

Secured Transactions
Professor Keith A. Rowley
William S. Boyd School of Law
University of Nevada Las Vegas
Fall 2009

Article 9 Priorities (Revised)

- I. **The Concept:** If the value of collateral is insufficient to pay all creditors, a creditor with higher priority gets paid before a creditor with lower priority.
- ◆ A lien with higher priority is often called a “senior” lien. A lien with lower priority is a “junior” or “subordinate” lien.
- II. **Unsecured and (Judgment) Lien Creditors vs. Secured Creditors**
- A. A general **unsecured creditor** has the lowest priority claim to a debtor’s assets.
- ◆ Non-UCC law affords special priority to certain unsecured (non-lien) creditors over other unsecured (non-lien) creditors. However, that is beyond the scope of this course.
- B. An unsecured creditor becomes a **lien creditor** after she
1. Obtains
 - a. a **writ of execution** based on a (deficiency) judgment against the debtor; or
 - b. a **writ of attachment** based on the likelihood of obtaining a (deficiency) judgment against the debtor; and
 2. Obtains a **lien**, pursuant to the writ, levying on specific property of the debtor; or
 3. Obtains and serves a **writ of garnishment**, following judgment against the debtor, that permits her to attach funds owed by a third party to the debtor and collect them directly from the third party; or
 4. **Records a judgment** for money damages – generally, this is done in the real property records, and gives the creditor a lien against all real property owned by the debtor within the county; however, some states now allow recordation in the UCC filing system, thus creating and perfecting a lien against personal property.

- C. **Priority Among Lien Creditors:** Governed by state statutes, lien creditors generally take priority on a “first-come, first-served” basis as follows:
1. Majority Rule: First to levy (repossess or disable) takes priority;
 2. Minority Rule: First to deliver the writ of execution (under the auspices of which the sheriff will levy) to the sheriff takes priority.
- D. **Lien Creditors vs. Purchase Money Secured Creditors:** A PMSI that attaches before the lien creditor can obtain its lien will take priority over the lien as long as the SC perfects by filing within 20 days of attachment. § 9-317(e).
- E. **Lien Creditors vs. Non-Purchase Money Secured Creditors:** Priority depends on which happens first:
1. The creditor becomes a lien creditor (as described above), or
 2. The SC perfects its interest or files a valid financing statement and later perfects. § 9-317(a)(2).
- F. **Lien Creditors vs. Future Advances:** What happens when an already-perfected SC lends additional funds to a debtor (claiming the same collateral in which the SC is already perfected) after a lien creditor’s lien attaches? The SC has priority with respect to any such *future advance* it makes
1. within 45 days after the LC’s lien attached, regardless of whether the SC knew of the lien’s existence, § 9-323(b);
 2. more than 45 days after the LC’s lien attached, provided that the SC did not have knowledge of the lien, § 9-323(b)(1); and
 3. more than 45 days after the LC’s lien attached, if the advance is “pursuant to a commitment” that the SC entered into when the SC did not know about the lien, even if the SC knew about the lien when it made the actual advance, § 9-323(b)(2).
- ◆ § 9-323(b) extends the SC’s priority over an intervening LC to “nonadvances” (*e.g.*, costs of collection, attorneys’ fees, etc.), provided for in the SC’s security agreement with the debtor, but which the SC does not incur until after the LC’s lien attaches. *See* § 9-323 cmt. 4.

III. Statutory Lien Creditors vs. Secured Creditors

A. Examples of Statutory Liens

1. **Mechanic's and Materialman's Liens** – in favor of a person who performs labor upon or furnishes materials used in constructing, altering, or repairing improvements to real property; against both the improvements and the real property (*see, e.g.*, N.R.S. §§ 108.221 to 108.246)
2. **Artisan's Lien** – in favor of a person skilled in some trade, craft, or art for the creation, repair, or improvement of the debtor's personal property; against said personal property (*see, e.g.*, N.R.S. §§ 108.249 & 108.370)
3. **Garage Keeper's Lien** – in favor of persons who repair or store vehicles; against the vehicle (*see, e.g.*, N.R.S. §§ 108.270 to 108.360)
4. **Veterinarian's Lien** – in favor of persons who care for, feed, and keep animals; against the animal (*see, e.g.*, CAL. CIV. CODE § 3051)
5. **Hospital Lien** – in favor of persons providing medical care to a patient; against any recovery the patient gains in a suit against the person whose acts or omissions gave rise to the patient's need for treatment (*see, e.g.*, N.R.S. §§ 108.590 to 108.668)
6. **Attorney's Lien** – attaching to the client's recovery in an action against a third person to secure payment of attorneys' fees and expenses incurred in prosecuting or defending the action (*see, e.g.*, N.R.S. § 18.015)
7. **Landlord's Lien** – in favor of a landlord; against either (1) the debtor's personal property located on the leased premises or (2) all of the debtor's personal property (*see, e.g.*, N.R.S. §§ 108.270 to 108.360)
8. **Cleaner's & Launderer's Lien** – in favor of a person who cleans or launders the debtor's clothes; against the debtor's clothes in the cleaner's possession (*see, e.g.*, N.R.S. §§ 108.770 to 108.820)

