SECURED TRANSACTIONS OUTLINE – SPRING 2012

**Introduction**

1. Secured Transaction = a credit transaction in which the creditor is given an interest in property (personal or real) to secure payment or performance of the obligation
   1. TWO separate obligations in secured transactions:
      1. (1) Underlying obligation to pay money back to creditor
         1. This doesn’t get wiped out if something happens to the SI
      2. (2) Security/collateral
2. The “Secured” Part is the Back-Up
   1. The primary obligation is to re-pay the loan (promissory note) on schedule
      1. If all goes well, the SI is never triggered (lender will exercise it if something goes wrong)
3. Law of the Course
   1. SIs in real property are governed by state real property law
   2. SIs in personal property are governed primarily by Article 9 of the UCC
   3. BK law to the extent that it affects SIs
4. Systems Approach
   1. This means that you have to look at how secured credit works in context, a big piece of which is the specter of BK. If a debtor goes into BK, then secured rights are affected.
5. Focus of the Course is Art. 9
   1. UCC governs the sale, payment, and financing of goods
      1. NOT a federal statute
         1. It is a uniform, model law that has to be adopted by each state in order to go into effect
      2. States can adopt non-uniform versions if they want to, but NOT so much with Art. 9—Art. 9 has been adopted extremely uniformly across the country
   2. 2013 effective changes to Art. 9 are incorporated into the CB
6. Consumer Transactions & Art. 9
   1. Sears delivers a fridge to you and you take possession of it before you have actually paid
      1. If you fail to pay Sears, Sears will use Art. 2 to make a claim (sale of goods) for breach of K
      2. If you did pay Sears, but your check bounced, Sears may have a right against you under a UCC Section based on negotiable instruments
      3. (But we are not concerned with the above 2 situations)
   2. We are concerned with what happens when you breach your promise to re-pay the lender (what Art. 9 deals with)
      1. Art. 9 deals with:
         1. How does Sears properly establish such a security interest?
         2. How do you file a SI?
            1. Sometimes has to be made public
         3. Priority of SIs in contest for the collateral?
         4. What does Sears have to do to repossess?
         5. Once you repossess it, what can you do?
            1. Do you have to sell the collateral in a certain way?
         6. \*Real property law has similar rules
7. The availability of security shapes the relationships b/w debtors & creditors
   1. If the bank couldn’t get an interest in your house as collateral, what would the lending relationship look like?
8. Before you lend money to an entrepreneur, you would want to know [in a world w/o SIs]:
   1. Likelihood of success of the debtor’s endeavor (and thus repayment)
   2. Regular salary
      1. See whether the combo of regular income and income expected from the new business is enough to repay the loan
   3. Even knowing the current salary and projected income from new business, you would want to know if other creditors are out there
      1. Even if assets/income picture looks good, have to look at the liability side, too
9. In a world WITH security interests:
   1. Lender will look to credit score to some extent, but has the back up of taking the collateral back (and this is what they care about—more than the borrower’s ability to repay)
10. Cost of Credit
    1. Cost of credit = the interest rate you have to pay
    2. With no security interests, cost of credit could be very high
       1. Credit is cheaper when lenders have collateral as a back-up (secured credit)
11. Floating liens on the inventory of a business
    1. Inventory shifts as a business buys and sells
    2. Many countries do not permit floating liens (only allow SIs in defined assets)
       1. These countries have expensive credit
12. The availability of security in the US is an important engine in our economy

**The Debtor-Creditor Relationship**

1. Creditors’ Remedies Under State Law
   1. Remedies of Unsecured Creditors under State Law
      1. Secured loans
         1. Two separate promises running from debtor to creditor
            1. (1) Promise to repay money borrowed; and
            2. (2) Security interest in certain collateral
         2. Secured creditors’ rights are in addition to those that an unsecured creditor enjoys
      2. Why is anyone unsecured?
         1. Involuntary
            1. Tort creditors
            2. EE who is owed wages from ER
         2. Loan context
            1. Riskier but higher interest rate on repayment
            2. Familial/friend relationship (“mom” loan)
         3. Tried to get a SI but made a mistake along the way
            1. The K parties entered into to try to obtain a SI was defective in some respect so the SI was not enforceable
      3. Unsecured Creditors’ Rights
         1. Right to go court and get a judgment on the debt
         2. Right to access assets to satisfy the judgment
            1. The economic value of that right is contingent upon the difficulties in exercising them
      4. **Prob. 1.1**
         1. Facts:
            1. $50k loan at prime +5 points [means the going interest rate plus 5%]

Prime rate = charged by major banks to their most creditworthy customers (adjusted from time to time in response to federal funds rate set by the federal reserve—PROF: 3.25%]

This prime+ rate fluctuates with the prime rate

* + - * 1. After loan, day care center moves and business decisions are made that are unattractive to the creditor. Creditor is worried about repayment.
      1. Issue: What can creditor do?
      2. Analysis:
         1. Debtor is not yet in default—creditor hasn’t suffered a loss

Creditor can’t do anything yet b/c debtor hasn’t missed a payment

Maybe Creditor should have negotiated for some voice in management decisions (if she didn’t, then the fact that the daycare is in trouble does NOT give creditor any rights here)

* + - * 1. PROF: Moral of this problem is that once the loan is made, the leverage can totally shift b/w the debtor and the creditor

Before the loan is made, creditor could have conditioned loan on veto power, etc. (but too late to do so after)

Creditor could have also used a clause in the agreement saying “if I have reason to believe that you will not be able to repay me when due, I can take some sort of insurance…”

* + 1. **Prob. 1.2**
       1. Facts:
          1. Creditor has default judgment.
       2. Issue: Creditor wants to know when she will be paid; how will creditor get the $60k back?
       3. Analysis:
          1. Go to the sheriff and get a writ of execution against assets.

To find out what the assets are, could go to court and order the debtor to provide a schedule of assets (discovery process)—this is expensive and time consuming

To find out debtor’s assets w/o going through the discovery, could consult public records

Easier for real property

Credit reports are not public

This is not always straightforward

* + - * 1. Even once you ID the available assets, sometimes levying on them can be very challenging

If debtor is trying to shield the assets, etc.

See ***Vitale*** case

* + - * 1. Creditor wanted to take the daycare equipment

Caution: exemption rights of debtor

Some daycare equipment may be shielded by this exemption

If you levy against property that is owned by someone other than the debtor, the creditor has committed a tort/conversion [don’t levy on assets before being clear of ownership]

Even if you levy successfully and the equipment IS owned by the debtor, how much is it worth?

If the debt is $60k, may only satisfy a fraction of the loan

* + 1. **Prob. 1.3**
       1. Facts:
          1. Creditors want to take the furniture from the debtor to satisfy the $1k debt owed
       2. Analysis:
          1. It does not matter that the creditor’s money/loan was used to buy the furniture—unsecured creditor can not use self help to repossesses the assets (he does not have a SI in the furniture)
          2. Advice:

If creditor asks for repayment and debtor says no, use small claims process to take debtor to court

Small value amount (lower legal costs b/c creditor could do this w/o a lawyer)

If the value is higher such that creditor needs a lawyer, probably do not recommend for creditor to take the debtor to court

If debtor chooses to resist, it probably wouldn’t be worth it

Creditor has rights, but the value of the rights are minimal due to this difficulty

* + - * 1. Creditor’s ability to get a judgment

At least creditor has a written IOU (other situations may just be one person’s word against another’s)

Creditor would have to prove that he made the loan and that debtor failed to repay it

* + - * 1. Even if creditor goes to court and gets a judgment here, problems of execution on the judgment may follow
    1. **Prob. 1.4**
       1. Facts:
          1. Creditor is a lobster fisherman and debtor is a seafood wholesaler. Creditor is owed $30k. C gets D to deliver 78 crates and C then sells them to satisfy this unpaid debt. C only got $19k out of the stolen lobsters; wants to get the last $11k.
          2. C committed theft/conversion. D will be coming after C when he finds out what happened. But D still does owe C $30k

Real result: C was indicted and convicted for theft. Fined $15k and ordered to repay the $19k back to the D

* + - 1. Issue: Frustrated vigilante problem
      2. Analysis:
         1. NO self help rule for unsecured creditors [have to go through the judicial process]
      3. Note: the original cause of action b/w the C & D was a breach of K [delivery but no payment]
         1. Not theft
         2. Otherwise, C would have to show elements of fraud at the time of the K [but in a normal sale of goods, this situation would just be a breach of K]
    1. **Prob. 1.5**
       1. Facts:
          1. Wisconsin exemptions

Even if you get your judgment and even if you find assets against which to execute that judgment, you nevertheless run up against significant limitations in the form of exempt property

Real property is the easiest to locate with public records, but it is also often the most protected under the exemption provisions (may not be able to use it to satisfy your debt)

* + - 1. Issue: Can creditor force D to sell these assets to satisfy a portion of the unpaid debt?
      2. Analysis:
         1. (a) Auto worth $15k

§ (g) exempts an auto not worth more than $4k

Any unused amount from § (d) can be used to increased value of car [§ (d) exempts consumer goods up to $12k]

So if no other consumer goods, can take the § 12k exemption and add it to the car and exempt the entire car

* + - * 1. (b) House worth $275k with a $225k mortgage

Only worth $50k to debtor

D has to be living in the house

When looking at residential property & exemptions, have to look at the equity that the D has in the house

“Exempt homestead”

To the amount of $75k and no more than 40 acres

But D only has $50k worth of value in it, so the house is exempt

Homestead exemptions vary from state to state—some states have no dollar limitation at all

* + - * 1. (c) Daycare equipment w/ resale value of $25k

§ (b) – exempt value not to exceed $15k

Partially exempt: D can protect $15k but not all of the equipment

But C could argue that b/c the business is closed, the equipment is no longer used “in the business of the debtor”

So the policy reason for protecting the equipment is no longer present

“Bought for use primarily in a business”

PROF: assets with mixed personal/private use can still count for the exemption

* + - * 1. (d) Bank account of $12,265.92

§ (k) -- $5k is exempt

The creditor can access the rest

If D says no, C has to get an order that is directed at the bank to pay the money out to C

Logistical problem: D could withdraw the money from the account

Money in depository accounts are hard to levy on b/c it can disappear so quickly

Note: laws preventing fraudulent transfers

* + 1. LESSON: the unsecured situation is not a good one to be in; want to have more an additional SI granted by the debtor
  1. Security & Foreclosure
     1. Liens
        1. Lien = interest in property to secure payment of a debt
           1. Note: this is about a relationship between particular property to a particular debt owed
        2. Types of Liens
           1. (1) Statutory

Imposed automatically by force of law

Ex: Mechanic’s Lien

If you take your car to the mechanic and ask for work to be done, you are promising to pay for that work

The work has already been done so the mechanic wants payment. If it is not forthcoming, mechanic can impose a mechanic’s lien on your car, which means that he has a statutory interest in your car. If you don’t pay him the obligation, mechanic has the right to keep your car and sell it and use the proceeds to satisfy the unpaid obligation.

