the secretary of state’s office) which is where you file any security interest governed by Article 9 [UCC 9-501(a)(2)].
   3. Article 9 only provides for local filings (county level) for real estate related collateral.

C. G/R: Federal Preemption: federal law includes methods of perfecting a security interest; for example, the Copyright Act provides that any transfer of copyright ownership may be recorded in the US copyright office. Under rules of federal preemption, Article 9 recognizes that filing a financing statement is not required, and in some cases cannot even be effective to perfect a security interest if a federal statute establishes a nationwide registration filing system [9-310(b)(3); 9-311(a)(1)].
   1. If the federal statute says “may” be recorded, such as the Copyright Act, the secured party better file in both the state and federal office.

§ 6.2: Article 9 Financing Statements: The Debtor’s Name

I. COMPONENTS OF A Filing System

A. Generally: several states now permit the electronic filing of financing statements and other records; to accommodate this, Article 9 is media neutral.
   1. The term “record” is defined as “information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form.” [9-102(a)(69)].
   2. Accordingly, the filing officer does not “stamp” the file number on a financing statement.
   3. The financing filing system systems vary widely from state-to-state.

B. G/R: Index: when a financing statement is filed, a filing officer assigns it a unique number, usually referred to as the file number, the system then uses this number as a means of identifying, indexing, and retrieving the statement.
   1. The filing office must index the financing statements according to the last name of the debtor [9-519(c)].

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2. The address will often be helpful to searchers to distinguish the debtor who is the subject of their search from other debtor’s with the same or similar names.
3. The debtor name index is of critical importance to the functioning of Article 9 filing systems because the vast majority of searchers can only find the financing statements they are searching for through the index.

II. **WHAT AND WHEN TO FILE**

A. **G/R:** Article 9 provides, as a default rule, that a financing statement must be filed for perfection to occur [9-310(a)].

B. **G/R:** What to File: the formal requisites of a financing statement to be sufficient to perfect a security interest are found in 9-502(a)-(b).

1. An initial financing statement to be sufficient must include:
   a. the name of the debtor;
   b. the name of the secured party; and
   c. indicates the collateral to be covered.
   *An initial financing statement that does not contain this minimum information is ineffective to perfect a security interest, even if it is accepted by the filing office.

2. The following information is also required for an initial filing statement, but not necessary for it to be legally sufficient are:
   a. the mailing address of the debtor;
   b. a mailing address of the secured party;
   c. whether the debtor is an organization; and
   d. if the debtor is an organization:
      i. the type of organization;
      ii. the jurisdiction of the organization; and
      iii. an organization identification number (or an indication that the debtor has no such number).
   *[9-516(b)(4)-(5)].
   **The filing office must refuse to accept a record that is an initial filing statement if it does not contain this information [9-520(a)].

3. If a filing is properly refused, it is not an effective to perfect a security interest [9-516(b)].
   a. If, however, a filing officer inadvertently accepts financing statement that contains the minimum required information but omits an additional required item, the security interest is perfected [9-520(c)].

4. **Remember:** a financing statement is a simple document that stands in sharp contrast to the security agreement which provides things such as the extent of indebtedness, the terms for payment, events of default, and covenants regarding the use of collateral. Article 9 provides a simple form for the financing statement, which if completed properly, will be sufficient as a matter of law [9-521].

C. **G/R:** When to File: a financing statement can be filed at anytime, however, it can also be filed before a security agreement is made or otherwise attaches [9-502(d)].
D. **G/R: Requests for Information:** the filing office will give a searcher any information it requests, however there is always a 3-day lapse because the new arrivals are not filed until at least two days after they are received [9-519(h), 9-523(e)].

   1. A filing officer is excused from delay for, among other things, computer failure [9-524].

**II(A). THE CORRECT NAMES FOR USE ON THE FINANCING STATEMENT**

A. **G/R:** the filing officer places the financing statement in the public files according to the debtor’s name [9-519(c)].

B. **G/R: Debtor’s Name Overview:** what name the debtor puts on the financing statement depends of whether the debtor is an individual, entity, or unincorporated association.

   1. **Registered Organizations:** if the debtor is a registered organization, meaning an organization organized under a state or federal law that requires the maintenance of public records indicating the organization’s existence, 9-102(a)(70) the financing statement must reflect the name shown on those records [9-503(a)(1)].

      a. 9-503(a)(1) refers to the debtor’s name as shown on the records in the jurisdiction of the organization. This means the jurisdiction under whose law the organization is organized [9-102(a)(50)].

   2. **Trusts and Estates:** Article 9 also has rules for decedent’s estates and trusts [9-502(a)(2)-(3)].

   3. **Other Debtors:** the general rule for other debtors is that, if the debtor has a name, the financing statement sufficiently provides the name of the debtor if: it provides the individual or organizational name of the debtor [9-503(a)(4)(A)].

      a. Thus, if an organization has name, even though it not a separate legal entity, the name of the organization is to be used.

      i. Organization is defined broadly to include both legal entities and associations that lack legal status.

      b. If the debtor does not have a name, the financing statement sufficiently provides the names of the partners, members, associates, or other persons comprising the debtor [9-503(a)(4)(B)].

   4. **Trade Names:** a financing statement that only includes a trade name does not sufficiently name the debtor [9-503(a)(c)]. However, the financing statement is not rendered ineffective because of the inclusion of a trade name.

C. **G/R: Individual Names:** the reference to individual names in 9-503 is to the names of human beings, as opposed to legal entities such as corporations, partnerships, or trusts.

   1. **Test:** a person’s individual name is the name by which he is generally known, for non-fraudulent purposes, in the community.

      i. “Community” is not defined and a birth certificate need not be determinative.

      ii. **Standard:** the cases on individual names, however, has consistently favored the longer more formal version of a name over a shorter, more colloquial version.

   2. Thus, a financing statement should ordinarily be filed in the full, formal name of the debtor, as well as in the shorter versions by which the debtor is more commonly known.

      a. This largely solves the problem for filers but not for searchers.
D. G/R: Corporate Names: if the debtor is a registered organization, it should use its registered name that is on file with the state or federal government [9-503(a)(1)].

1. Two other characteristics of corporate names are of significance to the Article 9 filing system:
   a. in the large majority of states, the name must show that the entity is a corporation, it does that by including a permissible designator (i.e. “inc.”, “co.” “ltd.”, “corp.” “LLC” etc…). This allows the searcher to determine whether he is searching for an individual or corporation (ex: McDonalds and McDonalds Inc. are separate); and
   b. no state will permit the formation two corporations with same name or confusingly similar names.

E. G/R: Partnership Names: the searcher must distinguish between different types of partnerships:

1. General Partnerships: general partnerships, which are ordinarily formed by contract, express or implied. If there is a written partnership agreement, it may assign a name of the partnership.
   a. Regardless of the agreement among partners, the legal name of the partnership is the name by which it is generally known in the community.

2. Limited Partnerships: the piece of shit book doesn’t really say, but in my opinion limited partnerships fall under the definition of “registered organizations” and hence, will be governed by the same imprecise terminology the piece of shit book used in describing corporations (e.g., placing limited liability companies under the same rubric as corporation and failing to mention the standard the UCC uses of registered organization).

3. 9-507 deals with name changes, which will be discussed infra.

F. G/R: Trade Names: a trade, or fictitious name is a name under which a person or entity conducts business that is not its legal name.

1. Fictitious Name Statutes: most states have fictitious name statutes requiring that every person or entity doing business in a name other than its own file notice in a public record system provided for that services; however, most of these systems have fallen into disuse.
   a. As a result, it can be hard to determine the legal name of a business doing business under a trade name.

2. G/R: trade names are neither necessary nor sufficient to identify a debtor on a financing statement [9-503(b),(c)].

III. ERRORS IN THE DEBTOR’S NAMES ON FINANCING STATEMENTS

A. G/R: Seriously Misleading Standard: a financing statement substantially satisfying the requirements of this part (?), even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading [9-506(a)];

1. A financing statement that fails to sufficiently provide the name of the debtor in accord with 9-503 is seriously misleading [9-506(b)].
2. Test: an error in the debtor’s name is seriously misleading if it would prevent the reasonably diligent searcher from discovering the financing statement; or alternatively, an
error in the debtor’s legal name is minor and not seriously misleading only if a properly executed search of the correct legal name by the filing office would disclose the filing without depending on the discretion of the clerk conducting the search [Transamerica v. General Electric Capital Corp.].

B. G/R: Filing Office Error: if the search is made under the correct name of the debtor, but does find prior filings made in the correct name of the debtor because the filing office indexed the prior filings incorrectly, the prior filings are nevertheless effective [9-517].

C. G/R: Test for Sufficient Debtor Name Descriptions: if a financing statement is challenged (usually by the trustee in bankruptcy trying to get priority over the secured creditor) the test is whether a hypothetical search by the trustee, or later lender, would have found the financing statement (i.e. the test is not whether the searcher actually found it) [9-506(c)].

§ 6.3: OTHER INFORMATION IN ARTICLE 9 FILING STATEMENTS

I. INTRODUCTION

A Generally: although not required, most creditors prefer to use the financing statement in its official form, 9-521, because it is usually cheaper to file and then the filing office can only refuse to accept it for the limited reasons set forth in 9-516(b).

B. G/R: Requirements for Filing: three items of information must be on an ordinary financing statement for the statement to be effective:

1. the name of the debtor 9-502(a)(1);
2. the name of the secured creditor, 9-502(a)(2); and
3. an indication of the collateral covered, 9-502(a)(3).

Even if those items are on the financing statement, 9-520(a) requires the filing officer to refuse to accept it unless it contains three additional items:

4. the mailing address of the secured creditor, 9-516(b)(4);
5. the mailing address of the debtor, 9-516(b)(5)(A); and
6. an indication of whether the debtor is an individual or corporation, 9-516(b)(5)(C).

a. If the debtor is an organization, 9-516(b)(5)(C) also requires rejection of the financing statement unless it contains three additional items:

7. the type of organization (corp., LLC, LLP, LP, etc…);
8. the debtor’s jurisdiction of organization; and
9. the debtor’s organizational identification number.

If the financing statement lacks any of these 9-pieces of information, the filing officer should refuse to accept it and communicate to the filer the reason for refusal and the date/time the record would have been filed [9-520(b)].

C. G/R: Incorrect Information on Financing Statement: the filing officer should not refuse filings that contain incorrect information—even if the information is implausible; that is, no section in Article 9 requires or authorizes the filing office to determine, or even consider, the accuracy of the information provided in a record [9-516 cmt. 3].
II. FILING OFFICE ERRORS IN ACCEPTANCE OR REJECTION

A. G/R: Wrongfully Accepted Statement: the filing officer should not accept an initial financing statement that entirely omits any of the items required by 9-516(b); however, if the filing officer does accept the financing statement the statement is effective [9-520(c) & cmt. 3].

B. G/R: Wrongfully Rejected Statement: Article 9 differentiates between two situations with wrongfully rejected financing statements:
   1. Lien Creditors: if the financing officer wrongfully rejects a financing statement that contains all the required information, although not on public record, that filing is effective against lien creditors (judgment debtors and trustee in bankruptcy) [9-516(d)].
   2. Purchasers: if the financing officer wrongfully rejects a financing statement that contains all the required information, that filing is not effective against a purchaser of the collateral which gives value in reasonable reliance upon the absence of the record [9-516(d)].
      a. A “purchaser” includes a secured party [1-201(32)].

III. FILER ERRORS IN ACCEPTED FILINGS

A. G/R: Limited Effectiveness Filings: the items in 9-516(b) are not necessary for the sufficiency of a financing statement; if the information is furnished in response to any of the items is erroneous (as opposed to omitted) the financing statement qualifies as a valid filing; that is, it is sufficient to perfect the secured party’s agreement.
   1. Lien Perfected: filings with information that contains incorrect 9-516(b) information will be effective against lien creditors, bankruptcy trustees, and others, but not against purchasers who give value and act in reasonable reliance on the incorrect information [9-338(1)-(2)].

B. G/R: Substantial Compliance: the items contained in 9-502(a) are necessary to effectuate a financing statement; however, if the financing statement substantially complies with the requirement to specify these items, the financing statement will be effective despite minor errors or omissions unless the errors or omissions make the financing statement seriously misleading [9-506(a)].

C. G/R: Seriously Misleading: the seriously misleading standard is a fungible standard; that is, its requirements change with the requirement on the financing statement. That is because the some requirements on the financing statement are less important than others.
   1. Ex: a minor mistake in the debtor’s name could be seriously misleading because of its importance in the indexing of the financing statement; whereas, a minor mistake in the secured party’s name many not be seriously misleading.
   2. The general standards for 9-502(a) requirements, other than the debtor’s name, are:
      a. Secured Party’s Name: the secured party’s name must be sufficient to enable a reasonably prudent creditor to locate the creditor with the interest in the property (3d parties need to locate the secured creditor for several reasons: see the terms of the security agreement, get a termination statement, etc…);
b. Description of Collateral: a description of the collateral is sufficient if it reasonably identifies all the collateral or contains a super-generic description of the property, such as, “all the debtor’s property.” [9-504].
   a. note: a super-generic description of the collateral is not sufficient in the security agreement [9-108(c)]. The difference being the only purpose at this stage is to put the searcher on notice of what may be covered by the security agreement.
   *[Dueutsche Credit Corp v. Lowe]*.

D. G/R: Notice Filing: the UCC has adopted a system of notice filing, which is not the filing of a financing statement itself, but only a simple notice which may be filed after, or before, the security interest attaches. The notice merely indicates that a secured party who has filed a UCC-521 financing statement may have a security interest in the collateral described. Further inquiry from the parties involved is necessary to disclose the complete state of affairs of the party.

1. Description: the description of the collateral in the financing statement is required only to put a third party on notice that there may be a security interest in the debtor’s property.
   a. It is not essential that the description be so specific that the property can be identified by it alone, if the description provides a method of inquiry or means of identification which, if pursued, will disclose the property that is covered.
   b. The critical inquiry is whether a security interest is perfected is whether a reasonably prudent creditor would have discovered the prior security interest.
   *
   *[Dueutsche Credit Corp v. Lowe]* [9-502 & cmt. 2].

IV. AUTHORIZATION TO FILE A FINANCING STATEMENT

A. G/R: Authorization Requirement: the requirement that the debtor’s signature be on an initial financing statement was eliminated to reduce fraud and to facilitate electronic filings. The debtor, however, must authorize the filing of an initial financing statement or of an amendment that adds either collateral or a debtor to the initial financing statement. [9-509(a)(1)].

1. By authenticating the security agreement the debtor authorizes the filing of an initial financing statement and any amendment to the that covers collateral described in the security agreement [9-509(b)].
   2. Authenticate means to sign or otherwise authorize through symbol, marking, etc… [9-102(a)(7)].

B. G/R: Unauthorized Filing: if the person filing the financing statement is not authorized to file it, the financing statement is ineffective [9-510(a)].

1. The victim of an unauthorized filing may file a correct statement [9-518(a)].
2. In addition, the person who filed the financing statement without authorization can be held liable for damages and a statutory penalty [9-625(e)(3)].
   a. note: If the debtor authorizes the filing with respect to inventory, and the secured party files a financing statement which covers inventory and equipment, the filing is effective only to inventory [9-510 cmt. 2].

§ 6.4: EXCEPTIONS TO THE ARTICLE 9 FILING REQUIREMENT
A. **G/R: Perfection by Filing and its Exceptions:** Article 9 provides that a financing statement must be filed for perfection to occur, 9-310(a); however, there are seven other ways to perfect under the UCC which are exceptions to the general filing rule. The three main exceptions, or other ways for a secured party to perfect, are:

1. by possession;
2. by operation of the law; that is, automatic perfection (in some kinds of collateral); and
3. by control.