B. **Common Law "Statutory" Liens:** Many jurisdictions recognized *possessory* common law liens in favor of artisans, materialmen, mechanics, and others long before these liens were codified – and many continue to recognize common law or equitable liens in addition to their statutory counterparts.

- ◆ For example, Nevada law provides a *retaining lien* attaching to the client's documents and other property in an attorney's possession. *See Argentina Consolidated Mining Co. v. Jolley Urga Wirth Woodbury & Standish*, 216 P.3d 779 (Nev. 2009).

C. **Priority of Statutory Liens**

1. Three basic schemes:
 - a. **“First in Time, First in Right”**: Priority in favor of attached statutory lien or perfected security interest based on whether the SLC’s lien attached or the SC perfected first
 - ◆ IF SLC’s priority is subject to FIT rule, the statute should indicate at what point it attaches – possession, completion of work, written notice, filing, etc.
 - b. **SC Wins** regardless of when SLC’s lien attached
 - c. **SLC Wins** regardless of prior perfected security interests
2. **§ 9-333**: *In the absence of a contrary statute*, a SLC has priority over an earlier-perfected SC if
 - a. the SLC furnishes the services or materials in the ordinary course of its business;
 - b. the lien is for (only) the purchase price of the services and materials;
 - c. the SLC possesses the personal property subject to the lien; and
 - d. the property subject to the lien is property “with respect to which” the SLC furnished the goods or services giving rise to the lien.

IV. **Secured Creditors vs. Secured Creditors**

A. **The Basics**

1. Between two SCs, the **first to file** (and later perfect) **or to perfect** has priority. § 9-322(a)(1).
2. A SC may file a financing statement and not lend until a later date; but, as long as the security interest reflected in the financing statement eventually attaches, the SC will have **priority as of the date of the filing**. § 9-322 cmt. 5.
3. The SC who gains priority retains it so long as there is **no lapse** – that is, no period during which that SC’s interest in neither filed nor perfected. § 9-322(a)(1).

4. **Special Rule – Priority of Future Advances:** Advances the SC makes to the debtor perfect when the SC makes the advance, but have priority when the SC files the financing statement concurrent with or prior to the first advance. §§ 9-323(a) & 9-322(a)(1).
5. **Special Rule – Goods Transferred by the Debtor:** A perfected interest in collateral in a transferor’s hands takes priority over a prior-perfected interest in the same collateral in the transferee’s hands. § 9-325.

B. Priority in After-Acquired Property

1. A security interest in after-acquired property attaches when the debtor acquires the property. § 9-203(b).
2. As against other SCs, priority dates from the **time of filing**. § 9-322(a)(1).

V. Special Priority Rules for Non-Fixture Personal Property

A. Purchase Money Priority

1. **General Rule:** A PMSI in collateral *other than inventory* has priority over a conflicting security interest in the same collateral – even one perfected before the PMSI arose – if the PMSI is perfected **no later than 20 days** after the debtor possesses the collateral. § 9-324(a).
 - ◆ Recall that a PMSI in consumer goods perfects automatically. § 9-309(1). Therefore, a SC with a PMSI in consumer goods takes priority over all conflicting security interests in those goods – even ones perfected before the PMSI arose.
 - ◆ If two PMSIs in the same collateral arise simultaneously, and one SC is the seller while the other a mere lender, the seller’s PMSI takes priority. § 9-324(g)(1). If both SCs are mere lenders, the basic rule of first to file or perfect applies. § 9-324(g)(2).
2. **PMSIs in Inventory:** The across-the-board 20-day “grace period” in § 9-324(a) does not apply if the purchase-money collateral is inventory the buyer’s hands. Instead, a PMSI in inventory will “trump” an earlier-perfected security interest only if:
 - a. The purchase-money lender (“PML”) perfects no later than when the debtor receives possession of the collateral; and
 - b. The PML gives the earlier-perfected SC notice, no more than five years before the debtor takes possession of the collateral, that the PML expects to acquire a PMSI in the collateral. § 9-324(b).

