Introduction to Debtor-Creditor Law

I. Key Players

A. **Obligor/Debtor:** Someone obligated to pay a sum of money or otherwise perform at some future time, including

1. someone who **borrows money**;
2. someone who **buys** goods or services **on credit**;
3. anyone else **legally obligated** to pay or perform at some future time; and
4. in some circumstances, someone only **contingently obligated** to pay or perform at some future time.

♦ UCC §§ 9-102(a)(28) & (59), respectively, define “debtor” and “obligor” more narrowly. In an Article 9 transaction, we defer to the statutory definition.

B. **Obligee/Creditor:** Someone to whom an obligor/debtor is obligated to pay a sum of money or otherwise perform at some future time, including:

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) – even if the debtor would rather not avoid them – to preserve as much of the estate as possible for the debtor’s unsecured creditors.
II. Key Terms

A. **Security Interest**: A consensual lien against specified collateral, which a debtor grants a creditor to secure an obligation to pay or perform. *See § 1-201(b)(35).*

♦ By contrast, a judgment or statutory lien arises by operation of law, not because the debtor granted it.

B. **Security Agreement**: A record 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**: A record 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 or otherwise give notice of their lien for it to be effective against third parties.

F. **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, provided that they maintained that preferred status at all relevant times.
G. **Default:** Any failure by the debtor to pay *or otherwise perform* as its agreement with the creditor requires.

H. **Post-Default Remedies**

1. **Judicial Help**

   a. An **unsecured creditor** generally *must* resort to judicial process to recover from a defaulting debtor.

   ◆ Exception: An unsecured creditor may “set off” the amount the debtor owes her against an amount she owes the debtor.

   b. A **judgment lien creditor** has, by definition, already prevailed in a suit or otherwise obtained a court order entitling her to recover from a defaulting debtor and may seek further judicial approval of the manner in which she chooses to enforce the judgment or order.

   ◆ A bankruptcy trustee has the same Article 9 status as a JLC. The TiB obtains that status by virtue of a bankruptcy court’s order creating a bankruptcy estate.

   c. A **statutory lien creditor** might have to obtain a court order to enforce its lien against a defaulting debtor; an SLC who does not have to do so *may* elect to do so in order to avoid subsequent litigation about its entitlement to enforce the lien, the manner of enforcement, or both.

   d. Likewise, a **secured creditor** may use the judicial process to enforce its security interest against a defaulting debtor.

   e. **Judicial Process in a Nutshell**

      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 of execution to the sheriff with instructions to **levy** (seize), and typically sell or otherwise dispose of, the debtor’s property and to return the original writ, along with an explanation of the sheriff’s actions in executing the writ, within the statutory time.
Other Writs: Creditors using judicial process have two other types of writs they may seek in furtherance of execution:

(1) A creditor may petition for a **writ of attachment** once the creditor sues the debtor, and at any time while the action is pending, to prevent the debtor from dissipating or secreting its assets. A writ of attachment authorizes the sheriff to levy in anticipation of the creditor’s judgment.

(2) A creditor may petition for a **writ of garnishment** either while the action is pending or after judgment. A writ of garnishment orders third-party garnishees that 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 creditor).

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

- Common exemptions: homestead; household goods; medical devices; personal vehicle; tools of the trade
- Uncommon Nevada exemptions: art curiosities; firefighter uniforms; mineral collections; mining or prospecting gear; paleontological collections

Exemptions only frustrate judicial lien creditors, not secured creditors or statutory lien creditors.

2. Self Help

a. Article 9 allows a secured creditor to enforce its security interest without the necessity of first filing suit or otherwise seeking court approval. A SC’s self-help remedies are:

i. **Repossession**: possessing or controlling the collateral; and

ii. **Foreclosure**: transferring ownership of the collateral.

b. State non-UCC law may allow an SLC to self help; but most SLCs and all JLCs and TiBs must get court approval before they can execute on a defaulting debtor’s property.
3. **Effect of Bankruptcy:** If the debtor files bankruptcy, all creditors (other than the TiB, who would not otherwise exist) face additional obstacles in recovering from a defaulting debtor.

4. **Effect of Other Non-UCC, Non-Bankruptcy Law:** Other state or federal law may constrain a creditor’s remedies against a defaulting debtor, a creditor’s ability to pursue those remedies, or both.

III. **Article 9’s Scope**

A. **Generally:** Subject to the exceptions in §§ 9-109(c) & (d), Article 9 applies to “a transaction, regardless of form, that creates a security interest in personal property or fixtures by contract.” § 9-109(a)(1).

- Substance, not form, determines whether a creditor has an enforceable Article 9 security interest.

B. **Security Interest vs. Lease**

1. **§ 1-203:** Whether a transaction “in the form of a lease” is truly a lease or is a “disguised sale” creating a security interest 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 parties entered into the transaction, that the goods would still have meaningful economic life when they reverted to the lessor at the end of the lease term. 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 most likely a disguised sale intended for security.
D. Preempted and Otherwise 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);

♦ **Right to Payment Exception:** 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).

♦ **Fixtures Exception:** The mere fact that personalty has come to rest on or in, or even has become attached to, real property, does not necessarily keep Article 9 from applying to a security interest in it. See §§ 9-109(d)(11)(B) & 9-334(a).

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).

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. **Judicial Test:** Courts typically consider three factors when deciding whether personal property collateral has become a fixture:

   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. **Statutory Exception:** Article 9 defers to non-UCC state 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 (emphasis added).

C. **Non-Fixture 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.