I. **COLLATERAL IN POSSESSION OF THE SECURED PARTY**

A. **G/R: Perfection by Possession:** the possession of some kinds of collateral is a substitute for the public notice filing and hence is sufficient to perfect the secured party’s interest [9-310(b)(6); 9-313].

1. Property that can be perfected by possession includes:
   a. negotiable documents;
   b. goods (all things that are movable when the security interest attaches, 9-102(a)(44));
   c. instruments (a negotiable instrument or any other writing that evidence a right to the payment of a monetary obligation, which is not a security agreement or lease 9-102(a)(47));
   d. money (domestic or foreign currency only, 1-201(24)); or
   e. tangible chattel paper (chattel paper evidenced by a record or records consisting of information that is inscribed on a tangible medium, 9-102(a)(78)).

2. **Possession gives notice theory:** this exception is grounded on two assumptions:
   a. the person who buys or lends against certain kinds of collateral will look at it before disbursing money; and
   b. looking at collateral in the “possession” of a secured party will alert the searcher to the possible existence of a security interest.

3. Under the possession gives notice theory, filing a financing statement is redundant because possession would give actual notice to the diligent searcher.

B. **G/R: Constructive Notice:** under the possession give notice theory, possession by the secured party constitutes *constructive notice* to the searcher; hence, the searcher is treated as if he had actual knowledge of the security interest.

C. **G/R: Possession:** is the detention and control, or manual or ideal, custody of anything which may be the subject of property for one’s use and enjoyment, either held personally or by another who exercises it in one’s place and name.

   1. The legal *right* to control is not determinative of possession.
   2. A secured party can possess collateral through an agent [9-313].

D. **G/R: Possession as an Alternative Method to Perfect:** possession can be an alternative to filing a financing statement with regard to some property.

   1. possession is alternative to filing a financing statement with regard to:
      a. goods,
      b. instruments,
c. tangible chattel paper,  
d. negotiable documents, and  
e. certified securities.

2. Goods: goods is the most obvious example of something a secured creditor can possess or file financing statement for perfection.

E. **G/R: Priority by Possession:** purchasers who subsequently take possession of these kinds of collateral generally take priority over secured creditors who previously perfected by filing. Possession and filing are both means of perfection, but perfection by possession trumps perfection by filing [9-328(1); 9-330(d); 9-331(a)].

1. Filing is, however, effective against lien creditors and trustees in bankruptcy.

F. **G/R: Things that Cannot be Perfected by Possession:** for some kinds of collateral, perfection by possession is impossible; such as, security interests in accounts and general intangibles, which may be perfected only by filing or by some automatic perfection; they may not be perfected by possession. [9-313(a)].

G. **G/R: Things that Can Only be Perfected by Possession:** money can only be perfected by possession; that is, Article 9 excludes the possibility of perfection by filing thereby protecting those who accept money from the possibility that a prior security interest was perfected by filing. [Article 9 does this through its definition of money, 1-102(24)].

II. COLLATERAL IN THE CONTROL OF THE SECURED PARTY

A. **G/R: Perfection by control:** some types of collateral can be perfected if the secured party has control of the collateral, such as, deposit accounts, electronic chattel paper, investment property, and letter of credit rights (with the most common being deposit accounts). [9-310(b)(8); 9-314].

B. **G/R: Deposit Accounts:** a deposit account is the type of property generally referred to as a bank account, 9-102(a)(29); however, a deposit account also includes certificates of deposit (CDs).

C. **G/R: Control of Deposit Account:** there are three ways a secured party can take control of a deposit account:

1. the secured party can be the bank in which the account is maintained;  
2. the debtor, the secured party, and the bank can authenticate a record instructing the bank to comply with the secured party’s instructions with regard to the account; and  
3. the secured party can become the bank’s customer, by putting the account in the name of the secured party.  
[*9-104(a)(1)-(3)].

**note:** the control required to perfect is “potential control” not actual control because a secured party can be in control of the account even though the debtor can write checks on the account and perhaps withdraw the entire amount [9-104(b)].

III. **PURCHASE MONEY SECURITY INTEREST IN CONSUMER GOODS**
A. **G/R: Automatic Perfection:** a purchase money security interest in consumer goods is automatically perfected; that is, by operation of the law without the requirement of filing a financing statement [9-309(1)].

B. **G/R: Purchase Money Security Interest (PMSI):** a security interest in goods (anything movable) is a purchase money security interest to the extent that the goods were purchase money collateral (goods that secure an obligation incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights) with respect to that security interest [9-103(b)].

1. In other words, if the secured debt is for the purchase price of the collateral, the security interest is purchase money.
   a. Ex: Megan buys the “pleasure man 2002” [a full sized blow up doll of LaMar with vibrating dick] from LaMar’s porn shop for $2000. She pays $100 down and signs a note promising to pay the remaining $1900. If the note is secured by an interest in the pleasure man, it is purchase money security interest.

C. **G/R: Consumer Goods:** a PMSI is automatically perfected only in consumer goods. A PMSI in any other kind of goods must perfected by the ordinary means required by the UCC for the type of collateral.

1. **Definition:** consumer goods are goods that are used or bought for use primarily for personal, family, or household purposes [9-102(a)(23)].
   a. **Test:** it is not the nature of the goods, but rather, the *use to which they are put* or the *purpose* for which they are bought that determines their classification.
      i. Hence, design, shape, size, weight, or *cost* are irrelevant.
      ii. Commentary suggest that the intended use of the consumer at the time of the purchase is the “intent” that controls in instances when a person purchases a good for one purpose and then uses it for another.
      *

IV. **SECURITY INTEREST NOT GOVERNED BY ARTICLE 9**

A. **G/R: Security Interests Excluded from Article 9:** security interests in a variety of types of collateral are excluded from Article 9 coverage.

1. The types of collateral excluded are:
   a. security interests in wage claims, 9-109(d)(3);
   b. insurance policies and claims, 9-109(d)(8);
   c. real estate interests, 9-109(d)(11); and
   d. tort claims, 9-109(d)(12).

§ 6.5: **THE LAND AND FIXTURES RECORDING SYSTEMS**

I. **REAL PROPERTY RECORDING SYSTEMS**
A. **G/R: Personal Property Security Interests**: to be effective against third parties, notice of most security interests in personal property must be filed in the appropriate public records system \[9-310(a)\].

B. **G/R: Real Property Security Interests**: to be effective against third parties, notice of security interests in real property must be recorded in the appropriate set of public records, which is the real estate recording system located in each county in the grand ol’ United States of America.

1. **Procedure**: generally the procedure for recording a mortgage is:
   a. walk your lazy ass into the mortgage recording office;
   b. pay the clerk a small fee for recording;
   c. the clerk then stamps the date and time of the recording on the face of the mortgage;
   d. then it is photocopied, indexed, and recorded with the original being sent back to your now debt ridden ass.

II. **WHAT IS RECORDED**

A. **G/R: Formalities for Creation of Mortgage**: the formalities for the creation of a mortgage against real property are:

   1. a mortgage document;
   2. signed by the debtor;
   3. containing a description of the debt secured and the collateral securing it.

   *A mortgage usually also has to be acknowledged before a notary public which authenticates the debtor’s signature by affixing the official’s own signature and seal. Some states also require witnesses.

B. **G/R: What is Recorded**: in the real estate system, the creditor must record the mortgage document, not merely a notice of its existence, which informs searchers not only of the existence of the mortgage, but also its terms.

III. **FIXTURES**

A. **G/R: the law considers permanent buildings part of the land to which it is situated; hence, a mortgage on a piece of property would include any permanent buildings located on it unless they were expressly excluded.**

   1. Such a mortgage is perfected by filing only in the real estate system; a UCC filing is unnecessary and ineffective \[9-109(d)(11)\].

B. **G/R: Fixture**: fixtures are goods that have become so related to particular real property that an interest in them arises under real property law \[9-102(a)(41)\].

   1. This definition by the UCC requires one to read the real estate statutes and case law defining “fixtures” in a particular jurisdiction.

   2. **Determining What is a Fixture**: generally, in determining what is a fixture most courts:
      a. start from the proposition that the status of goods as a fixture depends upon the intention of the parties to fix the good to the land permanently; and
b. that manifestation of intent is indicated by the firmness with which the goods are affixed to the real estate and how difficult that the fixture would be to remove.

C. **G/R: Test for When Personal Property becomes a Fixture:** for personal property to become a fixture and part of the realty, three elements must be met:
   1. the property is annexed or attached to the realty;
   2. the attached property is adapted or applied to the use of the realty; and
   3. it was intended that the property would remain permanently attached to the realty.
   
   *[In Re Cliff’s Ridge (I wish I was skiing rather than working on this piece of shit) Skiing Corp. (the test, according to Nelson, is fairly standard)]*

D. **G/R: Perfecting in a Fixture:** there are two ways to perfect a security interest in a fixture:
   1. a creditor may utilize the procedures under the state’s real estate law; or
      a. which is generally created by recording the mortgage in the county where the real property is located
   2. a creditor may take a security interest in a fixture and perfect that interest under the UCC.
      a. to take a security interest in a fixture under the UCC the creditor must file a *fixture filing*, which is a filing of a financing statement covering goods that are to become fixtures and satisfy 9-502(a)-(b).
      b. *Fixture Filing:* to perfect in a fixture the creditor must satisfy all of the requirements of 9-502(a) [name of debtor, name of secured party, indicate collateral covered]. In addition, a financing statement covering fixtures or goods to be come fixtures must:
         i. state that it covers fixtures;
         ii. recite it is to be recorded in real estate records;
         iii. contain a description of the real estate where the fixtures are located or to be located, which is sufficient to provide constructive notice under real estate law; and
         iv. if the debtor does not an interest of record in the real estate, the owner of record must be disclosed.
   
   *[9-502(b)(1)-(4)].

   3. The financing statement which covers fixtures, or goods to become fixtures, must be filed where a mortgage on the real estate would be recorded [9-501(a)(1)(B)].
      a. However, to be safe, the secured creditor should always file it in the UCC filing office too.
         i. **note:** although not a fixture filing, a creditor could attempt to take a security interest in fixtures by simply filing a financing statement because nothing in the UCC says one must make a fixture filing to perfect in fixtures; that is, a personal property filing is a method permitted by the UCC to perfect in property that are fixtures [9-334(e)(2)-(3)].

   4. After a proper fixture filing, a secured party has a perfected interest in the fixtures and may enforce its security interest against other persons according to designated priorities [see 9-334(c)-(g)].
   
   * *[In Re Cliff’s Skiing]*
E. **G/R: Mortgage as Fixture Filing:** a mortgage may be effective as a fixture filing from the date of its recording provided that:
   1. the record indicates the goods or accounts that if covers;
   2. the goods are, or to become fixtures;
   3. the record satisfies the requirements for a financing statement in 9-502(a)-(b); and
   4. the record is recorded.
   *§9-502(c).*

§ 6.6: **Characterizing Collateral for the Purpose of Perfection**

I. **Determining the Proper Place of Filing**

   A. **Generally:** there is a shitload of filing systems in the United States of America (over 4,000) and the law specifies which filings are properly made in each filing system, hence, in so doing the law necessarily classifies collateral

   B. **G/R: Real Estate:** each county in the US maintains a real estate filing system; that system is the proper place to file if the collateral is real estate or fixtures. The UCC defers to the real estate law of the state on the question of when goods are so related to mother earth that filing should be in the real estate records.
   1. Three factors are important in making the distinction between fixtures and non-fixtures:
      a. the firmness with which the collateral is affixed to the real estate;
      b. the intention of the parties as to whether the collateral is to become a permanent part of the real estate; and
      c. the degree to which the collateral is essential to the proper functioning of the real estate.
   2. The distinction between fixtures and non-fixtures is largely indeterminate and one should file and search in both the personal property and real property filing systems in many cases.
   3. **Fixtures:** although Article 9 defers to the real estate recording system as the proper place to file regarding a security interest in fixtures, it applies to the security interest, 9-109(a)(1), and specifies a proper fixture filing can be made in the real estate recording system, 9-502(b).

C. **G/R: Inventory and Equipment Distinction:** goods are inventory when they are held by a person for sale or lease or to be furnished under a contract for service [9-102(a)(48)].
   1. If goods are inventory they are not equipment [9-102(a)(33) (Defining equipment as goods other than inventory)].
   2. Inventory must be distinguished from “equipment” (see below) because of descriptions in collateral and different rights that arise:
      1. **G/R:** when a debtor sells the goods, buyers generally take free of a security interest in inventory (this is the most important reason for the distinction).
         a. When a security interest is in equipment, buyers generally do not take free of a security interest.
3. Test: the distinction between inventory and equipment depends on the manner in which the goods are used (not the intrinsic nature of the goods).
   a. Goods held for lease are explicitly included in the definition of inventory.
   b. **Implicit in the definition of inventory is that the debtor must be in the business of leasing or selling goods of that kind; hence, if the debtor is not in the business, the goods may be categorized as equipment [9-102 cmt. 4].

D. G/R: Farm Products Distinguished from Inventory: farm products, although classified separately, are in effect inventory of a farm; that is, they are the type of items a farmer would sell, although he does not have to sell them.
   1. “Goods” are farm products if they are:
      a. used or produced in farming operations;
      b. supplies used in farming operations.
   2. Goods are not farm products, and are inventory if:
      a. they are raw materials or work in process of business.

3. g/r: security interest in both farm products and inventory are both perfected by the filing in the statewide UCC system.
   a. Inventory financing statements are filed in the state where the debtor is located, 9-301(1).
   b. Farm products financing statements are filed in the state in which the collateral is located, 9-302.
   Thus, to determine the proper place for filing against a person who holds goods for sale in the ordinary course of business, it is necessary to determine first whether the debtor in possession of the goods is “engaged in farming operations” and if so, “whether the goods otherwise qualify as farm products.”

**Clear up those definitions and Rules!

II. DETERMINING THE PROPER METHOD OF PERFECTION

A. G/R: Instrument: an instrument is either a negotiable instrument (3-104) or any other writing evidencing a right to be paid money which is type of writing that is, in the ordinary course of business, transferred by delivery with any necessary endorsement or assignment [9-102(a)(47)].
   1. Thus, there are two basic categories of instruments:
      a. those that are negotiable, and
      i. a negotiable instrument, governed by Article 3, is essentially a written promise or order to pay a fixed amount of money that is in negotiable form, which means an instrument must be payable to bearer or order.
      ii. Ex: checks, promissory notes, and certificates of deposit (CDs)
      b. those that are not negotiable but that the marketplace treats as having the key attributes of negotiability, or sometimes called “quasi-negotiable.”

B. G/R: Intangibles: are generally divided into two categories under the UCC:
   1. Account: means a right to payment of monetary obligation, whether or not earned by performance for:
      a. property that has been sold, leased, licensed, assigned or otherwise disposed of;
b. for services rendered;
c. for a policy of insurance;
d. for a secondary obligation;
e. for the use or hire or charter of a vessel;
f. etc…

[9-102(a)(2)].

2. **General Intangibles:** is any personal property that does not fall within a different category in the UCC. Hence, general intangibles include any form of personal property that might be used as collateral and that is not covered by any of the other Article 9 classifications of collateral nor specifically excluded from the coverage of Article 9.
   a. It is residual classification.
   b. Ex: patent rights, tax refunds, refunds for overpayments to an employee pension plan, claims for breach of contract, liquor licenses, FCC licenses, water permits, and the like
   c. The term also includes software.

C. **G/R:** **Leases:** Article 9 applies to security interests in personal property but not to leases of personal property, unless they are intended as a security.
   1. **True leases:** are leases where the lessor retains a meaningful residual interest; that is, at the end of the lease term the property reverts back to the lessor. True leases are not security interests and a financing statement need not be filed.
      a. However, if the lessor is concerned that he has not achieved that status, he may file a financing statement just in case, without the filing being used as an admission by the lessor that the transaction is a security interest.
   2. **Other “Leases”:** in a transaction where the lessor grants an interest in the property to the lessee, and the lessee has the option to purchase the property at the end of the term and the lessor retains the right to repossess the collateral on non-payment, then, in effect, the lessor has taken a security interest in the collateral and should file a financing statement in order to protect his interests in case the lessee files bankruptcy or grants another party an interest in the property [see 9-109(a)] (this article applies to a transaction regardless of its form that creates a security interest).