- ◆ A typical provision in a non-PMSI inventory loan prohibits liens against inventory other than that of the inventory lender. If the inventory lender receives the § 9-324(b) notice from the purchase-money lender, it will know the debtor is about to default on the inventory loan.
- ◆ If the earlier-perfected SC does not receive notice, then the debtor is still in default and the earlier-perfected SC can avoid the “purchase money” treatment of the PML’s loan.

B. Priority in Deposit Accounts, Investment Property, and Letter-of-Credit Rights

1. A secured creditor *may* perfect by control a security interest in investment property or electronic chattel paper, § 9-314(a), and *must* perfect by control a security interest in a deposit account or letter-of-credit rights, *see* § 9-312(b)(1)-(2).
 - ◆ A secured creditor with a perfected security interest in the underlying collateral will have an automatically perfected security interest in an deposit account or letter-of-credit rights that is proceeds of collateral for which Article 9 permits perfection by a means other than control.
2. §§ 9-327 to 9-329 set forth a priority scheme for deposit accounts (9-327), investment property (9-328), and letter-of-credit rights (9-329), and the proceeds thereof, which favors control over other available means for perfection and also provide rules to resolve priority dispute between two or more claimants who have perfected by control.

C. Priority in Commingled Goods and Accessions

1. Where the collateral is goods, and the goods or a portion thereof subsequently become part of a product or mass,
 - a. if the collateral loses its identity in the product or mass, then the security interest continues in the product or mass, § 9-336(c); whereas,
 - b. if the collateral does not lose its identity, then the security interest continues in the collateral after it becomes an accession, § 9-335(a), but does not continue in the finished good unless the description of collateral in the accession lender’s security agreement covers the finished good, *see* § 9-335 cmt. 5.

2. If more than one SC has a perfected interest in a commingled product or mass under § 9-336(c), each perfected SC is entitled to equal priority based on the relationship that the cost of the collateral to which each interest originally attached bears to the value of the total product or mass. § 9-336(f)(2).
3. If more than one SC has a perfected interest in an accession, priority with respect to the accession is determined by the basic priority rules between SCs. *See* § 9-335(c) & cmt. 6.
4. Also subject to the exception below, if one or more SC has a perfected interest in a finished good containing an accession and one or more SC has a perfected interest in the accession, priority with respect to the accession is determined by the basic priority rules between SCs. *See id.* & ex. 3.
5. **Certificate of Title Exception:** If a SC has a perfected interest only in an accession under § 9-335, its interest will be subordinate to a perfected interest in the whole if the perfected interest in the whole was perfected under a certificate of title statute. § 9-335(d).
6. In all other cases, the priority of a security interest in collateral which becomes commingled or an accession is determined by general priority rules. *See* §§ 9-335(c) & 9-336(e).

VI. Priority in Fixtures

A. Key Terms

1. **Construction Mortgage:** A security interest against real property and improvements in favor of a party extending credit to the debtor to pay for the construction of improvements to real property. A construction mortgage is typically perfected by recording the mortgage in the real property records of the county in which the subject real property is found.
2. **Construction Lien:** A lien against real property and improvements in favor of a party providing construction goods or services on credit. A construction lien is typically perfected by filing a claim of lien in the real property records of the county in which the subject real property is found.
3. **Fixture Filing:** A financing statement evidencing a security interest in a fixture, filed in the real property records of the county in which the real property to which the fixture is attached is found.
 - ◆ Note that the fixture filing only encumbers the fixtures; whereas a construction lien in favor of a fixtures provider encumbers both the fixtures and the realty.

B. Fixtures Incorporated During Construction

1. A **construction mortgage** gives the mortgage holder (the *mortgagee*) as of the date it records the mortgage.
2. A **construction lien** gives the *lienholder* priority as of the commencement of construction.
3. A **fixture filing** gives the SC priority as of the date it was filed.