Note: debtor does not agree to this; it operates by force of law

* + - * 1. (2) Judicial

When you get a judgment against someone after you go to court (you can then execute that lien and have a sheriff levy on the assets)

By operation of judicial process

* + - * 1. (3) Security Interests

Consensual; instrument that is bargained for

When you are lending money, you bargain for the creation of the SI

Contingent on the nonpayment of the debt that it secures

* + 1. Foreclosure
       1. If the debtor is in default, the secured creditor forecloses
          1. Foreclosure = right of the creditor that lets him seize and liquidate the asset to satisfy the unpaid loan amount

Cuts off the right of the debtor to redeem its own collateral

* + - * 1. Foreclosure goes to the question of ownership, not the question of possession

Creditor becomes the owner of the collateral (usually immediately sells it)

* + - * 1. Critical to know that the process protects debtors in many ways, too

It has rules, it takes time (esp. in real property context)

Process protection for debtor

Creditor has to go through all of the mandated stages; creditors would love if they could just grab the asset right away

* + - * 1. Right of Redemption = Up until foreclosure, the debtor has the right to redeem its collateral even if it is in default and has thus triggered creditor’s right to access its collateral. If debtor can pay back the debt, can stop the foreclosure process.
      1. How foreclosure is carried out
         1. Judicial Foreclosure

C presents Art. 9 rights and asks court to enter an order foreclosing D’s right to redeem

Note: long waiting periods in which D can try to pay off the line

This can be protracted if D fights the process (can point to defective notice from C, etc.)

Once foreclosure is approved, there has to be a sale

Public notice of sheriff sale/auction

At the end of the day, the foreclosure & sale will generate money. If that amount is more than the underlying loan, the D gets that **surplus**. If it is less than the underlying loan, there is a **deficiency** (the C can then sue the D for a deficiency judgment)

Emphasizes that there is a relationship b/w the collateral and the loan

After the sale, some states allow the Ds an additional period in which they can still pay off the loan

Whole process takes about a year

Expensive to Cs (not getting any money while trying to foreclose)

* + - * 1. Deed in Lieu of Foreclosure

An alternative to judicial foreclosure (sometimes)

D can transfer property to the C

D decides not to drag out process anymore

Choice D and C make in cooperation once the default has happened

No action for deficiency is permitted if this is used

Even if the value of the home is not as much as the unpaid loan, the C is agreeing to just take the home and not go after the remaining obligation

Surplus is allowed if D has a lot of equity in the house

* + - * 1. Power of Sale Process

Another alternative to judicial foreclosure

Has to be provided for in the security agreement itself (ie. at the time you sign the mortgage)

Faster than judicial foreclosure; C can just sell the property w/o the court

* + - * 1. Personal Property Foreclosure

More streamlined & quicker/easier

Through the UCC process

* + - 1. How long does foreclosure take?
         1. Judicial foreclosure – generally at least one year
         2. The other alternatives are much faster
      2. Note: if the debt is greater than the value of the collateral, the C has a SI up to the value of the collateral and an unsecured interest in the remainder
    1. **Prob. 2.1**
       1. Facts: Karen has loaned Ted $10k and has taken a SI in:
          1. Car worth $15k;
          2. House worth $50k;

K took an additional “mortgage” aka SI on the house (in addition to the bank’s mortgage)

* + - * 1. Equipment worth $25k; and
        2. Bank account worth $12,265.92
      1. Issue: What can K foreclose on?
      2. Analysis:
         1. (a) **WI § 815.18(12); 815.20(1)**: K can take as much is needed to pay back the debt via foreclosure [could take everything]

Exemption statutes only exempt assets from the reach of unsecured creditors. If D grants a SI in assets, exemptions do not protect them at all.

B/c the status of being secured has been bargained for. The D knows that the bank has a right to take back the house when he signs the mortgage (D can assess the risk)

Consensual v. non-consensual

* + - * 1. (b) Waiver is a voluntary relinquishment of a known right

Is K’s SI void as a waiver of exemption rights under the statute?

NO. B/c this debt would not spring into existence w/o a SI (exemption statute deals with debts that are already in default)

The statute means to say that if you are a SC, this statute doesn’t apply

Statute says that D cannot contract away its exemption rights (only in the unsecured context)

A SI is a specific grant that deals with a specific piece of property and specific obligation (different from the blanket waiver that the statute is concerned with)

* + - * 1. Karen does not get all of this value [on D’s asset list]

C would choose to foreclose on the minimum/easiest assets to satisfy the obligation

If the car is repossessed and sold to generate the whole $15k value, the C would keep the amount owed to her and pay the residual to the D

* + 1. **Prob. 2.2**
       1. Facts: Car dealer (creditor) wants to avoid having to repossess a lot of cars, so leases cars for the monthly value of the car + option to buy
          1. Upon default, lease gives C the right to get the car back and terminate the lease
       2. Analysis: This will not circumvent the Art. 9 process b/c even though it is called a lease, it is really a SI
          1. UCC provisions say that it doesn’t matter what the interest is called

If the structure of the transaction is designed to grant security rights that are contingent on the non-payment of an underlying debt, it is a SI and have to follow the UCC process in order to foreclose.

* + 1. **Prob. 2.3**
       1. Facts: D is in default but willing to turn over the house. D doesn’t want to get sued or have a foreclosure on his record.
          1. D is not represented by counsel
       2. Issue: Can you help D is you are bank’s counsel?
       3. Analysis:
          1. YES, you can help D but you have to let them know that you are not neutral
          2. If D did have a lawyer, lawyer would advise:

Point out that Ds could buy themselves more time in the house with foreclosure option

Bank might be willing to offer D money in exchange for a deed in lieu of foreclosure (b/c bank would be able to sell the house right away instead of having to sit there for 12 months as an unproductive asset)

* + - * 1. Can you send Ds to get a lawyer?

You can, but this would disadvantage the interests of your client (the bank)

PROF: not a good idea

* + - * 1. Procedurally, D is proposing use of a deed in lieu of foreclosure [this would eliminate any deficiency, too]

You should get something in writing from the Ds while they are in your office (paper trail that explains why you think it was a fair procedure)

Can Ds do this if they execute a deed right now, and you record it?

YES if there are no other interests in the property

If there is another lien on the property, that will have to be foreclosure on through the regular process

If Ds say that they will execute the deed today but ask you to wait to record the deed for 60 days (and see if they will repay it)?

NO, b/c this is itself a mortgage

This deed in lieu of foreclosure would be a SI in itself and would be a new layer of SI

NOTE: deed in lieu of foreclosure has to be executed and recorded right away to be effective

* 1. Repossession of Collateral
     1. Generally
        1. Before you can go through the process of foreclosing on D’s rights, you first have to take possession as C
        2. Repossession & foreclosure are not the same thing
           1. Repossession shifts possession of the collateral, but doesn’t necessarily change the ownership rights at that moment – it is the process of foreclosure that transfers ownership from the D to the C
        3. D’s rights to continued possession of collateral after default but pending foreclosure
     2. Debtor’s Right to Remain in Possession of **Real Property** Pending Foreclosure
        1. D CAN remain in possession of the house/collateral the whole time pending foreclosure
        2. Some states give D another X number of months post-sale, in which it can remain in possession and redeem the property if it can scrape together the money
        3. Ds have very strong rights re: real property once in default (in most cases b/c it is the home)
           1. This creates a real cost to the C

The D is no longer paying its mortgage to the bank but is still living in the house for this long period (no income for the C and no repo rights)

BUT the amount of the debt continues to accrue upward for this period [goes to the value of the debt at the end]

The D may not preserve the collateral

Little incentive to pour money into maintenance if he knows he is going to lose the property

Value of collateral can deteriorate during this period

C have a hard time gaining access to show potential buyers the property

* + - 1. Balance rights of Cs and Ds
         1. Sometimes we allow the C a bit more protection

(1) Appointment of a Receiver

Appointed totally within discretion of the court if the C can convince the court that the value of the collateral will deteriorate severely without one

This allows the D kind of stay in possession, but turns over control of the property to the receiver, who would collect the rents, use that money for maintenance, etc.