D. **G/R:** **Realty Paper:** realty paper is a term used to refer to a promissory note secured by a mortgage or deed of trust. The proper method to perfect in realty paper is to perfect in the right to payment because the note will be (in most instances) an instrument, 9-308(e); 9-102(a)(47); hence, it can be perfected by possession, 9-313(a) or filing, 9-312(a).

E. **G/R:** **Chattel Paper, Instruments, and Accounts Distinguished:** the similarity between chattel paper, instruments, and accounts, is that all three involve a debt owed by a third party to the debtor. The debtor is using his right to that money as collateral to secure own debt to the creditor.
   1. The principle difference between these three types of collateral is in the documentation of the debt from the third party to the debtor:
      a. **chattel paper:** if the documentation evidences both a monetary obligation and a security interest in
         i. specific goods,
ii. software or additional goods *used in* the goods, or  
iii. a lease of specific goods, *then*  
iv. the goods are chattel paper.  
*\[9-102(a)(11)\]  
**Then perfection is by filing or taking possession \[9-312(a)(1); 9-313(a)\]  

b. *instrument:* if the documentation evidences a right to payment of a monetary obligation:  
i. is not itself a security agreement or lease; and  
ii. is of a type that in ordinary course of business is transferred by delivery with any necessary endorsement or assignment; *then*  
iii. the collateral is an instrument.  
**Then perfection is by filing or taking possession \[9-312(a)(1); 9-313(a)\]  
c. *account or general intangible:* if the debt is evidenced by neither of the above two, it is an account or general intangible (depending on the nature of the debt) \[9-102(a)(2), (42)\]; *then:*  
   Perfection is by filing 9-312(a)(1).  

F. G/R: Perfection in Chattel Paper: a security interest in chattel paper can be perfected either by filing or by taking possession; however, the two are not equivalent.  
   1. A purchaser of chattel paper who gives new value in the ordinary course of its business and who acts without knowledge of the security interest perfected by filing has priority over a security interest perfected earlier by filing \[9-330(b)\].  

**This chapter really brain fucked me: FIGURE OUT.**

§ 7: MAINTAINING PERFECTION  

§ 7.1 MAINTAINING PERFECTION THROUGH LAPSE AND BANKRUPTCY  

I. REMOVING FILINGS FROM THE PUBLIC RECORD  

A. G/R: Constructive Notice: from the time it is placed on public record, a filing or recording serves as constructive notice to the world that a security interest may be outstanding against property of the debtor.  
   1. Theory: the theory is that searchers will discover the existence of a prior holder’s interest and then contact them.  
   2. This prior interest encumbers the property and clouds title to it; hence, when the debt is paid, both the debtor and creditor typically want to remove the filing from the public record.  
      a. However, most filing systems do not permit the literal removal of the financing statement; rather, the debtor must *add* a document stating that the earlier document is no longer in effect.  
         i. most real estate systems are like this too.  

B. G/R: Satisfaction in Real Estate Systems: when a real estate mortgage is paid, the mortgagee executes a document called as *satisfaction of mortgage* for recording.
1. These a critical because even if the mortgagee has paid the entire debt, the mortgage will still cloud title until a satisfaction is filed; hence, because of the importance some states have provide for imposition of a penalty on a secured party who fails to give the debtor who has fully paid the mortgage a satisfaction.

C. **G/R: Releases in Real Estate Systems:** mortgages frequently encumber more than one parcel of real property; if such a mortgage has not been paid in full but the secured creditor is willing to release some of the property form the mortgage lien, the secured creditor accomplishes this by executing a release for recording.

1. **Paydowns:** in effect, this is like a “mini” satisfaction; but it done relatively rarely and most secured creditors only do this when required by contract; the usual accommodation being that the bank will release a piece of the real property in return for a partial payment of the mortgage, a paydown.
   a. Ex: this is the common situation with developers of subdivisions so the developer can sell the lots individually, even if he has one big mortgage for a big area of land.

D. **G/R: Article 9 Termination:** if the debtor has paid the secured obligation and the secured party is not required by contract to lend more money, the debtor can demand that the secured party file a termination statement within 20-days [9-513(c)(1)].

1. A termination statement, or amendment (see “E”) must:
   a. identify the initial financing statement, by its file number, to which it relates; and
   b. indicate that the identified financing statement is no longer effective.
   [9-102(a)(79)].

2. A termination statement, or amendment, becomes part of the financing statement to which it relates [9-102(a)(39)].

3. **Seriously Misleading Test:** because a termination statement is, in effect, a part of the financing statement, it is subject to the seriously misleading standard [9-506].
   a. Hence, such errors would not render the financing statement—including the termination statement or amendment—in-effective unless errors make the financing statement seriously misleading.

4. If the secured party fails to file a termination statement, the secured party becomes liable for actual damages and, in addition, a civil penalty of $500 [9-625(b), (e)(4)].

E. **G/R: Article 9 Release:** release of collateral from coverage of a financing statement is accomplished by amending the financing statement [9-512(a)].

1. The secured party is obligated to file a termination statement upon full payment of the secured debt, but is not obligated to file an amendment deleting collateral on partial payment unless the secured party has contracted to do so.

F. **G/R: Duration of Financing Statement:** the general rule under Article 9 is that a financing statement is effective for 5-years after the date of filing the financing statement (not when the security interest attaches!) [9-515(a)]
G. **G/R:** Lapse: unless the financing statement is continued pursuant to Article 9, the financing statement lapses at the end of the five year period [9-515(c)].

H. **G/R:** Continuation Statements: in order for a secured creditor to be perfected for more than five years it must file a continuation statement [9-515(c)].
   1. The continuation statement must:
      a. identify the initial financing statement to which it relates by file number; and
      b. indicate that it is a continuation statement for the initial financing statement. *[9-102(a)(27)].
      c. a financing statement that does not refer to the original cannot suffice as a continuation statement [Worthen Bank & Trust v. Hilyard].
   2. **Six-Month Window:** the continuation statement can only be filed within 6-months before the lapse of the financing statement [9-515(d)].
   3. Upon the effective filing of a continuation statement the financing statement is extended for an additional 5-years from the date that the original financing statement would have became ineffective (not the date that the continuation statement was filed).
   4. A secured party can file continuation statements forever, as long as they are filed in accordance with the above rules.

H(1). **G/R:** Failure to File a Continuation Statement: courts have uniformly held pursuant to 9-510(c) that when creditors file continuation statements after their financing statement have lapsed, the continuation statements are ineffective.

I. **G/R:** Filing Office Duties Upon Lapse: the filing office may destroy any written record immediately upon lapse, however, it must maintain a record of the information for at least one year [9-522(a)-(b)].

J. **G/R:** Effect of Lapse: upon lapse, the security interest becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value. [9-515(c)]. In other words, a secured party which allowed its financing statement to lapse will be treated as if it never filed at all if a case of a later priority dispute arises with a purchaser for value.
   1. **Exception:** this retroactive loss of priority does not apply in favor of a lien creditor (or trustee in bankruptcy).
   2. **Thus:** a secured party who allows its financing statement to lapse will find itself unperfected prospectively and will be deemed unperfected as against a purchaser for value whose interest arose before the lapse, but will retain its perfected status as against a lien creditor. [9-515(c)].

III. **The Effect of Bankruptcy on Lapse and Continuation**

A. **G/R:** Continuation when Debtor in Bankruptcy: a secured party must file a continuation statement at 5-year intervals to avoid lapse; no exception is made because the debtor is in bankruptcy [9-515(c)].
   1. The filing of a continuation statement during the pendency of bankruptcy does not violate the automatic stay [BC §§ 362(b)(3); 546(b)(1)(B)].
§7.2: Maintaining Perfection Through Changes in Name, Identity, and Use

A. Generally: there are three main changes in circumstances that may potentially affect where old filers and new searchers must look to find collateral, those circumstances are:
   1. Change in the debtor’s name;
   2. Changes affecting the description of collateral; and
   3. the conversion of the collateral into proceeds.

I. Changes in the Debtor’s Name

A. G/R: Change in Debtor’s Name: a financing statement is not rendered ineffective if the information becomes inaccurate, and even seriously misleading, after filing because of a change in the debtor’s name [9-507(c)].
   1. The initial filing continues to perfect with respect to:
      a. the original collateral; and
      b. after acquired property obtained by the debtor within four months (but not after) after the name change.
   2. If the name change would be (or is) seriously misleading, an amendment must be filed within four months after the name change in order for the financing statement to effective to perfect a security interest in collateral acquired more than four months after the name change.
      a. the name change is sufficient if it renders the financing statement not seriously misleading or puts the debtor’s new correct name.
      *[9-502(c)(2)].

B. G/R: Transfers of Collateral: a filed financing statement remains effective with respect to collateral transferred by the debtor (such as sole proprietorship to corporation) even if the secured party knows of, or consents to, the transfer [9-507(a)].
   1. Whether the transferee is bound by the terms of the existing security agreement turns on whether it is a “new debtor.”
      a. New Debtor: a new debtor is a person that is bound by the terms of the security agreement entered into by the original debtor [9-102(a)(57); 9-102(a)(60)].
   2. Whether a person becomes a new debtor, and hence is bound by the existing security agreement, is determined by law other than Article 9, primarily business organizations and contracts law [9-203(d)].

II. Changes Affecting the Description of Collateral

A. Generally: there are two types of changes that collateral can undergo:
   1. Type 1 Change: is a change in circumstances that did not control the place of filing but that does make the collateral difficult for the searcher to identify
      a. Ex: (a) Bankone gives security interest to debtor: (i) security agreement: describes collateral as loader, with serial number; (ii) financing statement: describes collateral as inventory. (b) Banktwo gives security interest to debtor: (i)
searches discovers Firstbank description; (ii) then lends against equipment, thinking loader is equipment. 
**The change is: debtor began using loader as equipment.

2. *Type 2 Change: is a change in circumstances that is sufficient to affect the method of perfection that would have been appropriate for the initial filing.
a. Ex: (a) Lumber company takes security interest in lumber it sells to debtor; (b) debtor uses lumber to build shed, lumber is now a fixture.

B. G/R: Change in Circumstances that Does Not Control the Place of Filing: if the change in circumstances does not control the place of filing the financing statement then even if the change in circumstances make the description seriously misleading, the financing statement remains effective [9-507(b)].

C. G/R: Change in Circumstances that Do Control the Place of Filing: if the change in circumstances does control the place of filing (such as chattel to fixture) 9-507(b) excuses the seriously misleading description of collateral however 1. it does not excuse the failure to make a filing in the other filing office (which in example would be real estate filing office with fixture filing).

III. *EXCHANGE OF COLLATERAL

A. G/R: Identifiable Proceeds: a security interest in identifiable proceeds continues in the collateral after the sale, exchange, collection, or other disposition of collateral [9-102(a)(64); 9-315(a)(2)]. The secured creditor will want, after the sale, exchange, collection or other disposition of the collateral, to:
   1. the security interest to be perfected in the proceeds; and
   2. the perfection to be continuous from the creditor’s initial filing.
   *How the secured party does that follows. . . .

B. G/R: Barter Transactions: there are three types of barter transactions:

B(1). Proceeds Received by Debtor After Trade Fall Under Description of Collateral In Original Financing Statement: if the debtor trades one type of collateral, for another type of collateral of the same kind, and the description in the original financing statement covers the new collateral then:
   1. the creditor’s security interest is perfected in the new collateral because the secured creditor has a perfected interest in that collateral on the basis of the original description [9-203(f)].
      a. Ex: debtor trades one kind of loader for another loader and financing statement gives creditor interest in debtor’s equipment.

B(2). Proceeds (Absent Cash) Received by Debtor After Trade Do Not Fall Under Description of Collateral in Original Financing Statement: if the debtor trades one type of collateral, for another type of collateral, which could be filed in the Article 9 filing system where the creditor’s financing statement is already on file, then:
   1. the secured party remains perfected without a new filing too [9-315(d)(1)]
a. Ex: debtor’s financing statement covers only inventory, he trades for an elephant, creditor is now perfected in elephant.
2. Thus, anytime the debtor has traded collateral, the financing statement may encumber property not described in it; and hence, unless the searcher knows of the trade he’ll be fucked because he won’t know about it.

B(3). **Proceeds (Absent Cash) Received by Debtor Require Filing in Different Office:** if the debtor trades a piece of collateral, for another piece of collateral that requires filing in a different office than the one in which the original financing statement was filed then:
1. to be perfected the secured party must refile in the appropriate office.
   a. Ex: debtor trades all store’s inventory for a piece of land in Megan’s backyard. Creditor would have to refile in real estate office.
2. to be **continuously** perfected in the two items, so that the creditor has one perfection dating from the time of filing on the original collateral, the secured party must make these filings **within 20-days** from the time the debtor receive the proceeds (the land in the example) [9-315(d)(3)].

C. **G/R:** **Collateral-to-Cash Proceeds-to-Noncash Proceeds:** there are two types of collateral-to-cash-to-noncash transactions. These occur when the debtor exchanges the original collateral for money (or sells it) then uses the money to buy some new shit.
1. Provided the creditor can trace its value through both transactions, the creditor’s security interest will reach the new property as proceeds of proceeds [9-102(a)(12), (a)(64)].

C(1). **Cash Received by Debtor used to Buy New Collateral that Falls Under Description of Collateral In Original Financing Statement:** if the debtor sells a piece of collateral for money, and uses the money to buy new collateral which falls under the description of the collateral in the original financing statement then:
1. the original filing remains effective to cover goods of the same description [9-315(d)(3)].
   a. Ex: debtor sells loader, uses money to buy new loader, and description in financing statement covered equipment.

C(2). **Cash Received by Debtor used to Buy New Collateral that Does Not Fall Under Description of Collateral in Original Financing Statement:** if the debtor sells a piece of collateral, and then uses that money to buy new collateral and the new collateral does not fall under the description of the old collateral in the original financing statement then:
1. the secured party would be required to file a new financing statement to cover the new collateral [9-315(d)(3)];
2. To remain continuous perfected, the secured creditor must file the new financing statement within 20-days of the debtor’s receipt of the new collateral.
   a. The secured creditor must do this in whatever filing office is appropriate after the change in the collateral (whether it be the same office or in a different office).
D. **G/R: Collateral to Cash Proceeds (No New Property):** if the debtor sells the original collateral and keeps the cold hard cash, then the secured party has continuous perpetual perfection in identifiable cash proceeds [9-315(d)(2)].

§ 7.3: **MAINTAINING PERFECTION THROUGH RELOCATION OF DEBTOR COLLATERAL**

I. **STATE-BASED FILING IN A BIG FAT FUCKIN’ COUNTRY**

A. **Generally:** the filing system is a means for a secured creditor who takes a non-possessory security interest in property of a debtor to communicate the existence of that security interest to others who may later consider extending credit to that debtor.

   1. The rules specify where to file and search [9-301 to 9-307].
   2. If revised Article 9 is adopted in all 50-states, the UCC tells filers and searchers the secretary of state’s office is where they should file or search.

II. **INITIAL PERFECTION**

A. **G/R: Non-Possessory Security Interests:** the general rule that governs non-possessory security interests is that priority and perfection are governed by the local law of the jurisdiction in which the debtor is located [9-301(1)].

