

Secured Transactions
Professor Keith A. Rowley
William S. Boyd School of Law
University of Nevada Las Vegas
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Introduction to Debtor-Creditor Law

I. Key Players

- A. **Obligor/Debtor:** Someone obligated to pay money or render a performance at some future time, including
1. those who borrow money from a lender (the traditional “debtor”);
 2. those who buy goods or services on credit;
 3. anyone else legally obligated to pay someone else a sum of money or render a performance at some future time; and
 4. in some circumstances, someone only contingently obligated to pay a sum of money or render a performance at some future time.
- ◆ UCC §§ 9-102(a)(28) & (59) define “debtor” and “obligor” more narrowly. In an Article 9 transaction, we defer to the statutory definition.
- B. **Obligee/Creditor:** Someone to whom a debtor/obligor is obligated to pay money, or for whom a debtor/obligor must render a performance, at some future time.
1. **Unsecured Creditor (UC):** A creditor who “lends” to the debtor without requiring any “security.”
 2. **Judgment Lien Creditor (JLC):** An unsecured creditor who successfully uses judicial process to collect some or all of an unsecured debt.
 3. **Statutory Lien Creditor (SLC):** A creditor in whose favor state law grants a lien without a specific agreement between the parties.
 4. **Secured Creditor (SC):** A creditor in whose favor the debtor agrees to pledge collateral against the outstanding debt.
- C. **Trustee-in-Bankruptcy (TiB):** A person appointed by a bankruptcy judge to assume control of a debtor’s bankruptcy estate and, for our purposes, to avoid any avoidable liens (including security interests) to preserve as much of the estate as possible for the debtor’s unsecured creditors.

II. Key Terms

- A. **Security Interest:** A contractual lien against specified items or types of collateral, which a debtor grants a creditor to secure the debtor's obligation to pay or perform. *See* § 1-201(b)(35).
- B. **Security Agreement:** Record(s) by which the debtor grants the secured creditor a security interest in the specified items or types of collateral. § 9-102(a)(73).
- C. **Financing Statement:** Record(s) by which the SC notifies third parties of its interest in the specified items or types of collateral. § 9-102(a)(39).
- D. **Attachment:** The point in time at which the SC's security interest becomes enforceable *against the debtor*.
- ◆ Attachment is primarily a function of the debtor's agreement with the SC, although a SC can attach certain types of collateral by other means.
- E. **Perfection:** The point in time at which the SC's security interest becomes enforceable *against third parties*.
- ◆ Perfection is primarily a function of the SC complying with the applicable requirements of Article 9.
 - ◆ Some non-Article 9 lienholders must record notice of their lien for the lien to be effective against third parties.
- F. **Default:** Any failure by the debtor to pay or otherwise perform the debt as required by its agreement with the creditor.
1. Upon default, the SC may seek to *repossess* or *foreclose* against the collateral. In a nutshell:
 - a. **Repossession:** taking possession or control
 - b. **Foreclosure:** transferring ownership, typically by sale
 2. An unsecured creditor's remedies on default are somewhat different
 - a. **Self-Help:** One of the major distinctions between unsecured and secured creditors is that unsecured creditors do not have the right (unless provided in their contract with the debtor) to act against the debtor's property without court approval.
 - ◆ Exception: A creditor may "set off" the amount the debtor owes her against an amount she owes the debtor.

b. **Judicial Help:** The unsecured creditor's only real means of forcing a defaulting debtor to repay is by taking the necessary steps to become a judgment lien creditor. To wit:

1. Sue the debtor for the deficiency;
2. Obtain a judgment against the debtor for the deficiency;
3. Record the judgment lien with the court clerk;
4. Obtain a **writ of execution** based on the judgment lien; and
5. Deliver the writ to the sheriff with instructions to *levy* (seize) the debtor's goods and return the original writ, along with an explanation of the sheriff's actions in executing the writ, within the statutory time.

◆ **Other Writs:** (Unsecured) creditors have two other types of writs they may seek in furtherance of execution:

(1) **Attachment:** sought when the creditor files the action or while the action is pending to prevent the defendant from dissipating or secreting its assets and authorizing the sheriff to levy in anticipation of judgment for the plaintiff; and

(2) **Garnishment:** sought either while the action is pending or after judgment to order third-party *garnishees* who possess or control, or may come into possession or control of, the debtor's property to hand it over to the *garnishor* (i.e., the plaintiff).

◆ **Exemptions:** Not all assets are subject to execution, attachment, or garnishment.

◆ Common exemptions: homestead, personal vehicle, medical devices, household goods, tools of the trade

◆ Uncommon (NV) exemptions: mining/prospecting gear; firefighter uniforms; mineral, art curiosities, and paleontological collections; medical debts

◆ Exemptions only frustrate judicial lien creditors, not unsecured creditors or statutory lien creditors.

3. **Effect of Bankruptcy:** If the debtor files bankruptcy, both secured and unsecured creditors face additional obstacles in collecting any unpaid debt.