Way of not dispossessing the D entirely but allowing C to protect the value of the collateral

Almost never available for residential property – used for commercial property

In most states, the mortgage instrument has to provide for this

PROF: this is really an exception

(2) Assignment of Rents

Can be part of the mortgage agreement

“In the event of a default, all rental payments that had been going to the D shall be assigned directly to the C”

* + 1. Debtor’s Possession of **Personal Property** Pending Foreclosure
       1. **UCC § 9-609**
          1. Transfer of collateral to creditor as soon as default
          2. **(b)** Two alternative ways for SC to proceed in obtaining possession

**(i)** With Judicial Process

Go to court and file for a Writ of Replevin (an order saying that D has to give over possession and if it doesn’t, the sheriff will execute the writ of replevin, aka seize it and give it to the C)

Does involve filing an action, but can happen really fast [usually about 10-20 days]

***Del’s Big Saver Foods v. Carpenter Cook, Inc.***

Carpenter in one day filed an action for replevin, submitted a default affidavit that the collateral would deteriorate and got a temp. writ of replevin

Del’s gave up possession of everything in their store (collateral) – took ONE day

This case shows how fast the judicial process is for personal property (different from real property)

**(ii)** Without Judicial Process

Self-help repossession under UCC

Can help yourself to collateral if you proceed w/o breach of the peace

Preferred means, but doesn’t work for everything

Limitations based on the nature of the collateral

* + - 1. Self Help Against Accounts
         1. Account = Right of payment of a monetary obligation … for property sold or services rendered [**UCC § 9-102(a)(2)**]

Not a bank account. It is an account payable from the POV of an account debtor [person who owes an account], or A/R from POV of account creditor.

* + - * 1. Account Financing

Lending against (or buying) a group of accounts

* + - * 1. Example: Tractor dealer

Farmer agrees to make payment to tractor dealer within 60 days of delivery (the dealer’s right is called an account)

This dealer could have many account debtors at any point in time. These A/Rs are valuable b/c they represent a right to obtain money down the road.

When the tractor dealer needs a loan, he can use his A/Rs as collateral

A/Rs are very liquid (hope to turn to cash relatively soon)

There is usually a pool of account debtors used for security (but can also only be one)

* + - * 1. Process:

Debtor sells a tractor

Sends invoice to secured creditor

Secured creditor advances 60% of tractor value

Not 100% b/c of the risk that account debtor may not pay the debtor (difference b/w “hope” to be repaid and “know”)

Account debtor pays debtor

If the account debtor doesn’t repay 100%, the debtor is still responsible to the creditor for that amount

Debtor pays 60% to secured creditor

* + - * 1. Self Help Repossession of this type of collateral

The accounts are intangible, so they way to exercise self help for accounts it through the process in **UCC** **§ 9-607**, which says that you give notice to the account debtors.

To repo the individual’s A/Rs, send letters to all of the account debtors and tell them to send their future payments to the secured creditor instead of the debtor (this is the repo)

* + 1. **Prob. 3.1**
       1. Facts: Lawn furniture loan example (from earlier)
          1. But now Lisa had signed an effective personal property security agreement designating lawn furniture as collateral
       2. Analysis:
          1. J could go repo the furniture w/o legal process if he doesn’t breach the peace b/c J IS a secured creditor now

He can use the value to satisfy the loan

* + - * 1. Breach of peace

A mere objection without more is not enough to cause a breach of the peace

But if L seriously objects to the taking, J has to revert to the legal process

* + - * 1. Advice:

Use self-help repo. Try to take the furniture when L is not around, b/c less likely to be a breach of peace.

Advise J to be surreptitious

* + 1. **Prob. 3.2**
       1. Facts: Self-help repo of equipment from building construction sites
          1. Collateral is a bulldozer owned by a sub-contractor. Site is owned by a developer. Fence and security guard provided by general contractor.
       2. Analysis:
          1. (a) No guard/no fence

Advise C to go under the cover of darkness b/c if the site is in active use, likely to be a BoP

Note: Trespass in itself does not make a repo a BoP

A trespass for the purpose of engaging in an authorized repo is ok

Trespassing onto residential property is way more likely to create a BoP than onto commercial property

People are more likely to be present on residential property, and people are more likely to defend with physical force

* + - * 1. (b) Fence/no guard

C can climb the fence, but problem of how to get the bulldozer (collateral) out

C can cut an opening in the fence or pick the lock

Potential problem: leaves the D’s other equipment/assets unprotected

C can still trespass

* + - * 1. (c) Guard provided by someone other than the debtor

Lie to the guard?

Give paper with forged signature saying that the bulldozer is needed for another job?

Ie. lobster example in the unsecured scenario

Lying is fine if it helps the SC get the collateral with no threat of violence

It can be a very effective method of self help

But cf: some courts do not appreciate/accept wholesale misrepresentation when SC could have used a writ of replevin

PROF: advise your client NOT to go up to the line/limit of self help/BoP

* + - * 1. (d) Guard provided by the D

This guard may know about the default and the possibility of repo

Odds of confrontation are different, b/c other/ignorant guard may think that any trespasser would be stealing

* + 1. **Prob. 3.3**
       1. Issue: D in default wants to know how to protect his collateral against self help repo.
       2. Analysis:
          1. D can’t hide the collateral, but he can force the C to use judicial process by causing a BoP

Throw a tantrum. Don’t just object, say that D is going to get a bat and chase the SC off. Then SC would have to leave get a Writ. At least this means that the SC won’t take D’s equipment that night.

* + - * 1. Can D call the police?

SC can’t use the police in self-help scenario (can use one after the judicial process)

But D can use the police. Bringing sheriff in is likely to stop a repo, b/c it insinuates a BoP.

PROF: calling police may even put D in a better position

* + 1. **Prob. 3.6**
       1. (a)
          1. Facts: Standard self-help of accounts. Debtor sells equipment to stores (account debtors). Uses A/Rs to get a loan from a bank.
          2. Issue: D is in default to the bank and bank notifies D’s account debtors to pay accounts directly to the bank. One store didn’t do this, and bank wants the store to pay the bank anyway even though this store already paid the D in full.
          3. Analysis:

**§ 9-607(a)**: Self-help provision

After default, a secured party: (1) may notify an account debtor or other person obligated on collateral to make payment … to or for the benefit of the secured party

**§ 9-406(a)**: The bank is right

The store essentially has to pay twice (have to pay the bank even though it already paid the fill account to the D)

The store will then have recourse to try to get the money back from the D

If the account debtor didn’t trust this notification from the bank?

Can ask for proof that this is a valid notification

If the SC doesn’t give proof, then if the account debtor pays the debtor, the account debtor is ok

* + - 1. (b)
         1. Facts: Wilson’s (account debtor) has an untended warranty claim against D
         2. Issue: Wilson’s wants an offset (Wilson’s owes $42k, but warranty defect of product is worth $19k) of what it has to pay the SC once Wilson’s is notified that D is in default
         3. Analysis:

The account debtor is protected by agreements it has made with the D (limitation on the ability of SC to take the full value of the account from Wilson’s)

**§ 9-404(a)**: Wilson’s does not have to pay the full $42k to the bank (SC). It can pay the $42K MINUS the warranty claim that it has

This is why banks typically will only lend 60% of what the product is worth

* + 1. **Prob. 3.8**
       1. GET NOTES FROM HELEN’S
       2. This prob. asks you to review the different status of different types of creditors and their comparative leverage
          1. D should then negotiate (not pay the whole amounts due to one creditor or the other)
    2. NOTES:
       1. If C and D both have good advice re: self-help repo, who wins?
          1. The well-informed debtor wins

Can fend off a self-help repo

PROF: most D’s don’t know the limitations on Cs in self-help repos. They know they are in the wrong and are in default.

* + - 1. The rules that govern these relationships are written by the banks
         1. Art. 9 is a creditor-friendly statute
         2. Consumer debtors are often disadvantaged and don’t appreciate the rights they do have
  1. Judicial Sale & Deficiency
     1. Procedure
        1. Sell collateral to the highest bidder
        2. Apply proceeds to reimburse the foreclosing creditor for sale expenses
        3. Then apply the rest of the proceeds to the debt
        4. Return surplus to the D
        5. C can move for “deficiency” if proceeds were not enough to satisfy the underlying debt
     2. Reasoning for public sale
        1. Property sells for “market [true] value”
        2. Secured party receives full value of collateral [up to debt] and full value of debt with deficiency
        3. D pays no more than it owes [“forfeiture”]
     3. Problems with public sales & why they fetch much lower values
        1. Advertising
           1. Not designed to attract multiple potential purchasers
        2. No right to inspect
           1. Potential buyers (who are not the creditor) have no right to inspect, and so they discount the value of the bid in accordance with the risk they are taking
        3. Buyers take subject to the defects in title and condition
           1. Title Defects: If buyer fails to discover the existence of a junior lienholder out there, buyer is stuck and owes that lienholder

***Marino v. US Bank of Illinois***

Buyer didn’t check the condition of the title. If he had gone to the county recorder’s office he would have seen that there was a 2nd mortgage on the property.

Mortgagee had no duty to join all liens and encumbrances at the sale

Buyer had to clear the lienholder’s interest (but his purchase price didn’t reflect this reality)

* + - * 1. Non-Title Defects:

Environmental liability

If it turns out that clean-up needs to be done before it can be used for another purpose, buyer is stuck.

Damage done by evicted D

Unknown risks can discount the amount of a bid

* + - 1. Hostile relations with homeowner
         1. In an ordinary sale, the owner wants to help the buyer

But here, the owner has 0 incentive to assist a potential buyer

* + 1. NOTE: Because of the above factors, the notion that a judicial sale really results in the FMV of the property is unlikely
       1. This is terrible for the D
          1. B/c in a state w/ deficiency judgments, the C will come back to D for one
          2. D can lose a valuable piece of property when it is undersold
       2. What can the law do about the fact that the FMV is unlikely to be obtained?
          1. (1) Sale can be set aside for inadequate price

D after the sale can go to a court and ask for the sale to be set aside b/c the amount of the winning bid was so grossly beneath FMV that the same can’t be approved

This is hard, though, b/c it has to be so low that it shocks the conscious of the court

***Armstrong***

Price below 10% of FMV will shock the conscience (set aside)

Above 40%, sale will probably not be set aside

Still opens up D to a substantial deficiency judgment

Between 10-40%, if you can point to a procedural irregularity, you may be able to get a sale set aside (but don’t rely on this)

* + - * 1. (2) Anti-Deficiency Statutes

Some states say NO deficiency judgments allowed for mortgages used to buy residential property [not home equity loans]

Lose the house, but C can’t come after D for money owed

Others look to the actual winning bid amount and credit the D instead with the real FMV of the value of the property [as though the winning bid has been the FMV]

Problem: can still lose some equity; valuation difficulty [maybe rely on appraisals, comparable home sales, etc.]