   1. The filing must be in the statewide filing office for non-real estate related collateral [9-501(a)(2)]

A(1). **G/R: Debtor Location and Type:** because non-possessory security interests are governed by the state in which the debtor is located, it is important to determine what type of debtor is involved:

   1. **Individual Debtor:** an individual debtor is located in the state of the individuals principle residence.
      a. Residence implies something more than mere physical presence and something less than domicile.
      i. Residence means living in a particular locality; whereas, domicile means living in that locality with the intent to make it a fixed and permanent home.
   2. **Registered Organization Debtor:** a registered organization that is organized under the law of the state is located, in that state [9-307(e)].
      i. A registered organization is an organization organized solely under the law of one state, or the US, and must maintain a public record in that state showing the organization to be organized (e.g., corporations, LPS, LLCs, professional associations, LLPs).
      ii. Ex: a Delaware corporation is located in Delaware even if its sole place of business is in bum fuck Wyoming.
   3. **Unincorporated Association Debtor:** an unincorporated association (general partnerships) debtor is located at:
      a. its place of business if it has only one place of business [9-307(b)(2)];
      i. place of business means a place where a debtor conducts its affairs, whether for profit of not [9-307(a) & cmt. 2].
b. its chief executive office if it has more than one place of business \[9-307(b)(3)\]
   i. **Nerve Center Test:** the chief is executive office is determined by using
   the never center test which states that: the organization is located in the
   place from which it is managed—regardless of its operations (i.e. where
   the command originate).

B. **G/R: Possessory Security Interests:** if the security interest is possessory, the law of the
   jurisdiction in which the collateral is located is the proper place to perfect \[9-302\].

C. **G/R: Location of Collateral:** fixture filings must be made in the office designated for the
   filing or recording of a mortgage on the real property to which the fixture is attached \[9-501(a)\].

III. **RELOCATION OF THE DEBTOR**

A. **G/R: Relocation of Individual Debtor:** when a individual debtor changes his state of principle
   residence, the secured creditor who filed in the original state has **four months** in which to file in
   the destination state \[9-316(a)(2)\].
   1. The security agreement will likely require the debtor to inform the secured creditor of
   any changes in their principle jurisdiction.

B. **G/R: Relocation of Registered Organization Debtor:** no legal procedure exits to permit a
   registered organization to change the state in which it is organized; however, it can be done
   through reincorporation by merger or sale.
   1. If a debtor reincorporates by merger or sale of assets, the secured creditor has **one year**
   in which to discover the merger and perfect in the destination state \[9-316(a)(3)\].

§7.3: **MAINTAINING PERFECTION IN CERTIFICATE OF TITLE SYSTEMS**

A. **Generally:** all states have enacted separate certificate of title statutes that cover motor
   vehicles (and additional goods such as TRAILERS, boats, and tractors). In addition to
   establishing paper titles to the designated goods, these state statutes also provide that a security
   interest in the property can be noted on the title itself; in some, but not all, this is the exclusive
   method of perfecting a security interest in the designated class of goods.
   1. In certificate of title systems security interests are referred to as “liens” and the filing is
   referred to as “lien notation”.
   2. **Advantages:** there are two main advantages to certificate of title systems:
      a. the certificate of title system contains title and lien information; and
      b. each item of collateral is identified by two numbers: (a) the license plate
         number and (b) the VIN number.

I. **PERFECTION IN A CERTIFICATE OF TITLE SYSTEM**

A. **G/R: Perfection in Certificate of Title System:** Article 9 recognizes that the filing of a
   financing statement is neither required, nor effective, to perfect a security interest in collateral
   covered by a state certificate of title statute \[9-310(b)(3); 9-311(a)(2)-(3)\].
   1. Rather, perfection is under the law of the state which generally requires:
a. by delivery of the certificate of title to the DMV, which notates the lien information on the title, makes a copy for its records, and gives the owner back the original.

II. **Accessions and Removal**

A. **G/R: Accessions**: accessions are analogous to fixtures, except that an accession is an item of personal property that attached to another item of personal property, rather than to real estates. Accession retain their identity and can be removed and sold separately.
   1. Accessions are goods that are physically united with other goods in such a manner that the identity of the original goods is not lost [9-102(a)(1)]
   2. Courts resolve affixed property problems by dividing affixed property into three categories:
      a. those which are not sufficiently related to the whole to be considered part of it and therefore *not* an accession (e.g. a spare tire);
      b. those which are so integrated into the whole that it is part of the whole for financing purposes therefore *not* an accession (e.g. mixer on back of cement truck); and
      c. accessions, the property in between that is sufficiently affixed to be reached by a security interest in the whole, but not sufficiently integrated that it can no longer be the subject of separate financing (e.g., my kick ass sony stereo in my kick as Honda accord).

B. **G/R: Perfection in Accessions**: an accession granting party could perfect its interest in the accession by filing an Article 9 financing statement, but *only if* it does so before the collateral becomes an accession [9-335(a)-(b)].

C. **G/R: Priorities Regarding Accessions**: Article 9 gives a security interest in the whole priority over a security interest in an accession to that whole—regardless of the order in which the two security interests were perfected and even though the security interest in the accession attached and became perfected before the accession was affixed and before the security interest in the whole was created [9-335(d)].

D. **G/R: Removal of Accessions**: after default, a secured party may remove an accession from other goods if the security interest in the accession has priority over the claims of every person having an interest in the whole [9-335(e)].
   1. **But note**: this bars the holder of subordinate accession interests from enforcing it, which it will always be the case under 9-335(d); hence, this section if fucking worthless.

§§: **Priority**

§8.1: **The Concept of Priority: State Law**

A. **Analytical Framework**: the determination of a priority dispute involves two basic steps:
   1. the status of each of the competing claimants in the conflict must be established; *then*,
      a. this element requires determining whether the party is:
i. unsecured;
ii. secured, and if so, whether that party has perfected.

2. the appropriate rule can be applied to decide the outcome of a conflict between any pair of claimants.

B. G/R: Priority: to say that one creditor has priority over another is to say that if the value of the collateral is sufficient to pay only one of them, the law requires that value be used to pay the one who has priority.
1. The rules that award priority come into play whenever there is more than one interest in property.

I. THE CONCEPT OF PRIORITY

A. G/R: Competing Liens in the Same Priority: two basic principles govern the timing of the enforcement of competing liens against the same collateral:
1. Absent an agreement to the contrary, any lien holder may foreclose while the debtor is in default to a lien holder, the existence of a prior lien generally does not block the exercise of rights under a subordinate one; and
2. No lien holder is compelled to foreclose.
*The holder of virtually any type of lien may foreclose; however, the procedure for doing so varies with the type of lien and each state statute varies.

B. G/R: Principles Governing Foreclosure: the principles that govern most judicial or foreclosure sales are:
1. Discharge: the sale discharges form the collateral the lien under which the sale was held and all its subordinate liens; however, it does NOT discharge prior liens.
   a. A good way to figure this out is list all the liens by date of perfection and then circle the lien that foreclosed: everything under it is discharged, however, everything above it is not discharged.
2. Transfer: the sale transfers the debtor’s interest in the collateral to the purchaser, subject to all prior liens [9-617(a)].
   a. The holder of the prior lien cannot enforce the debt against he person who purchases at the foreclosure sale, because that person has not assumed the debt or agreed to pay it.
   b. However, the prior lien holder can enforce the lien against the purchaser.
   c. Unless the debtor underlying the prior lien is paid by the purchaser or someone else, the holder of the prior lien is paid by the purchaser or someone else, the holder of the prior can foreclose.
3. Proceeds: the proceeds of the sale are applied:
   a. first to expenses of the sale,
   b. then to the payment of the lien under which the sale was upheld,
   c. then to the payment of subordinate liens in the order of their priority.
   *[9-615(a)].
   d. Then the remaining surplus, if any, is paid to the debtor [9-615(d)(1)].
   e. Unsecured creditors do not share in the distribution; their remedy is to levy on the surplus in the hands of the debtor.
4. **Deficiency:** the debt underlying each lien is reduced by the amount paid to the lien holder from the sale, but the balance remains owing. The lien holder is then entitled to judgment against the debtor for the deficiency, unless there is a statute providing otherwise [9-615(d)(2)].

**Lean bidding stuff: pp. 495-96**

C. **G/R:** Caveat Emptor: judicial sales are one of the few places in the American economy where the rule of caveat emptor still applies.

II. **RECONCILING INCONSISTENT PRIORITIES**

A. **G/R:** Taking Free and Clear: in some sale procedures, the purchaser takes free of all liens against the property and proceeds of the sale are distributed first (after payment of the expenses of sale) to the holder of the first lien.

1. Such procedures are relatively rare for two reasons:
   a. they deprive the holders of senior liens of their option not to foreclose (i.e., a small subordinate load could force the liquidation of a large first mortgage; and
   b. a procedure that required payment of the first lien first would require some mechanism for identifying and giving notice to the holder of the lien so that the holder could protect its rights by bidding at the sale.

B. **G/R:** Priority in Foreclosure: the one common priority rule in all foreclosure sales is that those creditors whose liens are discharged by the sale share in the proceeds of the sale in the order in which their liens have priority.

C. **G/R:** Mortgages v. Judgment Liens: mortgages usually have priority over judgment liens because when a debtor has judgment liens against his property no one will make a mortgage loan to the debtor; hence, the mortgagor will always be first in time to the judgment debtor which is the general rule in the priority system [Bank Leumi Trust v. Liggett].

III. **RIGHT TO POSSESSION BETWEEN LIEN HOLDERS**

A. **G/R:** Prior Perfected Creditor v. Judgment Creditor: the right of a prior perfected creditor to take possession of its collateral is superior to any right of a mere judgment creditor.

1. The prior perfected secured creditor may regain possession of the collateral from an officer who has levied on the property at the direction of a judgment creditor.
2. In addition, a secured creditor with a right of possession of the collateral after default may maintain an action for conversion against one who exercised unauthorized acts of dominion over the property to the exclusion of the creditor’s rights. *[Grocer’s Supply v. Intercity Inv. Prop.]*.

B. **G/R:** Junior lien holder v. Senior lien Holder: when junior and senior lien holders compete for the same collateral, the senior lien holder has the right to the property first; that is, the senior lien holder can prevent the junior lien holder from foreclosing on the property if the debtor is in default.
C. **G/R: Judgment Creditor’s Right to Levy:** most states have statutes authorizing judgment creditors to levy on the debtor’s property, and those statutes make no exception for encumbered property. Hence, because §9-401(a) says that whether a debtor’s rights in collateral may be voluntarily or involuntarily transferred is governed by law outside Article 9, an unsecured creditor may be able to levy on collateral encumbered by another’s security interest [*Frierson v. United Farm Agency*].

§ 8.2: **The Concept of Priority: Bankruptcy Law**

A. **G/R: Security Interests and Liens in Bankruptcy:** security interests and liens survive the filing of a bankruptcy case.

1. Through confirmation of a plan in a case under Chapter 11, 12, or 13, bankruptcy can reduce the amount of the lien to an amount equal to the value of the collateral as determined by the court and extend the time for repayment.

2. Security interests and liens will survive the resolution of a bankruptcy case *unless*:
   a. the lien can be *avoided* because they are unperfected or are preferences (see §§ 9.3 and 9.4 below).

3. *Generally,* the liens of secured creditors and their order of priority are maintained both in and out of bankruptcy.

B. **G/R: Priority:** means that when the value of collateral is sufficient to pay only one of two lien creditors, the law will seek to assure that the value is applied to payment of the one who has priority and in this respect, the definition does not change in bankruptcy.

C. **G/R: Priority Changes because of Bankruptcy:** the trustee or debtor in possession (DIP) can sell a secured creditor’s collateral “free and clear of liens”, effectively foreclosing the secured creditor lien on the trustee’s or debtor’s timetable.

1. This principle contradicts two of the main concepts of priority under state law, which are that:
   a. absent an agreement to the contrary, an lien holder may foreclose at any time after default *unless* the debtor is in bankruptcy then the secured creditor cannot foreclose because of the automatic stay [BC § 362(a)]; and
      i. Secured creditors can seek relief from the stay; however, there is no assurance relief will be granted [BC § 362(d)].
   b. that no lien holder could be compelled to foreclose; that is, although the debtor was in default, it remained the right of the secured creditor to choose the time to foreclose its own lien and force a sale.

I. **Bankruptcy Sale Procedure**

A. **G/R: Trustee’s or DIP’s Right to Sell Collateral:** during bankruptcy, the trustee or DIP can sell collateral. These sales may be judicial sales, held pursuant to an order of the court and confirmed afterward by the court, or they may be non-judicial sales held pursuant to the powers vested in the trustee or DIP by statute [BC §§ 363(b)(1) and (c)(1)].
B. **G/R**: Sale Subject to Liens: in a bankruptcy sale, the collateral may be sold subject to the liens of secured creditors. Once such a sale is complete:
   1. the collateral ceases to be “property of the bankruptcy estate”;
   2. the automatic stay expires; and
   3. if the debt is in default the secured creditor will be free to foreclose.
   *[BC § 362(c)].

C. **G/R**: Abandonment: if the liens against the collateral exceed its value, no one may be willing to buy it subject to the liens. The collateral is then considered burdensome to the estate and the debtor or trustee can abandon it *[BC § 554]*.

D. **G/R**: Sale Free and Clear of Liens: in bankruptcy, the trustee or DIP can also sell the property “free and clear” of the liens of secured creditors *[BC § 363(f)]*.
   1. A sale free and clear of liens works much the same way as a foreclosure sale by the first lien holder in the absence of bankruptcy:
      a. the buyer takes unencumbered title to property and presumably pays its full value as the purchase price;
      b. the liens are transferred to the proceeds of sale, with the ultimate effect that the proceeds are applied to the liens in the order of their priority.

D(1). **G/R**: §363(f) authorized a debtor to sell its property free and clear of liens and encumbrances so long as the DIP can satisfy any one of the five subsections:
   1. applicable non-bankruptcy law permits the sale;
   2. the secured creditor consents;
   3. such interest is a lien and the price at which the property is to be sold is greater than the aggregate value of all liens on the property;
   4. the interest is in bona fide dispute; OR
   5. the secured party could be compelled in a judicial proceeding to accept a money satisfaction of such interest.
   *[BC § 363(f)(1)-(5)].

D(2). **G/R**: Creditor’s Bid: just as in a non-bankruptcy foreclosure sale, secured creditors in a bankruptcy sale free and clear of liens are protected by their right to “bid in” the amounts of their liens *[BC § 363(k)]*.

II. **POWER TO GRANT SENIOR LIENS**

A. **G/R**: State Law Priority Rules: (outside bankruptcy) under state law, liens generally rank in priority in the order in which they are created and perfected and the general rule is that *liens rank in priority in the order they are created*. Hence, if a creditor becomes the first lien holder (which he knows if he will be after a proper Article 9 search) it can be assured that it will remain first because competing liens will be subordinate, that is, they were created later in time.
   1. This rule does not necessarily hold in bankruptcy.
B. G/R: Super-Priority Financing: in limited circumstances, a bankruptcy trustee or DIP can borrow additional money from a post-petition lender, secured by a lien prior to existing liens (hence violating the fundamental state law rule of first in time).
   1. Notice and Hearing Requirement: before obtaining credit, the trustee or DIP must notify the holder of the first lien of its intention to seek additional money; if the holder of the first lien objects (which he will) the court will hold a hearing to determine that the Code prerequisites are met.
   2. Code Prerequisites: the Code prerequisites, which the trustee has the burden of proving before obtaining credit, are:
      a. the estate is unable to borrow money without granting a prior lien; and
      b. there is adequate protection of the interest of the creditor whose lien is being displaced.
         i. When adequate protection is required under §364 that protection may be provided by safeguarding the secured creditor from diminution in the value of its interest during a reorganization.

III. PROTECTION OF SUBORDINATE CREDITORS

A. G/R: Subordinate Creditors under Non-bankruptcy Law: non-bankruptcy law emphasizes the protection of senior lien holders; once the debtor is in default, a senior lien holder controls the timing of his own foreclosure, even though that foreclosure may have severe adverse affects on the positions of subordinate, or unsecured, lien holders.
   1. The power of the senior creditor to foreclose will be felt by all subordinate creditors, who cannot force the senior creditor to take in action.