C. Fixtures Incorporated Without Construction

1. **General Rule:** The priority of Article 9 fixture filings and nonconstruction mortgages is determined by the order in which they are recorded in the appropriate real property records.
2. **Exceptions**
 - a. **Consent:** If the mortgagee consents to the fixture financier's security interest, the fixture financier will have priority with respect to the subject fixtures over a previously filed mortgage. § 9-334(f)(1).
 - b. **Right to Remove:** If the mortgage gives the debtor the right to remove the fixtures, the fixture financier will have priority over the mortgagee. § 9-334(f)(2).
 - c. **PMSI in Fixtures:** A SC with a PMSI in fixtures can “trump” a previously perfected mortgage by making a valid fixture filing not later than 20 days after the goods become fixtures. § 9-334(d).

D. Priority in Fixtures Based on Non-Fixture Filing

1. Recall that § 9-501(a)(1)(b) directs that a fixture filing be made in the real property records of the county in which the real property to which the fixture is attached is found.
 - ◆ Such a filing will give the SC priority as of its date.
2. However, § 9-501(a)(2) permits a SC to make a non-fixture filing against fixtures in the Secretary of State's office.
 - ◆ Such a filing, though in the wrong form and in the wrong place, will give the SC priority as of the date of the filing against subsequent judgment lien creditors and trustees in bankruptcy, but not against subsequent mortgagees or fixture filers who file in the proper real property office. *See* §§ 9-334(e)(1) & (3) & cmt. 4.

VII. Selling Collateral

- A. **General Rule:** An attached security interest continues in collateral notwithstanding sale. § 9-315(a)(1).
- B. **Buyers vs. Secured Creditors:** An attached security interest is effective against a purchaser of the collateral. § 9-201(a).
- C. **Exceptions:** Article 9 recognizes several exceptions to the rule that purchasers take subject to attached security interests.
1. **§ 9-315(a)(1): Authorized Disposition** – A security interest in collateral does not continue after purchase by a third party if the secured creditor authorized – in the security agreement or otherwise – the disposition “free of the security interest.”
 - ◆ The SC’s authorization may be express or implied (*e.g.*, if the SC knows that the debtor is making unauthorized dispositions and does nothing, the SC may be deemed to have “waived” and the dispositions “authorized”)
 2. **§ 9-320(a): Buyer-in-the-Ordinary-Course (“BOCB”)** – A BOCB of personal property can take free and clear of any security interest in the goods created by the seller.
 - a. A **“BOCB”** is one who buys from a person in the business of selling goods of that kind. § 1-201(b)(9).
 - b. BOCB protected even if she knows of the security interest’s existence, as long as she doesn’t know that the sale violates some provision of the security agreement. § 9-320 cmt. 3.
 - c. BOCB takes free only of security interests created by the seller; she takes subject to any liens created by the seller’s predecessors in title. § 9-320(a).
 - ◆ Exception: Buyers of farm products do not benefit from § 9-320(a). However, the Food Security Act provides comparable protection to BOCBs of farm products. 7 U.S.C. § 1631(d).
 - d. § 1-201(b)(9) indicates that a BOCB must either
 - i. **possess** the goods or
 - ii. have a right under § 2-502 or § 2-716 to recover the goods from the seller.

3. **§ 9-317(b): Buyer-Not-in-the-Ordinary-Course** – In a sale that the SC has not authorized, a BNOCB takes subject to any *perfected* security interest, but has priority over any *unperfected* ones.
4. **§ 9-320(b): Consumer-to-Consumer Sale** – If the goods are consumer goods in the hands of both the seller and the buyer, then a buyer (i) for value and (ii) without knowledge of the prior security interest takes free and clear of any automatically perfected PMSI in consumer goods.
5. **Future Advances:** A security interest attached at the time the debtor sells an item of collateral attaches to any funds the SC lends the debtor/seller
 - a. not more than 45 days after the sale, § 9-323(d)(2); and
 - b. before the SC knew that the debtor had sold the collateral, § 9-323(d)(1); unless
 - c. the advance is “pursuant to a commitment” that the SC made not more than 45 days after the debtor sold the collateral and without knowing that the debtor had sold the collateral, § 9-323(d).

VIII. Proceeds

- A. **Proceeds:** Anything received from selling, exchanging, collecting, or otherwise disposing of collateral. § 9-102(a)(64)
- B. **The Basic Scheme**
 1. **Attachment:** A security interest in collateral includes a security interest in any identifiable proceeds of collateral, unless the parties specifically exclude proceeds. §§ 9-203(f) & 9-315(a)(2).
 2. **Perfection:** A security interest in proceeds perfects automatically if the security interest in the original collateral was perfected at the time the proceeds arose. § 9-315(c).
 3. **Priority:** A perfected security interest in proceeds has the same priority as the security interest in the underlying collateral. § 9-322(b)(1).
- C. **Tracing Problems:** What if the proceeds of sale are not readily identifiable (*i.e.*, I can’t tell my money from debtor’s other money)? *See* § 9-315(b)(2).
 - ◆ **Lowest intermediate balance rule:** A security interest covers the lowest balance between when the debtor deposits the proceeds and when the SC claims the account as proceeds, provided that the SC cannot claim more than the debt owed.