D can still lose equity in the property even with anti-deficiency statutes

These just mean that the C can’t come back after D for more

If D’s house is worth way more than the mortgage debt but only brought a portion of that at the foreclosure sale, D loses equity

* + 1. NOTES re: Public Sale:
       1. Rare circumstances when no public sale is needed
          1. Where C can keep the property w/o exposing it to sale
       2. In some states, D may have a statutory post-sale redemption right
          1. Can go to the winning bidder and pay him the amount of the winning bid and get the property back
       3. Point of the public sale is to establish the true value of the property [idea that the market will put the correct value on the property]
          1. Ascertaining the value and selling it for that value so the full amount of the proceeds are realized

So the secured party will get the full value of the collateral and, but suing for the deficiency, can recover full amount of the debt

Also means that the D should not pay more than it owes

* + 1. **Example 1**
       1. Foreclosure sale
       2. Facts:
          1. Property’s true value is $100k
          2. Lien is $80k
          3. Equity is $20k
       3. Analysis:
          1. If the sale is for $100k, then $80k goes to the SC. Then $20k surplus goes to the D.

This is good b/c it means that the D is capturing its equity in the property, which is how it should be

* + 1. **Example 2**
       1. Facts:
          1. Property is worth $50k
          2. Lien is $80k
          3. D is in a $30k deficiency situation

C will sue for this amount if the property sells for $50k

The C is unsecured for the $30k deficiency

Security is a relationship b/w a particular debt and particular collateral

The SI only covers the $50k part of the loan

* + 1. Credit Bidding
       1. Generally
          1. What happens at actual foreclosure sales
          2. Called this b/c it is made by the SC on credit

Can only be made up to the amount of the loan

The bid is made, the collateral is transferred, and the debt is reduced by the amount of the C’s bid

* + - 1. **Example**
         1. D owes $100k to SC. Sale is happening at request of SC. Sheriff is to sell the collateral to the highest bidder and then pay the proceeds to the SC.

If the winning bidder is the SC, she can bid on credit

SC says that she is owed $100k, so can bid anything up to $100k on credit [so don’t have to pay sheriff and then be paid back]

* + - 1. Generally, credit bidders (aka SCs bidding on their own collateral) will often bid up to the full amount of the debt b/c:
         1. (1) It is then really unlikely that sale will be set aside for inadequacy; and
         2. (2) It makes it less likely that the D will redeem

The redemption right could be fixed at a low value otherwise, making it easier for the D to redeem

* + - * 1. Note: A SC may not want to bid up the value of the debt if there is the availability of a deficiency [that D is not judgment proof]

If SC knows he can get a deficiency, will want to get the property for as low as he can b/c SC will still sue the D for the difference b/w that amount and the amount of the debt [would get the undersold property itself AND get the deficiency]

* + 1. **Prob. 4.1(a)**
       1. Facts:
          1. Commercial is the only bidder (is also the SC who requested the foreclosure sale)
          2. D owes $530k. The house is worth somewhere between $400-450k
          3. State law says that Commercial is not going to be able to obtain a deficiency judgment, so whatever the house sells for is all Commercial (SC) gets
       2. Analysis:
          1. If Commercial is the only bidder at the sale, it should bit up to the amount of the debt with a credit bid [$530k] in order to avoid the debtor challenging the sale/judicial process
          2. If a deficiency judgment were available, then Commercial would want to bid high enough for the sale not to be set aside for inadequate price, but otherwise as low as it can. That way SC can get the property AND sue the D for the remainder owed via a deficiency judgment
          3. If a third party bids $530k or $531k, Commercial should not bid more than that b/c Commercial thinks that the land is worth only $400-450k

If Commercial won the property, it would just turn around and sell it

If Commercial wants to bid more than $530k, it is NOT on credit anymore (and they have no incentive to bid additional cash)

* + - * 1. If a third party bids $440k, it may make Commercial question what they estimated the value to be, so maybe they should bid up to $530k, get the property, and investigate.

Alternatively, Commercial may think that the hassle isn’t worth it so they will let it go to the third party

* + 1. **Prob. 4.2**
       1. (a) House worth less than D’s unpaid loan
          1. Facts: House has FMV = $400-450k

Loan = $530k

Law = deficiency judgment at the discretion of the court

* + - * 1. Issue: Should Sallie (D) do anything to prepare for the sale?
        2. Analysis:

Sallie’s primary incentive should be to get more people to the sale b/c the SC’s incentive is to get their bid as low as possible (b/c they know they can get a deficiency judgment). Sallie should solicit bids to get a higher value for her home at the foreclosure sale. Pressure the bank to bid up to the $530k loan amount.

* + - 1. (b) If the house is worth more than D’s unpaid loan
         1. Analysis:

Danger that D will lose her equity in the home (equity = $170k). If the house sold below its true value at the foreclosure sale, this will wipe out D’s equity.

D could try to sell the house in a non-foreclosure sale within the 4 weeks before the foreclosure sale in the hope that it would bring a higher amount and she can retain the equity (it probably would bring a higher price)

* + - 1. (c) If the brother-in-law is involved 🡪 when the house is worth less than the mortgage, he could let the SC buy it, then try to buy it from SC at FMV at the subsequent sale. Brother in law doesn’t want to try to outbid SC’s likely credit bid of $530k, b/c the house isn’t worth that much.
         1. If the brother in law is involved when the house is worth more than the unpaid lien, he could participate in the auction and outbid the SC
         2. Think about other solutions too – brother-in-law pay off the D’s mortgage?

If D’s house is worth less than the mortgage, this would be an expensive thing to do. If the house is worth more than the mortgage, the sister now owns the house free and clear [but if she has other creditors, they can get after D’s new equity in the house]

* + 1. NOTE:
       1. Law doesn’t prohibit the D from bidding on his own house, but this is not a practical reality
       2. The highest/winning bid sets the redemption value [another incentive for the SC to bid high]
    2. **Prob. 4.3**
       1. Issue: thinking about buying a property at foreclosure
       2. Analysis: step through the various challenges
          1. Lack of info re: title/condition, no right of inspection
          2. PROF: the real consequence of these limitations is that for one individual buyer who is looking to buy one individual home at a foreclosure sale, the risks are extraordinary

It is businesses/investors with diversified foreclosure properties who are doing this (they spread the risk of problematic foreclosure properties)

Not a great idea for an individual

* + 1. TAKE AWAY:
       1. It is a long process to foreclose on real property
          1. Acceleration of the mortgage to auction and sale, then possible post sale redemption process
       2. Deficiency statutes
          1. Many times, if the sale does not bring the full value of the loan, the SC can come after you for more
  1. Article 9 Sale & Deficiency [personal property]
     1. Personal property: how a SC can sell it after default
        1. (1) Strict Foreclosure
           1. Available, but have to get the D’s consent
        2. (2) Sale
           1. This happens more often [as with real prop]; use the proceeds of the sale to pay down the underlying debt
           2. The bank does not want to become the long-term owner of the equipment, stuff, etc. at issue [wants the cash].
     2. UCC permits more broadly for the SC to keep the collateral after repo for satisfaction of the debt
     3. **§ 9-620**
        1. SC may accept [keep] collateral in full or partial satisfaction of the obligation [strict foreclosure provision?]
           1. Partial satisfaction

SC can sue for deficiency owed if he accepts it in partial satisfaction

If SC is trying to keep the collateral only in partial satisfaction, it should be harder for the SC

To do this, have to get consent from the D after the default

It is no good to get a blanket consent or waiver pre-default [not enforceable if in a security agreement]

**§ 9-620(g)**: no partial satisfaction in consumer transactions

* + - 1. **Consent**
         1. **§ 9-620(c)**: To get consent to partial satisfaction, have to get it in an authenticated record (something in writing signed by the D that says that he understands that he will still owe money)
         2. To get consent for full satisfaction, can send a notification, and if the debtor fails to object, can keep it
      2. **§ 9-620(e)**: Consumer goods limitation
         1. If D has already paid the SC 60% of the item’s value, SC cannot keep it in satisfaction of the underlying loan [b/c D would lose equity and would be unfair to uninformed consumers]
    1. Sales
       1. Real property: SC is not in possession of property & sheriff runs the sale
       2. Personal property [UCC]: creditor runs the sale
          1. SC repos the collateral [would have already gotten possession of the item via self help or replevin] & arranges for its sale

SC has huge flexibility/latitude when compared with the real property context

**§ 9-610**

SC may sell, lease, license, or otherwise dispose of the collateral or follow commercially reasonable …

Through public or private proceedings

At any time or place and on any terms

\*Essentially says that SC can sell it however it wants to

* + - * 1. **§ 9-615** dictates the order of distribution of sale proceeds [pretty much the same for real and personal property]
    1. Protections for Debtor
       1. **§ 9-611**: Requires notification of how and when the property will be sold. SC has to give this notice.
       2. **§ 9-610(b)**: Every aspect of the sale has to be “commercially reasonable”
          1. If SC chooses a procedure that wont bring any kind of a decent price, it is not reasonable

This is totally fact specific

* + - 1. **§ 9-623**: Debtor’s right to redeem
         1. D may redeem collateral at any time before its disposition

Have to pay all of the unpaid loan plus expenses of SC in preparing for the sale

* + - * 1. Importance of the notification in collecting money to redeem
    1. At the Sale
       1. **§ 9-615(d)**: If the sale doesn’t generate enough proceeds, the SC can sue for a deficiency [similar to real property]
          1. D is liable for any deficiency
          2. If the sale brings back more than the value of the loan, the surplus goes back to the D [recovers equity like in the real property context]

But often the D will think that their property is worth more than what was gotten at the sale [but rare that Ds bring action for affirmative relief for loss of equity]

More common for Ds to start litigating when they are approached for a deficiency. Ds will then challenge the deficiency by saying that the sale was commercially unreasonable.