B. G/R: Subordinate Creditors under Bankruptcy: bankruptcy law provides for more protection for subordinate lien holders, requiring that the collection efforts of senior lien holders should be stayed if:
   1. the senior lien holders are adequately protected against loss; and
   2. the stay is likely to facilitate the collection efforts of subordinate creditors.

§ 9: COMPETITIONS FOR COLLATERAL

§ 9.1: LIEN CREDITORS AGAINST LIEN CREDITORS: THE BASICS

A. Generally: this section will describe the general rules involving lien creditor competitions:
   1. lien creditor v. lien creditor;
   2. lien creditor v. article 9 secured party; and
   3. lien creditor v. real estate secured party

I. HOW LIEN CREDITORS BECOME “LIEN CREDITORS”

A. G/R: Lien Creditors: the term lien creditor means:
1. a creditor who has acquired a lien on the collateral through a legal process such as attachment, levy, execution, garnishment, winning a judgment (judgment creditor);
2. an assignee of the benefit of creditors from the time of assignment;
3. a trustee in bankruptcy from the date of the filing of the bankruptcy petition (the trustee is a hypothetical ideal lien creditor); or
4. a receiver in equity from the time of that person’s appointment.

5. *Test:* the common element of a “lien creditor” under Article 9’s definition is that the parties property rights arise as the result of a judicial or quasi-judicial proceeding.

II. **Priority Among Lien Creditors**

A. **G/R: Lien Creditor v. Lien Creditor:** the rules governing priority among competing lien creditors are generally found in the state statutes, which set up a first in time, first in right system. That is, the first creditor to take the legally required step has the first lien, the second creditor has the second lien, and so forth.

1. The law generally awards priority as of one of four dates (in frequency of their use):
   a. **Date of Levy:** the date on which sheriff or other officer took possession of particular property.
      i. states differ on whether the possession has to be actual, constructive, symbolic.
   b. **Date of Delivery of Writ:** a writ of execution, attachment, or garnishment typically issued by the clerk of the court on the request of a creditor who is entitled to it.
   c. **Date of Service of a Writ:** service is the delivery of the writ by the sheriff to the garnishee, which is typically a bank or employer.
   d. **Date of Recordation of Judgment:** the date will be the date the judgment is delivered to the filing or recording officer (in a majority of states, this rule gives liens only in real estate).

B. **G/R: Writ of Execution v. Writ of Execution:** in a competition between writs of execution, the majority rule gives priority to the first to levy on the particular property.

1. **minority rule:** in a minority of jurisdictions, priority depends on the order in which the writs were delivered to the sheriff.

III. **Priority Between Lien Creditors and Secured Creditors**

A. **G/R: Lien Creditor v. Secured Creditor:** in a competition between a lien creditor and a secured creditor, the lien creditor will win if it became a lien creditor before the non-purchase money Article 9 secured creditor:

1. perfects the security interest; or
2. files a financing statement and complies with 9-203(b)(3) (authenticated security agreement).

*9-317(a)(2).*

**note:** these competitions usually arise in bankruptcy when the trustee, as an ideal lien holder, challenges, the steps taken by the secured party in perfecting. If he succeeds,
then, with the “ideal lien holder” status, and an unperfected security interest, the trustee will be deemed prior.

IV. PURCHASE-MONEY PRIORITY

A. G/R: Priming: when a lien creditor that is second in time, takes precedence over an earlier interest by a different secured party, the second secured party has primed the first secured party. This occurs a lot with PMSIs.

B. G/R: PMSI Exception [PMSI Holders v. Lien Holders]: PMSIs are an exception to the general rule of first in time, first in right. A PMSI can prime a lien creditor’s interest only if the PMSI comes into existence and attaches to the collateral before the creditor obtains its lien against that collateral.
   1. If the PMSI attaches first, the holder of the PMSI has a 20-day grace period in which it can perfect and defeat a lien that came into existence between the dates of attachment and perfection of the PMSI.
      a. This means that if a debtor buys property on credit on the lien creditor levies before the secured creditor perfects its interest, the lien creditor will prevail unless the secured creditor perfects its interest within 20-days of the time the debtor received delivery of the property;
      b. hence, a PMSI creditor that went public later can defeat a lien creditor who went public up to 20-days earlier.

   *[9-317(e)].

C. G/R: PMSI’s Priority: 9-317(e) creates an exception to the general rule of first in time first in right by allowing a secured party to prevail even though it perfects after a lien creditor’s interest attaches to the property that serves as the secured party’s collateral.
   1. This provision operates in favor of the PMS creditor with its primary purpose being to facilitate secured sales.
      a. It does this by allowing the buyer to take possession, without the seller first having to file a financing statement.
   2. The lien creditor is not prejudiced because it does not rely on financing statements in attaching and perfecting its lien to the property in the debtor’s possession.

§ 9.2: LIEN CREDITORS AGAINST SECURED CREDITORS: FUTURE ADVANCES

I. PRIORITY OF FUTURE ADVANCES: PERSONAL PROPERTY

A. G/R: Lien Creditors v. Secured Creditor w/ Future Advance Interest: Article 9 governs priority between a perfected security interest covering future advances and the interest of a lien creditor [9-323(b)]. The security interest has priority over the lien creditor if the interest secures future advances made:
   1. before the lien creditor’s interest arises;
   2. within 45-days after the lien creditor’s interest arises, even if the secured party knows of that interest at the time it makes the advance;
3. more than 45-days after the lien creditor’s interest arises if made without knowledge of that interest; or
4. pursuant to a commitment entered into without knowledge of the lien creditor’s interest.

*note: this gives the secured creditor absolute protection for the initial 45-day period.
  a. This rule enables the secured creditor to conduct one search at the time it begins its lending relationship with the debtor and make future advances without fear of lien creditors whom the secured creditors do not have actual knowledge.

II. PRIORITY OF NON-ADVANCES: PERSONAL PROPERTY

A. G/R: 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 fees. In complex transactions, the debtor often agrees to pay many more kinds of expenses that may be incurred by the secured before or after default.

B. G/R: Secured Creditor v. Judgment Creditor: when a person borrows a lump sum secured by specific collateral, the question of priorities between the lender and any subsequent person who obtains a judgment against the debtor is straightforward: the judgment creditor’s interest is subordinate to the lender’s, so long as the ledger has obtained and perfected a security interest in the debtor’s property before the lien attaches.

C. G/R: Future Advances for Lines of Credit: 9-323(b) rests on the assumption that when a debtor has borrowed a line credit and the collateral is constantly changing from inventory to accounts receivable, that each future advance gives rise to a new security interest, which arises when the creditor extends value; that is, each advance gives rise to a new security interest, which arise when the creditor extends value.
  1. 9-323(b) applies to situations in which there is a perfected security interest in existence when the judgment lien attaches.
     a. Perfection occurs when the debtor signs a security agreement containing a description of the collateral, value has been given, and the debtor has rights in the collateral [9-203(b)].
  2. Under 9-323(b) future advances are protected:
     a. in all cases for 45-days following attachment of the lien;
     b. beyond 45-days if the secured party makes the advance without knowledge of the lien; and
     c. beyond 45-days if the secured party is committed to make advances, provided the commitment was entered into without knowledge of the lien.
  3. However, the rules with regard to non-advances is:
     a. that non-advances made relating to advances made before the levy have the priority of the first advance; whereas,
     b. non-advances relating to advances made after the levy, which have only the priority of the future advance.
     **This has the effect of deteriorating the lien creditor’s position even if the secured party does not add another dollar to the debtor’s estate because interest,
attorney’s fees and costs accruing on prior liens will diminish the lien creditor’s potential for recovery.

*9-923(b) & cmt. 4* [Uni Imports Inc. v. Exchange Nat’l Bank].

III. **PRIORITY OF FUTURE ADVANCES AND NON-ADVANCES: REAL PROPERTY**

A. **G/R: Future Advance Clauses in Security Agreements:** future advance clauses are enforceable according to the their language because of their important role in the credit of economy and freedom of contract.

   1. Incident to a secured transaction, the debtor and secured party may contract that the lien or security interest created shall secure other and future debts which the debtor may come to owe the secured party.

      a. Such provisions are treated like any other contract clause, and will be enforced subject to the normal defenses.

      *Shutze v. CreditThrift of America*.

B. **G/R: Priority of Future Advances:** for priority purposes, the lien securing the future advance takes it date from the *recording of the original deed* of trust and by operation of law reaches forward to secure the advance made after intervening rights became perfected.

   1. Third parties dealing with the debtor are given notice by the public record that the recorded lien secures any future advances. Third parties are required to inquire of the debtor and prior secured creditors.

   2. This is considered the modern view

      *Shutze v. CreditThrift of America*.

§9.3: **TRUSTEES IN BANKRUPTCY AGAINST SECURED CREDITORS: THE STRONG ARM CLAUSE**

A. **Generally:** generally, a security interest will retain its priority when a debtor goes into bankruptcy; however, that is not true as to *unperfected* security interests. Under the BC’s strong arm clause, §544(a), the trustee or DIP has the power to avoid most kind of security interests that remain unperfected as of the time of filing of the bankruptcy case.

I. **PURPOSE OF BANKRUPTCY CODE §544(a)**

A. **G/R: Avoiding Powers:** the BC authorizes a series of avoiding powers—causes of action that allow the trustee and DIP to avoid, or nullify, certain inequitable or illegitimate dispositions of property by the debtor or obligations incurred by the debtor during some period of time prior to bankruptcy.

   1. The “strong arm” power is the power to avoid unperfected security interests and other transfers made or obligations incurred by the debtor that could have been avoided by judgment lien creditors, or bona fide purchasers, under state law.

B. **G/R: Purpose of the Strong Arm Clause:** the policy behind §544(a) is to avoid secret liens. Section 544 reinforces the requirements of Article 9 that creditors give public notice of their security interests whenever feasible.
1. Creditors can do this by filing notice of the security interest in the appropriate records office or by taking possession of tangible collateral.

2. Generally, if secured parties have perfected their liens in the manner required by law prior to the filing of the bankruptcy case, the policy is considered satisfied; in the have not, their liens are considered secret liens and the trustees of DIP can avoid some of them.

C. **G/R: Trustee’s Avoidance of a Security Interest:** if the trustee avoids a security interest, the interest is preserved for the benefit of the bankruptcy estates [BC §551].

D. **G/R: Judicial Lien Creditor Power:** [BC §544(a)(1)]: section 544(a)(1) gives the trustee the power to step into the shoes of a judicial lien creditor when avoiding a security interest.

1. This is done in essentially a two-step process:
   a. First, the trustee is armed with the powers of a judgment lien creditor as of the petition date (e.g., when bankruptcy was filed), which allows the trustee to assert any rights that a judgment lien creditor could have asserted under non-bankruptcy law.
      i. 9-317(a)(2)(A) provides that a lien creditor takes priority over an unperfected security interest.
   b. Second, the trustee can then assert its status as a lien creditor under state law to avoid the creditor’s unperfected security interest.

2. Section 544(a)(1) gives the trustee the status of a judgment lien creditor even if no such creditor actually existed on the petition date—hence the trustee is a hypothetical lien creditor.

3. **knowledge:** section 544(a)(1) allows the trustee or DIP to exercise the strong arm power to avoid an unperfected security interest without regard to any knowledge that the trustee, the debtor, or any creditor might have.
   a. This makes it impossible for the creditor to assert certain defenses that would allow it to prevail, even though unperfected, over other creditors with knowledge of lien.

E. **G/R: Bona Fide Purchaser:** [BC §544(a)(3)]: if the property in dispute is real property other than fixtures, the trustee can step into the shoes of a hypothetical bona fide purchaser who bought and paid for the property (that is, perfected such a transfer) at the time of the petition.

1. The trustee gets the rights of a bona fide purchaser only in circumstances where the competing transfer was capable of perfection.

2. Hence, this section allows the trustee to prevail only where:
   a. the competing creditor was supposed to do something to perfect its lien (like file in the county recording office); and
   b. the competing creditor failed to do it.

3. **Fixtures:** the trustee does not have the power of a bona fide purchasers in a dispute over fixtures; rather, he has the lesser power of a judgment lien creditor.

F. **G/R: Trustee’s Discretion:** BC §544(a) makes certain transfers avoidable, but it does not require the trustee’s to avoid them. When a transfer is avoidable, the trustee has discretion to avoid it or not, as may be in the interests of the estate.
1. In Chapter 7 bankruptcy cases, the discretion is almost invariably exercised in favor of avoidance.
2. If the trustee does manage to avoid one or more security interests or liens against property of the debtor, that property becomes property of the estate [BC §§ 551, 541(a)(4)].
   a. The proceeds of the sale are then available to pay the expense of administration, including fees of the trustee for administering the estate.

G. G/R: Proof of Claims: in order to preserve its security interest, the secured creditor may file a proof of claim. The secured creditor then attaches evidence of its security interest on that proof of claim. The trustee will examine the evidence carefully to make sure it cannot be avoided. If the secured party has perfected his interest properly, the security interest cannot be avoided.
   1. If the creditor does not file a proof of claim, the trustee may inspect the interest even more carefully and informally require the creditor to furnish proof of the validity and perfection of the security interest.
      a. If the secured party is unperfected, and the trustee never serves it with process to avoid the interest, his interest will pass through bankruptcy unperfected.

H. G/R: Grace Periods: many of the state statutes that require public filing to perfect a lien also provide the creditor with a grace period within which to make the filing. If the creditor files within the grace period, it will have priority over anyone who becomes a lien creditor in the interim.
   1. Ex: the holder of a PMSI has 20-days from the debtor’s receipt of possession in which to file, 9-317(e); hence, if debtor filed bankruptcy within that grace period, and the secured creditor subsequently filed after the petition, but before the end of the grace period, he would still be perfected against the trustee attempting to exercise his strong arm power.
      a. Other examples of grace periods include:
         i. construction or mechanics liens which typically require the recording of a claim of lien within 90-days of the lien holder’s completion of the work. If the holder records within the grace period, the lien relates back to some earlier date (usually the dates the construction commenced on the job or the date the lien holder commenced construction on the job).

§ 9.4: TRUSTEES IN BANKRUPTCY AGAINST SECURED CREDITORS: PREFERENCES

I. PRIORITY AMONG UNSECURED CREDITORS

A. G/R: State Law Priority Among Unsecureds: in a competition among unsecured creditors for assets of the debtor, state law gives priority among unsecured creditors based on the order in which they take particular legal steps to collect their debts.
   1. The critical step was creating a judicial lien on the property or taking a security interest in the property:
      a. levy on the asset (judicial lien);
b. deliver a writ of attachment or execution to the sheriff with instructions to levy on the asset (judicial lien);
c. record a judgment in the appropriate public record (judicial lien);
d. serve a writ of garnishment on a third party who owes money to the debtor or who holds property of the debtor (judicial lien); or
e. the unsecured creditor can obtain and perfect a security interest in the property before any competitors establish their judicial liens (security interest) [9-203(b)(1)].

2. Hence, state law gives priority to the first unsecured creditor who takes action on the property. Therefore the effect is to give preference to one creditor over others similarly situated.

i. Policy: debtors have the right to pay one creditor in preference to another; in fact, debtor’s do so every time they write a check to one creditor without writing a check to all.

B. G/R: Priority under Bankruptcy Law for Unsecureds: from the moment the debtor files bankruptcy, the automatic stay bars unsecured creditors from further collection efforts. Unsecured creditors are expected to file claims against the bankruptcy estate.

1. Priority: some unsecured creditors, such as wage claimants and taxing authorities, will be entitled to priority over general unsecured creditors.

2. Pro Rata Distribution: to the extent that general unsecured paid, if at all, they are paid pro rata—in proportion to their claims.

3. Hence, once the debtor is in bankruptcy, neither the debtor nor the trustee can take any action to prefer one pre-petition unsecured creditor over another.