- G. **Priority:** The order in which two or more persons with competing claims against the debtor's property are allowed to enforce their claims against a defaulting debtor. In other words: Who gets the debtor's money or property first?
1. Priority is most important when the debtor does not have sufficient assets to satisfy both/all claimants.
 2. Article 9 and other statutes provide a comprehensive priority scheme, which we will study in detail. As a general rule,
 - a. properly perfected SCs have priority over unsecured creditors and improperly perfected SCs; and
 - b. priority between a properly perfected SC and a SLC or TiB, or between two or more properly perfected SCs, depends primarily on who attained their preferred status first.

III. Article 9's Scope

- A. **Generally:** Subject to the exceptions in §§ 9-109(c) & (d), Article 9 applies to
1. "a transaction, regardless of form, that creates a **security interest** in personal property or fixtures **by contract**," § 9-109(a)(1);
 2. an **agricultural lien**, § 9-109(a)(2);
 3. a sale of **accounts, chattel paper, payment intangibles, or promissory notes**, § 9-109(a)(3);
 4. a **consignment**, § 9-109(a)(4).
- B. Substance, not form, determines whether a seller/lender/lessor/consignor has a valid security interest and is entitled to the protection of Article 9.
- C. **Security Interest vs. Lease**
1. § 1-201(b)(35): "Whether a transaction in the form of a lease creates a 'security interest' is determined pursuant to Section 1-203."
 2. **§ 1-203:** Whether a transaction is a "true lease" or a "disguised sale" is determined, in part, by
 - a. whether the **lessee can terminate** her obligations under the lease;
 - b. whether the lease term is for the **full "economic life"** of the good(s) – that is to say, at the end of the lease, the good(s) will have little or no market value;

- c. whether the “lessee” **must renew** the lease at the end of the original lease term for a period beyond which the goods are not expected to have any appreciable value or **may renew** the lease for such a period for **little or no additional consideration**; and
 - d. whether the “lessee” **may or must purchase** the leased good(s) at the end of the original lease term for **little or no additional consideration**.
2. **Economic Realities Test:** Considers the likelihood, at the time the transaction is entered into, that the lessor will receive the goods back when the goods still have meaningful economic life. If there is a reasonable likelihood the lessor will retain some residual interest in the goods, the transaction is probably a true lease; if not, the transaction is a disguised sale intended for security.

D. **Preempted and Other Excluded Transactions**

- 1. **Preemption:** Article 9 does not govern to the extent that
 - a. a **federal statute, regulation, or treaty** preempts it (*e.g.*, the federal law requires that security interests in patents be registered with the U.S. Patent & Trademark Office), § 9-109(c)(1);
 - b. **another state statute** expressly governs the creation, perfection, priority, or enforcement of a security interest created (*e.g.*, a certificate of title statute), § 9-109(c)(2);
 - c. another sovereign’s statute, **other than a statute generally applicable to security interests**, expressly governs creation, perfection, priority, or enforcement of a security interest created by the state, country, or governmental unit (*e.g.*, NV law does not permit an unlicensed party to execute against a licensed party’s gaming license), § 9-109(c)(3).
- 2. **Excluded SIs:** Article 9 does not apply – except, in some instances, to establish priority vis-à-vis one or more liens within Article 9’s scope – to
 - a. a **landlord’s lien**, other than an agricultural lien, § 9-109(d)(1);
 - b. a lien, other than an agricultural lien, **given by statute or other rule of law for services or materials** (*e.g.*, a mechanic’s lien), § 9-109(d)(2);
 - c. an assignment of a claim for **wages, salary, or other compensation of an employee** (*e.g.*, a garnishment order), § 9-109(d)(3);

- d. a sale of accounts, chattel paper, payment intangibles, or promissory notes **as part of a sale of the business** out of which they arose, § 9-109(d)(4);
- e. an assignment of accounts, chattel paper, payment intangibles, or promissory notes **solely for purposes of collection**, § 9-109(d)(5);
- f. an assignment of a **right to payment under a contract to an assignee that is also obligated to perform** under the contract, § 9-109(d)(6);
- g. an assignment of an account, payment intangible, or promissory note to an assignee in **full or partial satisfaction of a preexisting indebtedness**, § 9-109(d)(7);
- h. an assignment of a right represented by a **judgment, other than a judgment taken on a right to payment that was collateral**, § 9-109(d)(9);
- i. the creation or transfer of **an interest in or lien on real property**, including a lease or rents thereunder, **except** to the extent that another provision in Article 9 expressly encompasses interests in or liens on real property, § 9-109(d)(11);
- j. an assignment of a **claim arising in tort, other than a commercial tort claim**, § 9-109(d)(12); or
- k. an assignment of a **deposit account** as collateral (other than as proceeds) in a **consumer transaction**, § 9-109(d)(13).

E. **Article 9 and Real Property**

1. **Fixtures:** The general prohibition in § 9-109(d)(11) notwithstanding, the mere fact that personalty has come to rest on or in, or even has become attached to, real property, does not necessarily take a SI in it outside the scope of Article 9. *See* §§ 9-109(d)(11)(B) & 9-334(a).
2. **Rights to Payment:** While a security interest in or other lien on real property is outside Article 9's scope, *see* § 9-109(d)(11), a security interest in a right to receive payment secured by a security interest in or other lien on real property is within Article 9's scope, *see* §§ 9-109(d)(11)(A), 9-203(g) & 9-308(e).