This will be hard to do, often, b/c the SC has latitude

**§ 9-627**: If the D can show that the sale was not commercially reasonable, D can be credited for the proceeds that would have resulted if the sale had been reasonable [powerful defense to a deficiency claim]

* + - * 1. **§ 9-626**: Action in which deficiency of surplus is in issue

Doesn’t apply to consumer transactions

* + - 1. Reasonableness
         1. UCC: Procedure is more important than the price re: reasonableness

Unlike in real estate, where reasonableness is determined almost exclusively by price

If sale is below 10% of value, it is inadequate. If it is more than 40%, it is adequate.

* + - * 1. UCC – fact specific look at the type of the collateral and the procedure that the SC chose
        2. **§ 9-627**: the fact that a greater amount could have been obtained by a disposition at an earlier time is not enough to make it unreasonable

Detaches price from commercial reasonableness a little bit

Price is just a signal of what is going on

* + - * 1. Example:

Used car dealer’s auctions selling repo’d car—not open to the public

Many times the Ds say that this is unreasonable b/c the public would have paid more. The SC responds with “tough”—that there is a recognized market and procedure among dealers and this is ok (which is true)

Used car market is a **§ 9-627(b)(3)** kind of market

* + - * 1. **§ 9-627(b)(1)-(2)** Specified market
    1. **Prob. 5.1**
       1. Facts: Repo’d hummer and D was notified that it would be sold in a private sale after ten days of this notice.
          1. Balance owed on loan is $100k
          2. FMV is $80k
          3. Sells for $70k in a commercially reasonable sale
       2. Issues:
          1. What deficiency award?

$30k b/c measured from the sale price and the unpaid loan amount [**§ 9-615(d)(2)**]

* + - * 1. What amount necessary for D to redeem?

$100k [**§ 9-623(b)**]

Should D redeem this car or buy another car like it for $80k?

Should redeem this car b/c he still will have to pay the $30k deficiency [if he buys a different car it would cost the D $10k more]

* + - * 1. If D’s friend offers to pay the bank $80k and the bank doesn’t take his offer and instead sells it to someone else for $70k

Deficiency is still $30k b/c **§ 9-627** says that even though the chosen method didn’t bring as much as another one would have, it was nevertheless a commercially reasonable method.

PROF: this feels really unfair to the D, but that’s the deal

* + 1. **Prob. 5.2(a)**
       1. Facts:
          1. Highest bid = $47,136 [less than the debt]
       2. Issue: How to distribute the proceeds from this bid?
       3. Analysis:
          1. **§ 9-615** gives the order:

First: Subtract the bank and attorneys’ fees [reasonable expenses of sale]

Second: Pay in satisfaction of the underlying loan obligation

Leaves $60,886 of indebtedness

Which leaves a deficiency of $20k

The sale did not bring enough

* + - * 1. If the sale instead brought $75k [ie. more than the debt]

First pay the cost of the sale, then satisfy the unpaid loan completely. Now have a surplus that goes to the D.

**§ 9-615(a)(3)(A)**: Can pay over some proceeds to satisfy obligations secured by a subordinate security interest

The surplus goes to the D even if we now have another (unsecured) creditor that says that they have a money judgment against this D and wants to execute it against the surplus (wants the SC to hand it over to them)

Judgment lien is not the same thing as a SI

A SI is a consensual agreement

* + 1. **Prob. 5.5**
       1. Facts:
          1. P buys the store from Lamp Fair for $327k

Lien = $277k

Equity = $50k

* + - * 1. P defaults and surrenders the collateral (aka the personal property, which is the grocery store)

Use of the words “security interest” instead of “mortgage” strongly suggests personal property

* + - * 1. SC (Lamp Fair) resumed operation of the store and sent P a bill for $131k as his deficiency

SC kept the property in partial satisfaction and still wants a deficiency

Under Art. 9, this is “retaining the collateral in full/partial satisfaction of the debt” aka Strict Foreclosure

Strict Foreclosure: SC is not selling the collateral, simply taking it and keeping it

* + - 1. Issue: Can SC take this property in partial satisfaction and still go after a deficiency?
      2. Analysis:
         1. What about the idea of generating market price by exposing the collateral to sale?

The SC is telling how much it thinks the collateral is worth, but how does it know that?

* + - * 1. **§ 9-615(d)(2)**: Distribution of proceeds from sale

After making payments required by subsection (a) the obligor is liable for any deficiency

But no preceding section explicitly says that the SC has to sell the collateral

* + - * 1. **§ 9-610**: General sale section
        2. **§ 9-620**: Creditor’s ability to keep the collateral

**(a)(1)**: SC may use strict foreclosure only with consent of the D

D has to agree after default that the collateral will not be exposed to sale

**(c)(1)** This is harder to get with partial satisfaction [consent here has to be in a signed writing—which SC does not have here]

* + - * 1. SUM: There is no single Art. 9 provision that tells us that SC can’t do what it is trying to do here [private sale to itself + deficiency], but it feels a lot like strict foreclosure, which does have strict requirements that the SC did not meet.

PROF: SC should not be able to do this

**§ 9-610**

**Official Cmt. 7**: Shores up the position of the D here by saying that normally, a SC may buy at a public disposition, but not at a private one [but there are exceptions]

A SC’s purchase at its own private disposition is the same as a strict foreclosure and should comply with those rules

1. Creditors’ Remedies in BK
   1. BK & the Automatic Stay
      1. BK law is important to this class b/c:
         1. Of the Ds who default, many of them deal with cash flow problems by declaring BK
            1. So the rights of SCs against defaulting Ds very often transitions to dealing with the BK of your D
            2. Once the D declares BK, you are no longer in the secured transactions rights world. BK law is governed by federal law, which displaces inconsistent state laws

As a SC, you have a package of rights against your D under state law

The second your D declares BK, your package of state rights is suspended and replaced by a set of rights under BK law

Once the BK law is resolved, it is possible to pass back into the realm of state rights again

* + - * 1. The rights work differently depending on the kind of rights you have (unsecured v. secured)

For unsecured creditors, there are almost no meaningful rights under BK law

The auto stay will go into place, which means that unsecureds can’t try to seize any property. This is the boat they are in until the BK proceeding is closed.

Secured creditors are not so bad off, b/c they have the rights that flow from their SIs [but cannot go seize the property after BK]

They have the right to get either:

(1) Their collateral; or

(2) Something else of equivalent value

\*This is a promise that BK law makes to SCs

SCs can watch the proceedings to monitor their collateral

BK promises SCs they are going to get the value of their collateral, but that they can’t have it yet [it might take a while]

SCs don’t worry about BK quite as much as unsecureds

* + - 1. Even if a D never actually declares BK, all D/C relationships are structured in the shadow of BK law, b/c both parties are aware of this as a possibility
    1. Goals of BK
       1. Tries to resolve the claims of all the creditors against the debtor, make provision for whatever payments are possible to those creditors, and in certain kinds of BK, discharge certain debts that are not capable of being repaid
       2. Often when individual consumers declare BK, they are seeking a fresh start
          1. Seek a discharge of remaining debts
          2. But some debts are not dischargeable (but many are)
    2. Trustee’s Goal
       1. Maximize the value of the estate for unsecured (general) creditors [and pay these creditors off]
    3. Process
       1. Step 1
          1. When BK petition is filed, it creates a **BK estate**, which means that all the assets of the debtor (individual or corporate) are gathered into one pool called the estate
          2. Then the trustee is able to assess the value of everything in that pool

The property has to stay in that pool so it can be dealt with in an integrated proceeding

* + - 1. Step 2
         1. Creation of **automatic stay** upon filing of BK petition

This is a bar on any collection activities against any assets that now belong to the BK estate

Creditors can’t try to suck any assets out for their own use (aka seize property or collect debts)

Freezes everyone’s rights as of the moment the petition is filed. We don’t want individual creditors jumping out of line.

* + - * 1. Why have an **auto stay** if SCs are eventually going to get their hands on the collateral anyway [why not let SCs grab the collateral right away?]

(1) The collateral might be worth more than the debt

Equity/excess value could go to other general creditors. If the bank takes the house from the estate, it will sell it right away and have no incentive to ensure that the full value of the house is obtained. Worry that assets would be liquidated at amounts that don’t max the value to general creditors.

(2) Debtor may need that collateral to reorganize

The hope is that in keeping going, the D will generate more income for the benefit of general creditors down the road

We don’t want to incentivize SCs to pull value out to serve their own interests

* + - * 1. If SC doesn’t want to wait b/c the value of the collateral is going to deteriorate such that it won’t cover its loan anymore [thus putting him in a worse position than before BK filing], the SC can file to have the stay lifted with respect to specific collateral

What does SC have to prove?

**BK § 362(d)(2) TEST**

* + - * 1. If a SC commits a provable good faith violation of the stay (no notice of BK) and returns the property once SC knows, there would be no fines
      1. Step 3
         1. The estate is then liquidated to satisfy creditors with cash; OR the debtor is reorganized (there is a plan for continued operation)
    1. **Example**
       1. Assets
          1. Car, house, furnishings

Some are subject to a SI

House: worth $200k with $150k mortgage

The value of this house to any general creditors is only $50k b/c the bank will get the $150k

Same situation with a car that has a car payment

* + - 1. Ch. 7 Liquidation-type proceeding
         1. Trustee would first look to those secured creditors and make sure they get the value of their collateral, but then try to max the value of the non-exempt assets, liquidate them and distribute the money to any unsecured creditors
    1. **Prob. 6.1**
       1. POINT: auto stay is a complete bar to getting assets out of the estate
       2. Facts:
          1. Our client (Compusoft) has clients in BK that are costing them money [our client wants to collect]
       3. Issue:
          1. What kind of collection action can Compusoft take against BK debtors?
       4. Analysis:
          1. Outside of BK, only a SC can engage in self-help [we don’t know if this client is a SC]
          2. Assuming client is unsecured, client probably wants to take the debtors to collection [turn unpaid bills to collection agency]

Client CAN’T do this b/c of the auto stay

**BK § 362(a)**: Stay of any act to obtain possession of property of the estate; enforce any lien against property of the estate; collect/assess/recover a claim against the debtor that arose before the commencement of the BK case

**Stay is meant to be completely comprehensive**

* + - * 1. If the client tries to collect, it is a violation of the stay.