4. Remember, once a bankruptcy petition is filed, bankruptcy law supercedes state policy.

C. G/R: Bankruptcy Preference Periods: not only does bankruptcy law supercede state law when the petition is filed, it also imposes equal treatment of unsecured creditors retroactively for:

1. One-year against creditors who are insiders of the debtor;
   a. “Insiders” of individuals are relatives or partnerships, partners, or corporations in which the debtor has an interest.
   b. “Insiders” of corporations are directors, officers, or other persons in control of the corporation, partnership in which the corporation is a partner and general partners of the corporation.
   *[BC §101(31)].

2. Ninety-Days against creditors who are not insiders.

D. G/R: Transfers During Preference Periods: the trustee or DIP in can avoid any transfer made during the preference period that would have the effect of preferring on unsecured creditor over others [BC §547(b)].

1. Hence, preference law authorizes avoidance of transactions that were legal and proper when done, but that are seen retrospectively to violate the preference policy of bankruptcy law.

   a. Policy: this prevents debtors from defeating the bankruptcy policy of pro rata distribution by liquidating their own estates on the eve of bankruptcy.
II. SECURITY INTERESTS THAT CAN BE AVOIDED AS PREFERENTIAL

A. Elements in Avoiding a Transfer as Preferential: the trustee can avoid any transfer (whether voluntary or not) of an interest in the debtor’s property if the transfer meets ALL the requirements in BC §547(b):

1. Transfer to a Creditor and Benefit to that Creditor: preference law is concerned with only pre-bankruptcy actions that enable creditors to collect their pre-bankruptcy claims.
   a. Transfer: to “transfer” includes, among other things, to repay a loan to a creditor and granting a security interest in certain assets to secure a previously unsecured asset.
   b. Benefit: if the transfer does not benefit a creditor, such as a gift of valuable property to a friend, it cannot be avoided.
      *§547(b)(1)

2. On Account of an Antecedent Debt: (i.e., the transfer must have been made on a liability that the debtor incurred before the transfer was made).
   a. A transfer of a security interest is not made for or on account of an antecedent debt when no debt is owing from the debtor to a creditor and the creditor grants the debtor a “new” security interest.
      i. Ex: Bank agrees to lend debtor $1000. Debtor executes a security agreement and financing statement. Bank files the financing statement and gives debtor the $1000. Debtor files bankruptcy the next day. --This security interest is not avoidable as a preference because debtor did not owe the Bank any debt until the transfer of the security interest was complete.
      *§547(b)(2)

3. Insolvency: the debtor must have been insolvent at the time of the transfer; stated differently, if the debtor is solvent at the time of the transfer, the transfer is not avoidable as a preference.
   1. This element exists because when a debtor is solvent, it has assets sufficient to satisfy all of his creditors. Hence, paying or securing one creditor does not harm others because the debtor still has sufficient assets to pay or secure the others.
   2. Presumption of Insolvency: §547(f) provides that in any action to avoid a preferential transfer the debtor is presumed to have been insolvent during the 90-days prior to the filing of bankruptcy.
      a. The creditor to whom the transfer was made must affirmatively prove solvency to escape the application of this provision.
      *§547(b)(3)

4. Preference Period: to be avoidable the transfer must have occurred within the preference period (see above), which is 90-days for most creditors and 1-year for inside creditors [§547(b)(4)].

5. Improved Creditors Position: to be avoidable, the transfer must have improved the creditor’s position. That means the transfer must have enabled the creditor who received it to recover more than the creditor would have if the debtor has been liquidated under Chapter 7, without making the transfer.
1. In other words, if the transfer did not result in the creditor’s getting more than the pro rata share which he would have received in bankruptcy, there is no reason to avoid it.

*Nearly any transfer of a security interest or payment that meets the other elements will meet this one.

**547(b)(5).**

B. G/R: When the Transfer Occurred: the trustee must establish when the transfer occurred because it can only be avoided if it was in the preference period and because certain transfers in the preference period will relate back to earlier dates if there is an applicable grace period.

1. g/r: the basic rules is that the transfer of a security interest occurs when the security interest is perfected [§547(e)].
   a. To determine when a security interest is perfected, the BC refers to state law.
      i. *Real Property:* a security interest in real property is perfected when it is too late for a bona fide purchaser to acquire a superior interest (e.g., when the mortgage is recorded); and
      ii. *Fixtures and Personal Property:* a security interest in fixtures or personal property is perfected when it is too late for a lien creditor to acquire a superior interest (e.g., when the interest is perfected under Article 9).

2. g/r: a transfer is *not* made until the debtor has a acquired rights in the property transferred.
   a. This is important when the security interest has an after-acquired property clause. When the debtor takes possession of new property, that is after acquired, his interest in it transfers to the secured creditor pursuant to the after acquired property clause. Thus, if the debtor takes possession, or buys/receives/gets new property within the 90-day preference period, it can be avoidable by the trustee because it was a transfer that meets all the requirements of §547.
      *[BC §547(e)(3)].

C. G/R: Inventory and Accounts Receivable Exception: [BC §547(c)(5)]: the bankruptcy code creates a safe harbor for security interests in accounts receivable and inventory. Instead of treating the acquisition of each new item of after acquired property collateral as a transfer to the secured creditor, which could possibly be avoided as a preference, the Code treats the accounts receivable and inventory as a single item of collateral.

1. This exception exists because of the rule in §547(e)(3) that a transfer is not made until the debtor has acquired rights in the property. Debtors are constantly selling their inventory and collecting their accounts receivable, which by their nature would always be within the preference period and hence avoidable without this exception.

D. G/R: Relation Back Rules: in determining whether a transfer occurred within the preference period, the Code gives effect to grace periods that permit perfection, once made to relate back to an earlier time. Hence, if the relation back rule, or grace period, makes it so that security interest perfected at a time outside the preference period, the transfer is not avoidable.

§9.5: **SECURED CREDITORS AGAINST SECURED CREDITORS: THE BASICS**
I. THE BASIC RULE: FIRST TO FILE OR PERFECT

A. G/R: Competitions Among Secured Creditors: the general rule governing interests among security interests is: as between the holders of two security interests in the same collateral, the first to file or perfect has priority.

1. In other words, the priority date of a security interest is the earlier of the dates on which the secured party filed with respect to the interest or perfected.
2. As between two security interests, the one with the earlier priority date had priority.
3. The holder who gains priority by filing first or perfecting retains it so long as the holder remains continuously filed or perfected.

* [9-322(a)].

B. G/R: Creditors’ Intentions: section 9-322(a) assigns priority without reference to either creditors’ state of mind. Thus, the first to file or perfect has priority even if the first to file or perfect knows that the debtor intended that another creditor have priority, and even if the first believed itself to be subordinate at the time it filed or perfected.

C. G/R: Pre-Filing: the general rule on competing perfected security interests creates a special priority advantage to filing that is not available through any alternative method of perfection:

1. A security interest cannot be perfected until all the applicable steps required for perfection are taken and the security interest has attached;
2. nevertheless a secured party may pre-file a financing statement before the security interest attaches;
3. the secured party who files a financing statement but does not complete the process of attachment until later will achieve priority under the general rule (first to file OR perfect) against any creditors who perfect after that filing.

D. G/R: Priority of Security Interests in Transferred Collateral: 9-325 creates an important exception to the rule of first to file or perfect. Section 9-325 subordinates security interests perfected against a transferee to those perfected against a transferor; that is, if a debtor acquires property that would be covered by an after acquired property clause, but that property is subject to a previous perfected security interest, the previously perfected secured party has priority over the secured party of the debtor who received the property [9-325].

II. PRIORITY IN FUTURE ADVANCES

A. G/R: Priority of Future Advances: under the first to file or perfect rule, a security interest with priority under the general rule also gives the secured party priority for all subsequent advances secured by its security interest.

1. Hence, as long as the secured creditor’s financing statement “covers the collateral” all advances made by the secured creditor to the debtor have priority as of the filing of the financing statement.
2. note: the financing statement is not required to include the fact that the security agreement may grant the debtor future advances. Thus, for the searcher (a subsequent creditor) must know that the security agreement may cover future advances.

*[9-322(a)].
III. PRIORITY IN AFTER-ACQUIRED PROPERTY

B. G/R: Priority in After Acquired Property: Article 9 permits the grant of a security interest in property the debtor does not yet own; such as, an after acquired property clause in a security agreement (i.e., “any inventory or equipment debtor acquires in the future”). Once the debtor acquires property that fits in the description of the security agreement, the security interest attaches [9-203(b)].

1. If the description in the security agreement is broad enough to cover the after acquired property, the filing covers it; that is, as against another Article 9 secured creditor of the debtor, the after acquired secured lender’s priority dates from the time of the filing.
   a. Hence, the security interest has the same priority with respect to after-acquired property that it has with respect to the original collateral.
      i. This occurs most frequently when the debtor is selling inventory.
      *[9-322(a)(1)].

IV. PURCHASE MONEY SECURITY INTERESTS

A. G/R: Priority of PMSI’s: a PMSI in collateral other than inventory has priority over a conflicting security interest in the same collateral if the PMSI is perfected not later than 20-days after the debtor receives possession of the collateral [9-324(a)].

1. Thus, a PMSI in goods has priority over a conflicting security interest in the same goods (probably through an after acquired property clause) if the PMSI is perfected when the debtor takes possession (e.g., consumer goods) or if the PMSI lender files within 20-days.
2. The secured party may perfect by filing or any other available method.
3. Consumer Goods: if the collateral is consumer goods, the PMSI secured party’s interest is automatically perfected upon attachment, and no filing is necessary to obtain priority over conflicting security interests.
   a. note: the PMSI secured party will want to file in order to ensure that it does not lose its priority against a later consumer who buys the collateral without knowledge of the security interest.
4. If the collateral is not consumer goods, the PMSI lender’s must file a financing statement before the expiration of the grace period.

B. G/R: Effect of the 20-Day Grace Period: the 20-day grace period in 9-324(a) is not an exception; hence, because it exists, anyone lending against non-inventory collateral in the possession of the debtor must consider the possibility that:
   1. the debtor obtained possession of the collateral in the past 20-days; and
   2. the holder of one or more PMSI in the collateral has not yet filed a financing statement, but will do so before the end of that 20-days.
   *This puts an additional burden on the searcher to determine if the debtor has any PMSI or verify the debtor’s possession of the collateral and then wait 20-days beyond that period to search again.
C. **G/R: Priority Among Multiple PMSI's:** when there are multiple PMSIs, priority is given to a security interest that secured the price of the collateral over a conflicting security interest acquired through an enabling loan; hence, the general first to file or perfect rule governs priority among multiple PMSIs that secure enabling loans [9-324(g)(1)-(2)].

D. **G/R: PMSI in Inventory:** the 20-day grace period for the filing of a PMSI does not apply when the property sold will be inventory in the hands of the buyer.

1. A PMSI in inventory has priority over a conflicting security interest in the same inventory if:
   a. the PMSI is perfected when the debtor receives possession of the inventory;
   b. the purchase money secured party sends authenticated notification to the holder of the conflicting security interest
   c. the holder of the conflicting security interest receives the notification before the debtor receives possession of the inventory; and
   d. the notification states that the sender has or expects to acquire a PMSI in inventory of the debtor.

   *[9-324(b)].

2. The conflicting secured party (the first secured creditor with a interest in the inventory) gets around this possible conflicting security interest in the debtor’s inventory by including within the default provisions of the original security interest a clause which states that if it receives notification of a PMSI in the debtor’s inventory, the debtor is in default.

3. This exception is designed to accommodate the customs and practices in inventory financing—most inventory financing is extended on the understanding that inventory-secured lender’s lien will be the only lien against inventory owned by the debtor.

V. **PMSI Priority in Proceeds**

A. **G/R: PMSI Priority in Proceeds:** purchase-money priority under 9-324(a) extends to the collateral or its identifiable proceeds [9-324(a)].

1. Ex: a secured party takes an interest in one form of collateral (equipment) and another secured party takes an interest from the same debtor in a different class of collateral (accounts). A seller then sells a piece of equipment to debtor retaining a PMSI and perfects within 20-days (thereby obtaining priority of the equipment secured party). When the equipment is sold, and it creates accounts, the accounts are proceeds of the equipment collateral.

   a. The equipment secured party has a security interest in the proceeds because a security interest attaches automatically to identifiable proceeds received upon disposition of collateral [9-315(a)(2)]. If the equipment secured party perfected through a financing statement, perfection in the account proceeds would be continuous.

   b. However, the equipment secured party’s interest is subordinate to the PMSI seller, who also has a security interest in the proceeds, because the 9-324(a) gives the PMSI secured party priority over the equipment secured party [9-324(a)] and that security interest extends to identifiable proceeds [9-315(a)(2)].
c. In addition, the PMSI secured party has priority over the accounts secured party because the Seller’s PMSI flows through to the account, giving it priority over the earlier secured party’s interest in accounts.

*If that makes any fucking sense.

3. Exception: the rule that PMSI status flows through into proceeds is subject to the exception that PMSI status in inventory flows only into chattel paper, instruments and cash proceeds.

§9.6: SECURED CREDITORS AGAINST SECURED CREDITORS: LAND AND FIXTURES

I. MORTGAGE AGAINST MORTGAGE

A. G/R: Contractual Agreements: in most cases, a mortgagee contracts with the debtor for its priority; that is, the mortgage signed by debtor and mortgagee provides that it is a first, second, or third mortgage. So long as the debtor has such an agreement with all of the mortgages and the agreements are consistent, the agreements determine priority among mortgages.

1. All the rules regarding recording statutes are default rules which are applied in the absence of an agreement to the contrary.

B. G/R: Priority among Mortgages: generally, real estate mortgages, like security interests in personal property, rank in the order in which they were perfected.

1. Most of the rules of priority among interests in real estate are embedded in the statutes that govern recording and specify its effect. There are three main statutes that govern priority among mortgages:
   a. Pure Race Statute: first mortgage recorded has priority, regardless of mortgagee’s state of mind;
   b. Notice Statute: the order in which the mortgages are recorded does not matter; rather, notice statutes provide that if a second mortgagee acquires an interest in the property without notice of the first, the second prevails. Hence, the first mortgagee must record to protect his interest.
   c. Notice-Race Statute: provides that if the recipient of the second mortgage takes the mortgage without notice AND records before the holder of the first mortgage, the second mortgagee has priority.

C. G/R: Good Faith Purchaser for Value: most recording statutes only protect good faith purchasers for value, which generally means someone who took the property for value or valuable consideration—something more than nominal consideration.

II. JUDGMENT LIENS AGAINST MORTGAGES

A. G/R: Judgment Liens: in nearly all states, an unsecured creditor can obtain a lien against the debtor’s real property by suing the debtor, obtaining a judgment against the debtor, and recording the judgment in the real estate recording system of the county where the real property is located.

1. The judgment will constitute a lien against real property owned by the debtor at the time of recording and real property of the debtor that he later acquires.
B. G/R: **Priority Between a Judgment Lien Creditor and Mortgage:** the recording of the judgment both creates and perfects the judgment lien. Unless the recording statute changes the result, priority between a judgment lien and a mortgage depends on which was first created.

### III. **Construction Liens Against Construction Mortgages**

A. **G/R: Construction Liens:** [sometimes called mechanic’s liens]: construction liens are statutory liens; that is, they arise by operation of the law pursuant to the statute creating them.

1. The purpose of these liens is to protect those who supply labor and material incorporated into the construction of a building.
2. The protection comes in the form of a lien against real property into which the labor or material was incorporated.
3. While construction liens are usually associated with the construction of buildings, the statutes of many state provide for liens in favor of virtually anyone who participates in the making of any improvement to real property.

B. **G/R: Priority of Construction Liens:** statutes that fix construction liens usually distinguish the obvious construction of buildings from the not-so-obvious casual alteration or repair of a building.