IV. **Characterizing Personal Property**

A. **Key:** The key consideration is **actual or intended use** at the time the security agreement attaches, rather than the **intrinsic nature** of collateral.

B. **Personal vs. Real Property**

1. **Fixture:** An item of personal property that has become so attached to real property that a right in it arises under real property law. § 9-102(a)(41).
2. In deciding whether personal property collateral that has become attached to real property is a fixture, courts typically consider three factors:
 - a. the **firmness** with which the collateral is affixed to real estate;
 - b. the parties' **intent** as to whether the collateral is a permanent part of the realty; and
 - c. the degree to which the collateral is **essential** to the ability of the realty to serve its intended function.
3. Article 9 defers to state non-UCC law to determine whether an item of personal property has become a fixture, except that Article 9 dictates that "ordinary building materials incorporated into an improvement on land" lose their identity as personal property. *See* § 9-334(a) & cmt. 3.

C. **Tangible Personal Property**

1. **Goods:** All things that are movable when a security interest attaches to them, including (i) fixtures, (ii) standing timber to be cut and removed under a contract of sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, including the product of trees, vines, and bushes, (v) manufactured homes, and (vi) embedded software and related information. § 9-102(a)(44).
2. The most common types of goods for Article 9 purposes are:
 - a. **Consumer Goods:** Goods used or bought for use primarily for personal, household, or family purposes. § 9-102(a)(23).
 - b. **Farm Products:** Crops, livestock, farming supplies, and unmanufactured products of crops and livestock. § 9-102(a)(34).
 - i. Farm products are not inventory. § 9-102(a)(48).
 - ii. The debtor must be "engaged in ... farming operations." § 9-102(a)(34).

- c. **Inventory:** Goods held for sale or lease by a person in the business of selling or leasing such goods. § 9-102(a)(48).
- d. **Equipment:** Goods other than inventory, farm products, or consumer goods. § 9-102(a)(33).
 - ◆ When in doubt dealing with tangible collateral, “equipment” is the default type, unless the setting permits using the more generic “goods.”

D. **Intangible Personal Property (a.k.a. “Non-Goods Personal Property”)**

- 1. **Account:** A right to payment of a monetary obligation, whether or not earned by performance, for, *inter alia*, the sale, lease, or license of property or the rendition of services, excluding, *inter alia*, rights to payment evidenced by chattel paper or an instrument, commercial tort claims, deposit accounts, investment property, and letters of credit and letter-of-credit rights. § 9-102(a)(2).
- 2. **Chattel Paper:** A document evidencing both
 - a. a monetary obligation and
 - b. a security interest in or lease of specific goods. § 9-102(a)(11).
 - ◆ **Electronic Chattel Paper:** Chattel paper evidenced by one or more electronic record(s). § 9-102(a)(31).
- 3. **Commercial Tort Claim:** A tort claim in favor of
 - a. a corporation or other business organization or
 - b. an individual, provided that the claim arose in the course of her business or profession and does not include damages arising out of personal injury or death. § 9-102(a)(13).
- 4. **Deposit Account:** A demand, time, or other account in a depository institution, excluding investment property and accounts evidenced by an instrument. § 9-102(a)(29).
- 5. **Document:** A document of title, as defined in § 1-201(b)(16), or a receipt of the type described in § 7-201(b). § 9-102(a)(30).

6. **Instrument:** A device that
 - a. evidences a right to payment of money;
 - b. is not itself a security agreement or lease; and
 - c. is “of the type which is in the ordinary course of business transferred by delivery with any necessary indorsement or assignment.” § 9-102(a)(47).

7. **Investment Property:** Securities (§ 8-102(a)(15)), securities accounts (§ 8-501(a)), securities entitlements (§ 8-102(a)(17)), commodities accounts (§ 9-102(a)(14)), and commodities contracts (§ 9-102(a)(15)). § 9-102(a)(49).

8. **Letter of Credit:** An issuer’s undertaking, at the request of an applicant, to pay a beneficiary upon the beneficiary’s presentation of certain documents evidencing its entitlement to payment. § 5-102(a)(10).

9. **Letter-of-Credit Rights:** A right to payment or performance under a letter of credit other than the beneficiary’s right to demand payment or performance. § 9-102(a)(51).

10. **Money:** A domestic, foreign, or intergovernmental medium of exchange. § 1-201(a)(24).

11. **General Intangible:** Any intangible personal property, including
 - a. **Things in Action:** legal claims (excluding commercial tort claims);
 - b. **Payment Intangibles:** A general intangible under which the account debtor’s primary obligation is to pay money, § 9-102(a)(61); and
 - c. **Software,** excluding software that is embedded in goods, § 9-102(a)(75),

but excluding accounts, chattel paper, deposit accounts, documents of title, electronic chattel paper, instruments, investment property, letter-of-credit rights, letters of credit, money, and unextracted oil, gas, and other minerals, § 9-102(a)(42).

◆ When in doubt dealing with intangible collateral, “general intangible” is the default category.