All our client can do is to file a Proof of Claim in the BK process [total up of how much she is owed]

* + - * 1. Bills that our client is sending to the debtors every month that reflect the amount of the unpaid account are a problem

Under BK, these bills themselves violate the auto stay b/c they are soliciting payment from the D

Tell the client to STOP billing the debtors

* + 1. **Prob. 6.2**
       1. Facts:
          1. SC has a judgment for possession of some equipment (after replevin process)
          2. SC and the sheriff go to get the equipment

D had already filed for BK

* + - 1. Analysis:
         1. SC can NOT go ahead with the replevin b/c the auto stay is an immediate bar

Frustrates the efforts of the SC just like it did with the unsecured creditor in **6.1**

* + - * 1. SC’s lawyer would want proof of filing of BK petition. Otherwise, the D could lie about BK and then take the equipment away
        2. It does not matter whether it is the creditor or the sheriff that is trying to seize the equipment

The stay applies to all entities trying to enforce a judgment obtained before BK per **BK § 362(a)**

* + 1. **Prob. 6.3**
       1. Facts:
          1. We represent SC bank. Debtor just filed under Ch. 11.

Debtor filed for BK but still owes SC bank $250k. Loan is secured by a restaurant worth no more than $250k. The restaurant has already been closed.

* + - 1. Issue: Can SC simply foreclose ASAP on the restaurant and take the hit
         1. NO, can’t foreclose b/c of the auto stay [bars collection activity of both secured and unsecured creditors]
      2. Analysis:
         1. SC should move the BK court to lift the stay

**BK § 362(d)(2) TEST**

Relief from the stay if SC can show that D has no equity in the collateral and the property is not necessary to an effective reorganization

This **§** applies b/c the D has no equity in the property [value of the debt is equal or more than the value of the collateral] and this collateral is not necessary to the reorganization b/c the restaurant is already closed.

* + - * 1. There is no BK purpose in letting this asset stay in the BK estate, b/c BK promises the SC that it will eventually get the value of this collateral out 🡪 the only reason to leave it in is if the collateral has some additional value that might be realized for the unsecured creditors

PROF: thus, makes sense to lift the stay now and let the SC foreclose

* + 1. **Prob. 6.4**
       1. Facts:
          1. Same lender as **6.3**.
          2. This time, the debtor is a store.

Lien is $210k

Value of collateral is $600k

* + - 1. Analysis:
         1. SC can’t foreclose
         2. Petition to have the stay lifted will probably be unsuccessful b/c of the significant equity in the collateral [**BK § 362(d)**]
         3. PROF: want to keep the property IN the estate to make sure that the additional value is not frittered away by the SC
         4. **BK § 362(d)(1)**: Can grant relief from the stay for cause, including lack of adequate protection of interest in the property

If the neighborhood is in a bad area, the value of the property may plummet

Also matters how much equity cushion there is between the amount of the debt and the value of the collateral

PROF: no court will lift the stay in this scenario b/c the equity cushion is so big

SC can petition again if the circumstances change while still in BK [SC has a right to protect his collateral]

* + 1. **Prob. 6.5**
       1. Facts:
          1. Collateral is a boat worth $700k. Lien is $350k
       2. Issue: Insurance on the boat has been cancelled in derogation of the agreement between the SC and D. SC Bank is now allowed to get an insurance policy and charge it to the D—but can’t get one. Can SC Bank get the stay lifted?
       3. Analysis:
          1. **BK § 362(d)**: Nothing in this **§** specifically keys to the value proposition alone

Aka it is clear here that the boat is WORTH more than the value of the lien, but we are saying that there is a lack of adequate protection of the SC’s interest here b/c the interest can be wiped out if the boat goes out one day and doesn’t come back

* + - * 1. PROF: court would be willing to lift the stay here b/c there is no other way of protecting the interest
  1. The Treatment of Secured Creditors in BK
     1. Unsecured v. secured rights when it comes to calculations of claims and distributions of proceeds
     2. How to Calculate a Claim in BK
        1. A creditor’s claim in BK is the amount of the debt owed to the creditor under non-BK law at the time the BK case/petition is filed
        2. Some claims grow throughout the BK process and some do not [**BK §§ 502 & 506**]
           1. Unsecured: The claim you have at the beginning of BK process is pretty much going to be your claim at the end.

It doesn’t matter that you are incurring attorneys’ fees, interest, etc, during BK

If you have incurred attorneys’ fees PRE-filing, even for an unsecured claim, if you have a loan agreement that says the D is responsible for these, they become part of the unpaid debt when the BK petition is filed. But POST-petition, this claim will not grow.

Rationale for not allowing interest to accrue for unsecureds is that it is a zero-sum game (only a limited value in the BK estate)

* + - * 1. Secured: claims generally DO grow during BK

During BK process, the value of your clam can increase as additional interest is due on the underlying debt

For SCs, their interest accrues only up the value of their collateral (but CAN accrue post-BK petition)

Give SCs interest b/c they have a promise in BK to get either the value of their collateral or their underlying debt

* + 1. **BK § 506** Secured Claims
       1. “An allowed claim secured by a lien … is a secured claim to the extent of the value of such creditor’s interest in the estate’s interest in that property”
       2. If it turns out that the amount you are owed at the date the petition is filed exceeds the value of the collateral, the SC has a bifurcated claim.
          1. Secured as to the value of the collateral and unsecured for the remaining amount of the debt
    2. **Prob. 7.1** [Unsecured Example]
       1. Facts: Unsecured creditor has billed an account debtor for $30k.
          1. Feb. 15: work done
          2. March 15: bill sent
          3. Sept. 15: BK
          4. Dec. 15: now
       2. Issue: What else is included in addition to this $30k base amount?
       3. Analysis:
          1. Items included in creditor’s claim:

$30k principal

18% annual interest accrues from March 15 (in the agreement)

(A) NO interest from Feb. 15 to March 15

(B) $2700 interest from March 15 to Sept. 15

Take 30k x .18 = annual interest owed (divide this by 12)

Rate of interest per month is 1.5%

(C) NO interest from Sept. 15 to Dec. 15 [**BK § 502(b)(2)**]

Court shall determine the amount of the claim … except to the extent the claim is for unmatured interest

This **§** is where we get the proposition that for an unsecured claim, calculate the BK claim without adding future interest (ie. interest after the petition is filed)

NO attorneys’ fees (even though they were incurred pre-petition)

The problem says that there was nothing in the agreement providing for this

Could put your client in a better position by writing into the K that creditor can get attorneys fees/costs of collection

* + - * 1. **TOTAL** amount of claim = $32,700
      1. General Rule: post-petition interest is not included in the claims of unsecured creditors per **BK § 502(b)(2)**
    1. **Prob. 7.2** [Unsecured Example]
       1. Facts:
          1. All assets have been accounted for in the estate and this is how much they are worth

Compusoft (our client) claim: $32,700

Total claims of unsecured creditors: $1,191,500

Total amount available to pay claims: $59,575

* + - * 1. Pro rata distribution: every creditor gets the same % payout on its claim

BK is a collective proceeding for unsecured creditors

* + - * 1. % payout here is 5% to each creditor

Our client gets $1,635

* + - * 1. Payout is often 0%

93% of cases resulted in NO distribution for unsecured creditors

* + 1. **Prob. 7.3** [Secured Example]
       1. Facts:
          1. 6 months interest unpaid, then BK, then 3 months pass
          2. Lien = $340k
          3. Value = $400k
          4. Interest = 12% annually
       2. Claim?
          1. **$340,000** principal
          2. **$20,400**—6 month interest [pre-BK]

Take the principal x 6% [6 months interest from 12% annual interest rate]

* + - * 1. Interest does accrue on the claim amount post-filing (wouldn’t for an unsecured)

3% b/c it is ¼ of a year

Calculate the interest on the $360,400

At the moment the BK is filed, that is when we value the BK claim (worth $360,400 at the time BK is filed)

**$10,812** for these 3 months post-filing of BK

* + - * 1. **TOTAL = $371,212** [value of secured claim TODAY, which is 3 months after BK filing]
      1. **BK § 506(b)**
         1. Post petition interest provision

Interest allowed on the claim AND any reasonable fees/costs under the parties’ agreement

* + - 1. NOTE: If the BK plan is confirmed today, there is still a time period before the distribution is actually paid out
         1. SC will get the time value of money of this amount, too

SC gets interest so the VALUE of the claim remains

* + - * 1. In this problem [interest still accrues in the period between plan confirmation and payout], the additional $14,460 in interest would be unsecured general debt b/c it exceeds the $400k of the original debt
        2. **Interest accrues only up to the value of the collateral**

MORAL of the story is that creditors should protect their interests by taking collateral that is worth way more than the amount of the debt

The more over-secured a creditor is, the less risk he runs that in a long BK proceeding his aggregate claim is going to hit that collateral value cap

Strong incentive for creditors to take more collateral than they need outside of BK law

* + 1. **Prob. 7.4**
       1. Facts: client is Commercial Investors (SC). At time of BK filing, value of collateral us already less than the value of the claim.
          1. $340k lien
          2. $325k value of collateral
          3. Timeline: 6 months of unpaid interest, then BK, then 3 months passes
       2. (a) SC’s Claim
          1. Breakdown

Bifurcated claim: secured claim for $325k (principal); unsecured claim for $15k (principal)

6 mo. Interest: $20,400 (unsecured)

3 mo. Interest: $0

* + - * 1. Totals

Total Secured Claim: $325k

Total Unsecured Claim: $35,400

* + - * 1. \*This is what SC will get at the end of the BK – will not accrue interest during BK

but does the secured portion accrue interest even after BK?