1. A lien for an alteration or repair (such as installation of a new furnace) takes priority as of the recording of the claim of lien.
2. Liens that arise out of the construction of a building typically all take priority as of the same date—usually the commencement of construction.

### IV. **Article 9 Fixture Filings**

A. **G/R: Fixture Filings:** an Article 9 security interest can exist in goods that are fixtures under real estate law. Article 9 authorizes the perfection of an interest in a fixture by a “fixture filing” in the real estate recording system (and possibly the Article 9 recording system).

1. Priority is governed by 9-334.

B. **G/R: Priority in Fixture Filings:** Article 9 fixture filings and mortgages rank in the order in which they are recorded in the real estate recording system [9-334(c) and 9-334(e)(1)].

1. Generally, the non-purchase money fixture-financier will be subordinate to whatever mortgages exist at the time of the fixture filing.

   a. This is so, because in the typical case, the mortgage will have recorded during construction of the building or some other time long before the fixture is purchased and incorporated into the building.

   i. If this result is unacceptable to the fixture financier, it may wish to seek the mortgagee’s consent to the security interest [9-334(f)(1)].

2. **Exceptions:** there are two important exceptions to this rule:

   a. the fixture filing will have priority over the mortgages if the debtor has the right under the mortgages to remove the fixtures; and
   
   b. the fixture filing will have priority over the mortgages if the security interest is a PMSI in good affixed after the mortgage is in place and the fixture filing is made not later than **20-days** after the goods become fixtures [9-334(d)].
§9.7: **Competitions Involving Cross-Collateralization and Marshaling Assets**

I. **Cross-Collateralization Provisions in Security Agreements**

A. **G/R: Cross-Collateralization**: is the term used to describe a security interest in which more than one item of collateral secures a single debt.
   1. To determine whether a particular debt is cross-collateralized, one need only read the security agreement— if it provides that multiple items of collateral are security for a single debt, then it is cross-collateralized.
   2. Cross-collateralization occurs almost any time an after-acquired property clause reaches an additional item of collateral.
   3. A secured party cross-collateralizes property in order to “oversecure” the collateral.

II. **The Secured Creditor’s Right to Choose its Remedy**

A. **G/R: Right to Foreclose**: a secured creditor generally has the right to choose when it will foreclose; in addition, in a cross-collateralization security agreement, the creditor secured by more than item of collateral generally has the right to choose when it foreclose against each.
   1. Under this general rule, a creditor secured by multiple items of collateral might have numerous strategic options:
      a. A secured creditor that wanted to force its debtor into bankruptcy reorganization with minimum effort, might file an action for replevin of just a single item of collateral—but one without which the debtor could not continue business.
      b. In most circumstances, this does not arise because the applicable rule permits the creditor to foreclose against part of the collateral, without waiving or abandoning its rights in the rest.

B. **G/R: Foreclosure Severance**: when a security agreement covers both personal and real property, 9-604(a) specifically authorizes the secured creditors to sever the foreclosure against personal property collateral from their foreclosure of real estate collateral.
   1. Foreclosure against one piece of personal property does not, in ordinary circumstances, bar later foreclosure against another piece of personal property; hence, the secured party can sever all the collateral in the security agreement and foreclose on one at a time. *[9-604(a)(1)].

C. **G/R: Release of Collateral**: a corollary of the secured creditor’s right to choose what collateral it will proceed against is that all collateral remains encumbered until the debt is paid in full.
   1. Hence, for the debtor sell a piece of its property it would have to pay the debt in full, which ordinarily cannot be done. Hence, the only way for the debtor to sell a piece of encumbered property free and clear, absent paying the entire debt, is to obtain a release from the secured creditor.
   2. A release is a voluntary surrender of the property by the secured party.
But Note: debtors do not need release clauses for collateral that is inventory. UCC 9-320(a) sets as the default rule that a sale of inventory automatically releases the property sold from any security interest created by the seller.

a. The rule can be varied by agreement, and some inventory loan agreements do require that the debtor obtain the consent of the secured party to the sale of each inventory item (for example, when selling a big fat jumbo fuckin’ jet).

III. Marshaling Assets

A. Generally: an over-secured creditor’s election to proceed against one item of collateral, over another item of collateral, can determine the fate of other unpaid creditors.

B. G/R: Marshalling Assets: is an equitable doctrine developed to limit the senior secured creditor’s choice of which collateral to pursue. When the doctrine applies, it requires that a creditor to look to the asset not encumbered by junior liens, so that the holders of junior liens, can recover from the only collateral available.

1. When the doctrine operates to the benefit of junior lienors, it is usually to the detriment of unsecured creditors.

C. G/R: Elements of Marshalling: marshalling is an equitable doctrine which rests upon the principle that a creditor having two funds to satisfy his debt may not, by his application of them to his demand, defeat another creditor, who may resort to only one of the funds.

1. The purpose of the doctrine is to prevent the arbitrary action of a senior lien holder from destroying the rights of a junior lien holder or a creditor having less security.
2. Equity requires that the senior creditor look first to property which cannot be reached by a junior creditor, but only if the senior creditor or third parties are not prejudiced.
3. Elements: to apply the marshalling doctrine, three elements must be present:
   1. the existence of two creditors of the Debtor;
   2. the existence of two funds owned by the Debtor; and
   3. the ability of one creditor to satisfy its claim from either or both funds, while the other creditor can only look to one of the funds.

*[In Re Robert Derecktor].

D. G/R: Marshalling Against Property Owned by Third Parties: the courts are split on whether to allow marshalling against the assets of a third party (i.e., it is not unusual for a creditor to take a security interest in property that does not belong to the debtor). Most courts read the common debtor requirement (element 2) to require:

1. two or more creditors of the same debtor; and
   a. a minority of jurisdictions only require this element.
2. the funds or assets must be in the hands of that common debtor.

E. G/R: Limitations on the Doctrine of Marshalling: there are three major limitations on the doctrine of marshalling:

1. the doctrine of marshalling assets can be applied only if the senior creditor is not prejudiced;
a. time also enters into this factor because even though the secured party may not lose any money, it may be more difficult, and more energy consuming, to foreclose on a different piece of collateral, and this is prejudice under to the secured party.

2. the doctrine cannot be used to compel the senior creditor to foreclose against homestead property; and

3. the doctrine cannot be used by one junior lien holder where the effect would be to prevent recovery by another junior lien holder.

§9.8: SELLERS AGAINST SECURED CREDITORS

I. LIMITS OF THE AFTER-ACQUIRED PROPERTY CLAUSE

A. Generally: the prototypical situation is:

Seller Supplier       Debtor       Secured Lender for Inventory w/ After Acquired Prop. Cls.

I. LIMITS OF THE AFTER-ACQUIRED PROPERTY CLAUSE

A. G/R: Limited Security Interests: Article 9 does not require that the debtor be the owner of the collateral to grant a valid security interest in it. The debtor need only have “rights in the collateral” [9-203(b)(2)].

1. The usual rule is that a debtor’s grant of a security interest in collateral in which the debtor holds only a limited security interest conveys only a security interest in the limited interest.

B. G/R: Void Title Rule: the void title rule provides that a thief who steals a piece of property obtains not title (a “void” title) in the property she steals; hence, when the property is transferred or sold to third party, even a bona fide purchaser for value, the third person receives no title either.

1. In other words, one who does not have title, cannot convey it.
2. Nemo Dat: if a thief steals the property from the true owner, the true owner can recover the property regardless of who the competing party is, or how that party acquired its interest.

C. G/R: Secured Creditors as Good Faith Purchasers for Value: the UCC (through its definitions of purchaser, purchase, good faith, and value) dictates that when creditor acquires a security interest in collateral, the creditor is a purchaser (even through the use of an after acquired property clause) and eligible for whatever protection purchases have elsewhere in the law. In addition, because of the definitions of good faith and value, the secured creditor is a good faith purchaser of collateral for value and hence entitled to all the protections of a good faith purchaser under the law.

1. Hence, the secured creditor can prevail over the true owner of goods even if the title of its transferor, the debtor, was avoidable because the debtor procured the collateral through fraud.
II. **SUPPLIERS AGAINST INVENTORY SECURED LENDERS**

A. **G/R: Priority between Sellers and Inventory Secured Lenders:** when the debtor-seller (such as a pornography store owner) has a security agreement with a creditor (bank) which covers the inventory in its store, and also has floating liens from suppliers to cover the property, then when the porn shop closes, the bank will have the right to take possession of all the inventory and sell it [9-609(a)].

1. As a secured creditor, it will have priority over the suppliers in the inventory.
2. The result is different if the supplier requires the debtor to take the inventory subject to a PMSI, which would give it priority over the bank, 9-324(a); however, to do so it must notify the secured party, which will most likely make the debtor go into default (see above).

III. **SELLERS’ WEAPONS AGAINST THE AFTER-ACQUIRED PROPERTY CLAUSE**

A. **G/R: PMSI:** theoretically, sellers have the option to timely comply with the PMSI requirements of Article 9 and thereby obtain priority in the property they sell; but recall, many lenders bar their debtors from granting a PMSI, and if the debtor does so, it will put him in default and allow the secured party to call the loan.

B. **G/R: Retention of Title:** if a seller attempts to retain title, in order to avoid the harsh effects of Article 9, by *contracting to sell*, with the title to pass to the buyer only when the buyer pays for goods, Article 9 treats such contracts an immediate sale, with the seller retaining a security interest [see 9-109(a)(1)].

1. If the seller did not anticipate that treatment, it probably did not file a financing statement or give notice necessary to retain a PMSI entitled to priority; as a result, the seller’s security interest will be subordinate to that of the inventory secured lender.

C. **G/R: Consignment:** is an arrangement in which a manufacturer or wholesaler of goods entrusts the goods to an agent or bailee (the consignee) for sale.

1. When the agent or consignor sells the goods, title passes directly from the consignor to the buyer.
2. The consignee remits a portion of the sale proceeds and keeps the rest as a fee for selling the goods.
3. By the consignment contract, unsold goods remain the property of the consignor and the consignee ultimately returns them to the consignor.

*This is a common arrangement in certain industries, such as retail clothing.*

C(1). **G/R: Consignment as a Security Interest:** Article 9 governs consignments and deems the consignee to have full rights and title to the goods, and Article 1 deems a consignment, even if a true consignment, to be a security interest [9-109(a)(4); 9-319(a); 1-207(37)].

1. The security interest of a consignor in goods that are subject of a consignment is PMSI in inventory; as a result, the consignor will have priority over the inventory lender only if the consignor complies with the perfection and notice requirements of Article 9 [9-103(d); 9-324(b)].
D. **G/R: Right of Reclamation**: in certain circumstances, unpaid sellers have the right to reclaim goods they have sold. The buyer must have received the goods while insolvent and the seller must make a demand for reclamation within **10-days** of receipt, *unless* the debtor misrepresented his solvency within three months before delivery of the goods [2-702(2)].

1. However, the seller’s right of reclamation is subject to the rights of a buyer in the ordinary course of business or other good faith purchaser for value [2-702(3)].
2. This effectively nullifies the seller’s right of reclamation and courts have uniformly held that the seller’s right of reclamation is subject to the security interest of the debtor’s inventory lender.
   a. This is because Article 9 defines a secured party as a good faith purchaser of collateral.
3. **Bottom Line**: inventory cannot be reclaimed the moment the inventory security interest attaches.

E. **G/R: Express or Implied Agreement with the Secured Lender**: the most direct means for a seller to protect itself against the buyer’s inventory is by agreement with the secured lender (in fact, this may be the only way for the seller to protect herself).

F. **G/R: Equitable Subordination**: it is a long-standing principle that bankruptcy courts have the authority to subordinate claims on equitable grounds [BC §510(c)(1)]. In order for a bankruptcy court to subordinate a claim the court will apply a three-pronged test:

1. the claimant must have engaged in some type of inequitable conduct;
   a. there are three types of conduct that satisfy this prong:
      i. fraud, illegality, or breach of fiduciary duties;
      ii. undercapitalization; and
      iii. claimant’s use of the debtor as a mere instrumentality or alter ego.
   b. thus, the misconduct must be *gross or egregious*.
2. the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and
3. equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy code.

*this test poses an exacting standard for the seller seeking equitable subordination and the seller rarely wins.

G. **G/R: Unjust Enrichment**: traditionally, courts have refused to apply unjust enrichment under Article 9 because the purpose and the effectiveness of the UCC would be substantially impaired if interests created in compliance with the UCC procedure could be defeated by the equitable doctrine of unjust enrichment [*Peerless Packing Co.*].

1. **Caveat**: some courts, however, have recognized the doctrine of unjust enrichment under Article where a secured creditor initiates or encourages transactions between the debtor and suppliers of goods and services, and benefits from the goods and services supplied to produce such debts; in this situation, equitable principles require that the secured creditor compensate even an unsecured creditor to avoid being unjustly enriched [*Credit Ass’n v. Duggan*].

**§9.9: Buyers Against Secured Creditors**
I. **Buyers of Real Property**

A. **G/R: Priority between Buyer and Mortgagee:** in a competition between buyer and mortgagee, the general rule is that the first time has priority; that is, if the mortgage was created before the debtor sold the property to the buyer, the buyer takes subject to the mortgage.

1. **Sale First:** if the sale takes place first, it will be free of a later mortgage granted by the debtor-seller.
2. **Recording Statutes:** a recording statute may reverse either of these results.
   a. However, in general, under all 3-types of recording statutes, a bona fide purchaser of real estate for value will take free of a prior un-recorded mortgage if he records before the mortgage holder.
3. All purchasers of real property are expected to search the public record, are deemed to have constructive notice of duly recorded mortgages, and take subject to them.
4. **NO EXCEPTIONS** are recognized for sales in the ordinary course of business or even sales to consumers.

II. **Buyers of Personal Property**

A. **G/R: Buyer of Personal Property:** the general rule governing sales of encumbered person property is: buyers take subject to encumbrances of record [9-201; 9-315(a)].

III. **Exceptions to the Rule that Buyers Take Subject to Encumbrances of Record**

A. **G/R: Authorized Disposition Exception:** a the authorized disposition exception, a buyer of personal property does not take subject to the security interest in the collateral if the secured party authorized the disposition free of the security interest [9-315(a)(1)].

1. **Waiver and Implied Authorization:** the authorization to sell free of the security interest need not be express. Numerous cases have held that a secured creditor who knew that the debtor was making sales of collateral in violation of the provisions of the security thereby waived the provisions and authorized the sale so that the buyer can take free of the security interest.
2. **Conditional Authorizations:** a conditional authorization, that is one where the debtor sells the goods to the buyer only on the condition that the buyer pay the proceeds to the debtor as a payment on the loan, have resulted in a split of authority--some courts treat this disposition as authorized, while others do not.

B. **G/R: Buyer in the Ordinary Course Exception:** a buyer in the ordinary course of business can take free of a security interest created by its seller [9-320(a)].

1. A “buyer in the ordinary course of business” is a person that buys goods in good faith, without knowledge of the security interest, and in the ordinary course from a person in the business of selling goods [9-201(9)].
   a. Thus, the buyer must be in the ordinary course of the **seller’s business**, NOT the buyer’s business.
      a. Ex: Farrah is buying the super-vibrator 2500 (a 14-incher with a width of 3.5 inches) from Megan’s super crazy sex and get yourself off shop,
which LaMar’s Bank has a security interest in the inventory of the store. Since Megan is the business of selling vibrators, Farrah would take the vibrator free of any security interest LaMar might have it.

2. **Buyer’s Knowledge:** §9-320(a) protects a buyer in the ordinary course of business even though the buyer knows of the security interest’s existence; notwithstanding the definition in 9-201(9) because the result is:
   a. the buyer’s taking free if the buyer merely knows that a security interest covers the goods but taking subject if the buyer knows, in addition, that the sale violates a term in an agreement with secured party.
      i. **g/r:** in other words, merely knowing of the security interest should not prevent a consumer from taking free of the security interest; however, if the buyer knows of the security and also knows that buying the goods would be a violation of the security, then he takes subject to the interest.