- D. **Continuing Perfection:** A perfected security interest in proceeds becomes unperfected **twenty (20) days after the debtor receives those proceeds unless:**
1. The proceeds are identifiable *cash proceeds*, § 9-315(d)(2);
 2. If the proceeds are *non-cash proceeds acquired with cash proceeds*,
 - a. a filed financing statement (*i.e.*, no perfection by possession) covers the original collateral, and
 - b. the proceeds are collateral falling within the collateral description in the original financing statement, § 9-315(d)(3) & cmt. 5; or
 3. If the proceeds are *non-cash proceeds not acquired with cash proceeds*,
 - a. a filed financing statement covers the original collateral; and
 - b. the proceeds are collateral in which a security interest is properly perfected by filing in the same office as the original financing statement, § 9-315(d)(1).
- E. **Authorization to File:** The SC does not need the debtor’s authorization to file a new financing statement to perfect proceeds of collateral. § 9-509(b)(2).
- F. **Purchase Money Priority in Proceeds**
1. **General Rule:** Purchase money priority under § 9-324(a) extends to “collateral or its proceeds.”
 2. **Exception – Inventory Proceeds:** Purchase money priority in inventory flows only into inventory proceeds in the form of cash, chattel paper, and instruments. § 9-324(b).

IX. Article 9 Priorities in Bankruptcy

- A. **The “Strong Arm” Clause:** 11 U.S.C. § 544(a)(1) affords a bankruptcy trustee (TiB) or debtor-in-possession (DiP) the same priority with respect to personal property as a non-statutory lien creditor who simultaneously extends credit to the debtor and becomes a judgment lien creditor at the moment the debtor files bankruptcy.
- B. As a consequence of this status, the TiB or DiP will generally
1. **have priority** over any unsecured creditor who had not yet become a LC at the time the debtor filed bankruptcy;
 2. **have priority** over a statutory lien creditor whose lien

- a. does not attach before the debtor files bankruptcy or another insolvency proceeding, becomes insolvent, or has an execution levied on behalf of another creditor, 11 U.S.C. § 545(1), or
 - b. is not perfected or enforceable against a bona fide purchaser when the debtor files bankruptcy, 11 U.S.C. § 545(2);
3. **have priority** over any secured creditor whose security interest was unperfected and unfiled at the time the debtor filed bankruptcy, §§ 9-317(a)(1) & 9-322(a)(2); and
 4. **have priority** over any secured creditor with respect to any future advance made more than 45 days after the debtor filed bankruptcy, § 9-323(b), but
 5. **yield priority** to any secured creditor whose security interest was
 - a. perfected at the time the debtor filed bankruptcy or
 - b. evidenced by a financing statement on file (provided that the SC had also satisfied § 9-203(b)(3)) at the time the debtor filed bankruptcy and subsequently perfected upon attachment. § 9-317(a)(2).
- C. **“Grace Period” Exception:** If state law affords a secured creditor a period of time following attachment in which to perfect or take the necessary steps to establish its priority, the TiB or DiP will be subject to retroactive priority in favor of the secured creditor. *See* BC §§ 362(b)(3) & 546(b).
- ◆ *E.g.*, § 9-317(e) allows the holder of a PMSI who files within 20 days following the debtor’s receipt of the collateral to defeat a lien creditor whose interest attached after the PMSI arose but before the PMSI lender perfected by filing.
- D. **After-Acquired Property and Value Tracing:** A secured creditor’s collateral may shrink, grow, or change after the debtor files bankruptcy.
1. **Proceeds and Other Derivative Collateral:** 11 U.S.C. § 552(b) allows a secured creditor to claim traceable proceeds, product, offspring, rents, and profits generated after filing by its pre-bankruptcy collateral.
 - ◆ Recall that a SC seeking to claim product, offspring, rents, or profits as collateral must have made included product, offspring, rents, or profits in the security agreement’s collateral description.
 2. **After-Acquired Property:** Except for proceeds and other derivative collateral, 11 U.S.C. § 552(a) does not allow a secured creditor to claim property the debtor or estate acquires after filing bankruptcy.