* + - * 1. **Process**

Take the lesser of the claim OR the value of the collateral (at time of BK petition) to get the secured claim

The rest is unsecured

**BK § 506**: talks specifically about secured claims and bifurcation

SC’s claims only accrues interest during BK proceeding if the value of the collateral exceeds the value of the lien

So this claim will NOT accrue interest during BK b/c we have already hit the collateral cap

* + - 1. (b) SC should expect to be paid the present value of $325k under a plan of reorganization
         1. Will SC get anything else at the end?

Re: unsecured claim, SC will be treated like all of the other unsecured creditors [will get the pro rata distribution that all other unsecureds get [ie. 10 cents on the dollar]

Add 10% of unsecured claim to total 🡪 so final claim that SC will get is $360,400

* + - 1. This is why SC like to be over-secured
    1. **Prob. 7.5**
       1. \*Helps to determine the value of a claim in BK and how to distribute out of the estate to various types of creditors
       2. Facts: same as 7.4, but collateral is worth $0
       3. Analysis:
          1. 10% distribution to unsecureds

SC will get $36,040 b/c his whole claim of $364k [principal lien + interest] is now unsecured

But note that in most BKs, there is no dividend to the unsecured creditors, so this person would get nothing

* + 1. **Prob. 7.7**
       1. Facts: Debtor files under Ch. 7. Trustee has liquidated, etc.
          1. BK estate has the following:

Proceeds from sale of aircraft: $214k

Proceeds from sale of coin collection: $26k

Proceeds from turnover of cash in bank account: $2,200

TOTAL: $242,200

* + - * 1. Debtor only has one SC, Friendly, who is owed $150k against the aircraft
      1. (a)
         1. If SC’s lien is on the Aircraft, the client’s BK estate is:

Aircraft = $214k

Owed to SC = $150k

Owed to all other unsecured creditors = $300k

* + - * 1. Aircraft is sold for $214k; 150k of that is given to SC; remaining $92,200 of estate left for the unsecured creditors

Unsecureds get 30.73% of their claims

* + - 1. (b) SC now has a SI in the proceeds of the coin collection. SC is owed $150k, but secured in only $26k [unsecured in the remainder]; has a bifurcated claim.
         1. $216,200 available for distribution

.51 per dollar for unsecureds

Have to remember to **ADD** SC’s unsecured claim into the pool of the rest of the unsecured claims

[300k general unsecured + $124k SC’s unsecured claim = $424k total unsecured claim]

216,200 / 424,000 = .51

* 1. Trustee’s Process
     1. Once all debtor’s property has been gathered, the trustee must identify all of the allowed creditor’s claims and identify the assets available to satisfy those claims
     2. Then, if it is a liquidation BK, trustee starts selling things [minus things that are exempt]
     3. Trustee has more or less free rein to use sale procedures that are going to maximize value for the general creditors
  2. Three Ways Assets Can Come Out of the BK Estate
     1. (A) **“Subject to that lien”**
        1. This is the usual way that an asset is sold if it is subject to a SI
        2. Ex: boat is worth $100k and is subject to a $80k lien [$20k equity that we want to realize for the benefit of the unsecureds]
           1. Trustee can sell this boat, but gets sold subject to the SI [aka the lien goes with the property]
           2. **BK § 362**: auto stay is lifted [it is only in place as long as the assets is in the BK estate – no longer effective if it is sold out of the estate]

This means that the SC is going to foreclose b/c creditors is back in the realm of state law rights

* + - * 1. New buyer doesn’t want foreclosure to happen b/c he just bought the boat. Buyer will only pay $20k for the boat b/c he knows that he is getting a $100k boat subject to a $80k lien

New buyer will pay off the creditor and clear the lien.

The buys is still NOT the debtor in this scenario, but he has bought a piece of property subject to a lien, so if he wants to own it free and clear he has to pay off the SC.

SC gets what he was promised – the value of the collateral

* + 1. (B) **“Free and Clear of Liens”**
       1. Trustee can sell the property like this, which transfers the SC’s lien to the proceeds of the sale, or in some circumstances, to some other asset
    2. (C) Trustee can **abandon** property out of the estate
       1. Decide that the property has no value to the estate b/c the debtor has no equity in it. Thus, wont spend money dealing with it if there is nothing in the proceeds that will benefit anyone (no one would bid anything for a boat worth $80k that has a $100k lien)
       2. 🡪 Once the asset is out of the BK estate, ownership reverts to the debtor, the stay is terminated and the SC can foreclose
    3. \*Shows that the trustee has the flexibility to look at the value to the general creditors of the pieces in the estate
  1. Discharge of Debt
     1. Discharged debt means that it becomes “nonrecourse” debt
        1. Meaning that it is still out there, but it cannot be enforced against the debtor
     2. **“Nonrecourse unsecured debt”**
        1. Could get nothing or could get 2 cents on the dollar, etc., and that is all you get
        2. It is no longer collectible
           1. Think about the situations in which you can’t get a SI (ie. family loans, EE/ER contect)
     3. **“Nonrecourse secured debt”**
        1. Debtor has made a promise to the creditor that it will pay money and has granted a SI in particular collateral
           1. SC can no longer go after the D for the debt/promise, but the SI is still there
        2. Once the collateral comes out of the BK process, the SI is till there (the discharge of the underlying debt doesn’t strip this away)
           1. Once the asset comes out of BK, it can be foreclosed upon and SC can get its money that way
        3. NO deficiency judgment here b/c if SC enforces its rights under the SI by foreclosing on property and then selling it, SC don’t get to go after the debtor for the rest b/c the debtor doesn’t owe SC that loan anymore (it has been discharged)
     4. General
        1. Some debts are not dischargeable in BK
           1. Student loans, etc.
        2. All SC gets is the entire value of the collateral – not the value of the unpaid loan
        3. In BK, debtor can keep household furnishings up to a certain amount; debtor can choose what it wants to keep
        4. In sales, trustee’s SOLE purpose is to maximize value for unsecured creditors
           1. They will be aggressive in disqualifying alleged SIs
        5. By going through BK process, you get a fresh start

1. Creation of Security Interests
   1. Formalities of Attachment
      1. **§ 9-203(b)** Attachment
         1. SI is enforceable [attachment occurs to specific collateral] against debtor only if:
            1. (1) Value has been given;
            2. (2) Debtor has rights in the collateral; and
            3. (3) Either:

(i) The debtor has authenticated a security agreement containing a description of the collateral; OR

Make sure that it is signed or indicated an intention to adopt it as its own

“I grant a SI in X collateral to secure the value of the loan …”

(ii) The collateral is in the possession of the secured party

This is largely used in the pawnshop type context

Ex: pawnshop can keep collateral if the debtor fails to redeem

Problem b/c the debtor can’t use the collateral to earn money

* + - * 1. \*Have to have all three of these for attachment to occur

Timing-wise, have to know when the last of these 3 things happened (b/c this is when SI attaches)

* + 1. Attachment is not the same as perfection
       1. Perfection means that a SI has obtained priority as against other competing SIs
       2. FIRST, a SI attaches; THEN a SI is perfected
          1. A financing statement is a public notice that a SI has been created
    2. **Composite Document Rule**
       1. Take more than one document, look at them together and hope that as a group they meet the requirements of authenticated + description of the collateral
          1. Can be used to convince a court, etc. that a valid SI was created
       2. Disagreement re: requirement of signature
          1. ***In re Giaimo***

Application for car’s certificate of title combined with the actual certificate of title

The actual certificate wasn’t signed by the debtor but the court looks at it via this doctrine

* + - * 1. ***Ace Lumber***

A bunch of notes from telephone conversations can’t be considered b/c they were not signed by the debtor

Seems like the documents all need to be signed

* + - 1. Disagreement re: how documents have to refer to each other
         1. What if there is no internal referencing, but the docs clearly relate to the same transaction?
      2. Don’t want to have to rely on this rule, b/c courts are sometimes less generous on what they’ll let you do
    1. Description of collateral in a separate list [instead of the security agreement itself] --- IS THIS THE COMPOSITE DOC RULE?
       1. Common situation; “I grant you a SI in all collateral that is listed in exhibit A attached hereto”
          1. Often this exhibit will not be signed by the debtor, but this will probably be fine b/c of the internal reference to the list
       2. Probably NOT ok if the list is prepared after the security agreement is signed
          1. **§ 9-203(b)(3)**: debtor has authenticated a SI that has described the collateral

At the moment of authentication, that description needs to be there (either in SI itself or in an attached list)

You would want this for evidentiary purposes; avoid the risk of SC adding things that debtor never intended to grant an SI in. Re: SoF, when you sign something, you are deliberating about the rights you are about to confer (cautionary role of signature)

* + - * 1. Some courts don’t care about the timing and say that if the debtor signs the security agreement and is, in essence, authorizing the filling in of the collateral description later, that is ok
    1. Value Given
       1. Value is defined broadly
       2. SC gives value if it lends money in return for the SI
          1. It has also given value if it makes a binding commitment to lend
       3. Past consideration is value
          1. If you take a SI in order to secure a pre-existing debt, value has been given (do NOT even have to make a new loan)

Ie. a lender has loaned 10k unsecured (money has already been dispersed)

If lender gets nervous and gets a SI, value has been given

* + 1. Debtor has to have rights in the collateral
       1. Can’t grant SI in something you don’t own
    2. **Prob. 8.1**
       1. Issue: do these exhibits meet the authenticated security agreement requirement?
          1. (i) Promissory note signed by D but not SC
          2. (ii) Unsigned financing statement that describes the collateral [what SC uses to perfect a SI] accompanied by signed authorization to file it
          3. (iii) Letter from debtor’s lawyer assuring SC that he has a SI
       2. Analysis:
          1. First: ask if any of these docs standing alone meet the requirements of an authenticated SI

NO; one thing describes the collateral but isn’t signed, etc.