3. A buyer becomes “a buyer” under 9-320(a) when:
   a. the buyer takes possession of the personal property; or
   b. the property, through the contract of sale, is identifiable; that is, when goods become identified to the contract.

C. **G/R:** Consumer-to-Consumer (or Garage Sale) Exception: the garage sale exception applies only if the goods are consumer goods in the hands of the buyer after the sale.
   1. The exception provides that a buyer of consumer goods takes free of the security interest in the goods if the buyer buys:
      a. without knowledge of the security interest;
      b. for value;
      c. primarily for consumer use (e.g., buyer’s personal, family, or household purposes); and
      d. before the filing of a financing statement covering the goods.
         i. this is the element that will usually cause the consumer to take subject to the security interest, such as a PMSI.

   *§[9-320(b)].*

D. **G/R:** Buyer’s Not in the Ordinary Course: those who buy goods outside of the ordinary course of business have no exemption from Article 9. Those buyers are expected to search the UCC records and are charged with constructive notice of the filing they would have found.
   1. This result is that in a sale not authorized by a secured creditor, the buyer is not in the ordinary course and takes subject to any security interest that is perfected, but has priority over unperfected ones.

   *§[9-323(d)-(e); 9-317(b)].*

§9.10: **Statutory Lien Creditors Against Secured Creditors**

A. **G/R:** Statutory Liens: a statutory lien is a lien that arises by operation of law, which includes liens that arise by statute, at common law, or in equity.
   1. There are three major categories of statutory liens:
      a. **Statutory liens:** liens that arise by operation of a statute;
b. **Consensual liens:** are liens that arise by contract between the debtor and creditor; such as, security interests, mortgages, and deeds of trust.

c. **Judicial liens:** arise as the result of some act take during litigation; such as, execution, attachment, and garnishment.

**B. G/R: Perfection on Statutory Liens:** although most kinds of statutory liens arise without any action on the part of the lien holder, some kinds of statutory liens require the holder to take steps to perfect.

1. For example, with a construction lien, the holder typically has to record a “claim of lien” in the real property recording system within 90-days of the last date on which the lien holder furnished labor or materials, or the lien is lost.

**I. Variety of Statutory Liens in Personal Property**

**A. Generally:** most states recognize dozens of different types of statutory liens; in addition, there are number federal created statutory liens, such as a federal tax lien.

1. Some types of statutory liens, in addition to the one’s below, are:
   a. hospital liens;
   b. landlord’s liens;
   c. agricultural liens;
   d. dry cleaners’ and launders’ liens;
   e. among others.

**B. G/R: Artisan’s Liens:** most state’s have codified the artisan’s lien. An artisan is a person skilled in some kind of trade, craft, or art requiring manual dexterity. Artisans have lien against personal property they improved or repaired.

1. Persons successfully claiming artisans’ liens have included jewelers, laundry operators, garage mechanics, and accounts.
2. **Perfection:** to retain its lien the artisan has to retain possession of the property (which perfects the lien) and if the artisan surrenders possession of the property, the lien is lost.

**C. G/R: Attorneys’ Charging and Retaining Liens:** under the law of every state, attorney’s are granted statutory liens to secure the payment of at least some kinds of fees. These liens are of two general types:

1. **Charging Lien:** is a lien that attaches to the client’s recovery in an action against a third person.
2. **Retaining Lien:** is a lien that attaches to documents and records that the client has delivered to the lawyer for use in connection with the representation.

**D. G/R: Garage Keeper’s Lien:** persons who repair motor vehicles are, in most states, entitled to common law artisan’s liens, but a substantial number of states have enacted a statute specifically entitling garage keepers and mechanics to liens.

**II. Statutory Liens in Bankruptcy**
A. **G/R: Statutory Liens in Bankruptcy:** the bankruptcy code generally recognizes and gives effect to liens and priorities that creditors perfected under non-bankruptcy law prior to the filing of the petition for bankruptcy. In general, bankruptcy law gives effect to statutory liens as well.

1. **Trustee’s Avoidance Powers:** there are three types of liens the trustee can avoid:
   a. a lien that becomes effective not when the debt arises, but only after the debtor is in financial difficulty;
   b. a statutory lien that, at the time of filing the bankruptcy case, was not sufficiently perfected to be effective in the absence of bankruptcy against a hypothetical bona fide purchaser; and
   c. the trustee can avoid statutory liens for rent and liens for “distress of rent.”
      a. “distress of rent” was a self help remedy available to landlords at common law.  
      *[BC §545(1)].

2. **Effect of Avoidance:** when the trustee avoids a statutory lien in bankruptcy, the lien is preserved for the benefit of the estate; that is, the trustee has the rights of the holder of the lien, including the lien’s right to priority [BC §551].

III. **Priority of Statutory Liens**

A **G/R:** Priority of Statutory Liens: a statutory lien has the priority specified in the law that creates it.

B. **G/R: Rules Governing Priority between Statutory Liens and Security Interest:** there are three types of rules governing priority between statutory liens and security interests:

1. **First in Time:** one rule gives priority to the lien or to the security interest based on which was first in time.
   a. if the statute gives priority on the basis of first in time, it will probably, but not necessarily, specify what the holder of the lien or security interest must do first in order to perfect.
   b. security interests are usually dated as of perfection;
   c. statutory liens may be dated as of the time the lien holder gives value, contracts to give value, files a claim of lien, or takes some other action.

2. **Statutory Prevails:** a second rule gives priority to the statutory lien regardless of the order in which the two interests arose.

3. **Security Interest Prevails:** the third rule gives priority to the security interest regardless of the order in which the two interests arose.

C. **G/R: Priority Between Security Interests and Liens Arising by Operation of Law:** section 9-333 addresses the issue of priority between security interests and liens arising by operation of the law. Section 9-333 does not create any liens, and determines the relative priority of a statutory lien only if the statute or rule of law creating the lien does not.

1. **Default Rule:** the default rule of priority (that is if the statute does not give priority) that a lien by operation of the law has priority over an earlier perfected Article 9 security interest.
2. The liens to which the default rule apply must be:
a. in favor of a person who furnishes services or materials in the ordinary course of her business;
b. for the purchase price of the services and materials;
c. on goods in the possession of the lien holder.

3. In other words, the liens subject to the default rule are essentially possessory artisan’s liens.

*[9-333(a)-(b)].

IV. SECURED CREDITOR RESPONSES TO STATUTORY LIEN PRIORITY

A. Generally: most laws giving statutory lien holders priority over earlier perfected secured creditors turn out to provide limited protection against the secured creditors. Secured creditors can and do take steps to protect themselves. Among the means secured creditors use are:

1. 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.
   a. Such covenants are relatively ineffective because they do not bind statutory lien holders who are not a party to them.

2. Payments: the secured party can have a provision in the security agreement stating that it will pay off the statutory lien (in order to avoid foreclosure or take possession) and then that amount will be added to the loan.

3. Waiver: some statutory lien laws permit the lien holder to waive its rights; if the debtor has sufficient leverage with the lien holder to extract such waiver, the secured creditor may, as a condition of its loan, require the debtor to obtain the waiver.

4. Monitoring: statutory liens that prime prior perfected security interests can arise in large amounts in some instances, and to protect against being subject to one of these the secured creditor can monitor the debtor.

§9.11: COMPETITIONS INVOLVING FEDERAL TAX LIENS: THE BASICS

A Generally: the government is on the principle competitors for the debtors’ assets. It competes on the basis of hundreds of kinds of obligations, including taxes, criminal fines, small business loans, student loans, social security benefits, and many others; however, it most frequently competing for unpaid taxes.

I. CREATION AND PERFECTION OF FEDERAL TAX LIENS

A. G/R: Creation of Federal Tax Lien: when the IRS determines that a tax is owing, it assesses the tax by recording the amount on its own records. When it notifies the taxpayer of the assessment, that notice constitutes a demand for payment and the tax lien comes into existence and relates back to the date and time of the assessment [IRC §§ 6321, 6322].

B. G/R: Attachment: the lien attaches to ALL property and rights to property, whether real or personal, belonging to the taxpayer [IRC §6321].
   1. In other words, the lien reaches all the property the debtor owns, this is the ultimate fucking floating lien.
2. However, like security interests that have attached and are not perfected, this unperfected tax lien will be effective against the third party, but not against third parties who acquire liens against or purchase the property.

C. G/R: Perfection: the Federal Tax Lien Act (FTLA) does not use the word perfection; instead, it deems the federal tax lien not valid until the IRS files notice of its lien [IRC §6323(a)].
   1. The IRC then defers to state law as to the system in which the IRS must file notice.
   2. The filing of the notice has the same effect as perfection—if the Notice of Tax Lien has not yet been filed when a debtor sells its property, grants a new security interest, or loses possession to a sheriff under a writ of execution, the tax lien will not be valid against that competitor.
      a. If notice of the tax lien has been filed before any those events occur, the tax lien will be valid against that competitor.
      b. In other words, federal tax liens do not have super-priority.

C(1). G/R: Maintaining Perfection: the IRC establishes a “required filing period” for a Notice of Tax Lien. The period is the 1-year period ending 30-days after the expiration of 10-years after the date of assessment of the tax.
   1. If the IRS re-files within this period, it can maintain the tax lien perpetually.
   2. Lapse: if the IRS fails to re-file during the required filing period, the effect is that the lien lapses.
      a. The IRS may be able to revive the lien by refilling after lapse, but the lien will then be subordinate to competing liens perfected against the property/collateral before re-filing.
   *[IRC §6323(g)(3)].

D. G/R: Priority: the FTLA does not use the term priority; instead, it deems the tax lien “not valid” against a particular competing interest until notice of the lien is filed.
   1. This has been read to mean that the lien is subordinate to certain competitors if those competitors perfect before the notice of tax lien is filed.
   2. First in Right First in Time: the IRS, with regard to tax liens, participates in the perfection and priority laws along with all other creditors.
      a. Its tax lien prevails over the liens of others if the IRS files first, and loses to them if it does not.

E. Note: while the IRS pays the game of perfection/priority essentially as it is defined by state law, it brings its own set of rules; those rules, most of which are contained in IRC §6323, re-conceptualize much of the state law in ways disconcerting to those familiar with Article 9.

F. G/R: Remedies for Enforcement: the FTLA provides the remedy for enforcement of federal tax liens. If the taxpayer does not pay the tax within 10-days after notice (that the levy is coming) and demand, the IRS can levy on the taxpayer’s property.
   1. The IRS is not required to use the services of the sheriff to levy; IRS employees can perform the levy and if necessary sell the assets.
   2. The IRS can levy two ways:
      a. physically seize the property of the debtor; or
b. serve notice of levy on a bank at which the debtor has an account or on some other third party who is in possession of the debtor’s property. The third party must then remit the bank account or other property to the IRS or be liable for its value.

3. State exemption laws do not apply against the IRS; the FTLA contains a set of exemptions from the federal tax levies that are less favorable to debtors than exemption laws of most states.

4. The IRS sells the property, as soon as possible, after levy to the highest bidder.
   a. The tax sale is subject to prior liens, which often include security interests and mortgages, the buyer at a tax sale takes free of subordinate liens, which are discharged by the sale.

G. G/R: Name Changes: the purpose of IRS §6323 is to give notice to subsequent takers of the existence of an IRS lien. Where the IRS has notice that a delinquent taxpayer has changed her name, and where notice of the tax lien was filed under the taxpayer’s original name, the IRS is under an affirmative duty to re-file the notice of tax lien to show the taxpayers new name [US v. LMS Holding]

II. COMPETITIONS INVOLVING FEDERAL TAX LIENS

A. G/R: Competitions Involving Federal Tax Liens: the general rule governing competition between federal tax liens and the rights of third parties is that the tax lien shall not be valid against any purchaser, holder of a security interest, mechanic’s lien holder, or judgment lien creditor until the IRS files a Notice of Tax Lien.
   1. Tax liens and third party interests rank in the order in which they became valid within the meaning of the FTLA—first in time, first in right.
      *[IRS §6323(a)].

B. G/R: Ways Third Parties Can Prevail Over the IRS: the holder of a competing interest in the collateral can do 3-things in order to be “valid” and prevail over the IRS before it files its Notice of Tax Lien—involving security interests, purchasers, and judgment creditors.

C. G/R: Security Interest: a security interest will prevail over the tax lien if the security interest satisfies the IRS’s test for a security interest before the government files its Notice of Tax Lien.
   1. The IRC provides that a security interest only “exists” only when:
      a. the property is in existence and the interest has become protected against a judgment lien under local law; and
      b. the holder has parted with money or other value, the repayment of which is secured.
      *an Article 9 security interest will meet this test when it is perfected with respect to a particular advance.
      *[IRS §6323(h)(1)].

D. G/R: Purchasers: to prevail over a tax lien, a purchaser must acquire its status as such before the government files notice of a tax lien. In addition, a purchaser can prevail over the tax lien if, before the government files notice of the tax lien, the purchaser does whatever it is required to do
to prevail over a second, later purchaser of the same property who busy without actual notice of the would-be purchasers interest [IRC §6323(a)].

1. “Purchaser” is defined as a person who, for adequate and full consideration in money or money’s worth acquires an interest that is valid under state law against a subsequent purchaser without actual notice of the interest. [IRC §6323(h)(6)].

§9.12: COMPETITIONS INVOLVING FEDERAL TAX LIENS: ADVANCED SHIT

I. PROTECTION OF THOSE WHO LEND AFTER THE TAX LIEN IS FILED

A. G/R: Future Advances: the IRC protects future advances made by secured creditors against federal tax liens; that is, the IRC gives future advances priority over the federal tax lien, if the security interest was “valid” before the Notice of Tax Lien was filed.

1. However, the Code only protects future advances to the extent that the security interest would be protected under state law against a judgment arising out of a secured obligation.
2. Thus, future advances made within 45-days after the filing of the tax lien have priority over the tax lien.
[IRC §6323(d)].

B. G/R: Commercial Transactions Financing Agreements: §6323(c) offers protection to lenders secured by Article 9 floating liens against the sudden effects of a tax lien filing for 45-days; that is, any transactions occurring within 45-days of the IRS’s filing of a notice of tax lien has priority over the tax lien.

1. This protection of commercial transactions financing extends to collateral acquired by the debtor during the 45-days after the tax lien filing—even if the creditor learns of the tax filing.
*I[IRS §6323(c)].

C. G/R: Real Property Construction or Improvement Financing: construction lenders are protected against a tax lien filed during construction [§6323(c)]. The Code requires that the construction lender have entered into a contract to finance the construction prior to the filing of the tax lien.

1. The protection afforded against the tax lien extends only to the real property improved.
2. The only condition (no 450-day requirement) of protection is that the construction lender’s priority must be protected under state law against a judgment lien arising as to the time of the tax lien filing.

D. G/R: Obligatory Disbursement Agreements: the IRC protects lenders how have agreed before the tax lien is filed to make disbursements that the lenders then make after the lien is filed [IRC §6323(c)(4)].

E. G/R: Statutory Liens: the IRC grants some statutory liens priority over a federal tax lien, even when those statutory liens arise after the federal tax lien is filed.

1. Among those granted priority are:
   a. the artisans’ lien in favor of those who make repairs or improvements to personal property and retain possession of the property as security for their claim;
b. real property tax and special assessment liens;  
c. mechanics’ liens for improvements made to real property; and  
d. attorney’s liens for fees against a judgment or settlement amount obtained by  
the attorney on behalf of the client.  

*[IRC §6323(b)].

F. G/R: PMSIs: there is no provision in the IRC for protecting PMSI’s against an earlier filed tax lien; however, the courts quickly read such a provision into §6323(b) and the IRS acquiesced.

G. G/R: Non-Advances: are given the equivalent protection of the security interest in which they are created if they are reasonable [IRS §6323(e)].