* + - * 1. Then: can we use the composite document rule?

When looking at the docs, try to establish the intent of the parties [want to know if the D realizes and intends to create a SI and confer it upon this particular creditor]

Think subjectively (this D’s intention) AND objectively (look at the docs after the fact)

Can we discern intent here?

Focus on the attorney letter b/c this is the one thing that uses the phrase “security interest”

The other docs suggest it but don’t use the phrase

BUT the letter is from the D’s lawyer, not the D himself

May want to know the extent to which the D has authorized the attorney to represent him and who this lawyer is (ie. is it a partner who is fully immersed in the deal or just an associate who was instructed to write the letter but who may not know if everything was completed)

On one hand, why would you do this if you haven’t already granted a SI? The fin statement has no function other than to perfect a SI [so no purpose in authorizing the filing of one unless you are recognizing the presence of a SI]

But on the other hand, you may authorize a fin statement in anticipation of a deal that is never completed [so don’t put too much weight on this]

* + - 1. PROF: need more facts/details to see if the composite document doctrine could be relied upon here
         1. The issue is whether the SI was granted. If you don’t have a clear indication of this conferral of rights, court may be hesitant
    1. **Prob. 8.2**
       1. Issue: exactly when did the SI attach to the restaurant?
       2. Facts:
          1. 1st element: Value was given when Friedman (bank EE) delivered bank (SC)’s 1st check for $388,390 [1st time SC parted with some money]

This check went to the bank that held the 1st SI [NOT the debtor]

* + - * 1. 2nd element: Debtor retained rights in the restaurant/collateral when the seller delivered a bill of sale, keys to the restaurant, and assignment of her rights under the lease
        2. 3rd element: Somewhere, when they are completing the transaction, debtor must be required to execute the security agreement. He signed the promissory note AND a security agreement before the value was given.

Promissory note – D is saying that he agrees to repay the $600k before the money has even been dispersed [this is not value given b/c it is an obligation of the D]

* + - 1. Answer: the giving of value was the latest event, so that is when the SI attaches
         1. Argument that moment of attachment is a different time?

Argument that SI attaches when the closing has been successfully completed

Most closings are conducted on the implicit understanding that no exchanges of documents have effect unless they ALL happen

* + - * 1. Time of attachment becomes more important when you have competing creditors in the picture

Creditor priority can sometimes relate back to the moment of you SI attaching

* + 1. **Prob. 8.3**
       1. Facts: you represent SC and come to closing with SI. Description of collateral says “see attached list” but there is no attached list. You don’t have a description b/c the list was forgotten.
          1. Issue: does the bank, at that moment, have an enforceable SI

At that moment, **§ 9-203(b)(3)(A)** has not been satisfied b/c there is no description at all [no SI]

* + - 1. If the list is later stapled to the security agreement, could argue that the SI would be enforceable b/c of the reference to the list
         1. But could also argue that the D’s signature doesn’t reach this list b/c it wasn’t attached when D signed

Courts are divided on this timing issue

* + - * 1. PROF: this is questionable
      1. If TWO years later the list is attached, the argument for enforceability would be even more tenuous
         1. PROF: technically, don’t know why 2 years would be different than 2 weeks [but it makes it more difficult to prove intention]

Time span would make courts less comfortable saying there is a valid SI

* + - 1. If you discover this after your client has filed for BK
         1. You can’t attempt to bring a valid SI against property after the auto stay is in place
         2. NO SI here
    1. **Prob. 8.4**
       1. Facts: BK context. Description in a security agreement is completely blank. At closing, the your client, the creditor (who is selling the equipment) promised you a description of the bulldozer. The debtor (purchaser) tells you to go ahead and fill in the description later [signs it then even though the description is blank]. The creditor emails the description to you, but you didn’t insert it in the blank of the agreement. The debtor has not declared BK and the Trustee has asked you for the security documentation.
          1. B/c the creditor sent the email with the description, the problem is that the debtor has not said “I grant you …”

The description coming from the CREDITOR is not going to be helpful here

* + - 1. Analysis [OPTIONS]:
         1. Should you tell your client that the SI is void?
         2. Leave the description blank and use multiple documents to show debtor’s intent to create the SI?

PROF: maybe, b/c the composite document rule does give the court some latitude when there is no effective security agreement

There is a good faith argument when you combine the signed security agreement, email with the description of the collateral, and debtor’s authorization for you to fill in the blank, etc.

* + - * 1. OR you could fill in the description in the security agreement and THEN go talk to the BK trustee

Less ethical, but D authorized you to fill it in and the SC/D expected you to do it. You would be effectuating the clear intent of all of the parties to the transaction.

The tempting aspect is that no one would know

It’s YOUR file

This shows how much this is in the control of you as the lawyer (no public step here)

But you can **NOT** do this in accordance with BK code re: auto stay & ethics rules, b/c this would be a deliberate violation of the auto stay AND a misrepresentation of the chronology

PROF: temptation to violate the ethics rules here is very great b/c you say to yourself “no harm done”

But the harm IS done to the unsecured creditors who, under the rules of BK, should at this point have access to that asset

* + - * 1. Staple the email description to the agreement?

After the stay, not supposed to do anything to create a lien

If the motion of stapling is an act trying to create a lien, then it would be a violation of the stay

But if you hand everything over to the trustee w/o stapling/pretending re: the timing, then you haven’t really acted at all

* + - * 1. Turn the matter over to your client and withdraw?
      1. Think: what are my options here as a lawyer?
         1. BK trustee would argue that there is no SI

The whole role of the trustee is to maximize the assets that are in the BK estate for the benefit of the general creditors (he wants to strip potential liens off the assets in the estate)

* + - 1. As trustee: Prof would argue that being authorized to fill in the description of the collateral doesn’t change the fact that the security agreement is still blank [and can’t fill it in now b/c of the auto stay].
      2. CB pp. 142: description of collateral added after the D signed the security agreement invalidates the agreement for some courts [and this is even when the description is actually filled in]
      3. SUMMARY: Court could accept the whole file from the lawyer, here, and accept the agreement under the generous composite doctrine rule (by looking at the email)
         1. But can’t try to improve your position
    1. **Prob. 8.5**
       1. Facts: same as above, but you have turned the matter over to your client and withdrawn. 5 months later, you are in a BK courtroom and you hear the testimony of your ex-client. This client doesn’t say anything about how/when the description was filled in to the security agreement, but says that it is a valid security agreement.
       2. Analysis: You CAN’T disclose client confidences. You do NOT have a duty to disclose the truth of the situation b/c the ethics rules says that you MAY disclose info to the extent necessary to prevent client from committing fraud [**MR PR 1.6**]
       3. **MR PR 3.3**: lawyer may not knowingly make a statement of false fact to a tribunal [but this is not the case here]
          1. **3.3(a)(3)**: if the lawyer’s client or a witness called by the lawyer has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take remedial measures including disclosure to the tribunal.

But does this apply to former clients?

Yes- if you know that your former clients is making a false statement of facts with respect to something you have knowledge of, this rule persists

BUT your client here is testifying that the signature on the security agreement was his own, the agreement was genuine, and it expressed the agreement between the parties

There is NO false statement of fact, here

Your client is not saying anything explicit re: when the description of the collateral was filled in

* + - 1. LATER CLARIFICATION:
         1. Really complicated and there is no clear answer re: there is a duty to disclose to the tribunal if it is a formal client. Some advisory opinions say that if you have withdrawn and you found out about the problem AFTER, you cannot disclose.
      2. PROF: one way to look at this is that there is NO false testimony here
         1. The problem is that there is a little bit of a ½ truth in that you know there was a timing issue and not disclosing this seems not to be full disclosure to the tribunal
         2. There is not a perfectly clear answer to this as long as what the client does remains short of presenting evidence that is false [the actual evidence here is just incomplete – does this make it inherently false?
      3. LEGACY: Think about the control that the UCC process puts in the hand of the private individuals and the lawyers of those private individuals
         1. And the way these individuals act affects 3rd parties

Creates room for dishonesty/unethical behavior that is unfortunately a part of this

* 1. What Collateral & Obligations are Covered? [ie. Sufficiency of Description in Security Agreement]
     1. SI is a relationship b/w particular collateral and a particular obligation [SI attaches to specific collateral and secures specific obligations]
        1. Thus, the security agreement has to describe the collateral sufficiently clearly
     2. **§ 9-108(a)**: “Any description of personal property is sufficient if it reasonable identifies what is described”
        1. **Cmt**: test is that the description must make possible the identification of the thing described
        2. Do not have to identify specifically each item to which the SI attaches
           1. Ie. Bank that lends to farmers. Bank’s SI does not have to list the serial numbers of all tractors, etc. Just use “tractors.”
        3. Description is good enough if it identifies collateral by **type** as defined by a category set out in the UCC
           1. Ie. equipment, inventory, general intangibles
        4. Can also identify collateral by **category**
           1. Ie. tractors
     3. **§9-108(c)** Limitation
        1. Does not permit super-generic descriptions
           1. ie. “all the debtor’s assets/property” does not reasonable identify the collateral]
     4. **Changes** in the Relationship b/w the SI in Collateral & the Secured Obligation
        1. Examples
           1. (1) SI attaches to collateral worth $225k. Collateral is the debtor’s two tractors. SI secures the repayment of a $250k loan.

Relationship b/w the loan and the tractors 🡪 SC is slightly **under-secured** b/c the amount of the secured loan actually exceeds the value of the collateral [in other situations, SC could be **over-secured** if the loan is worth less than the collateral].

What if the collateral changes?

**Under-secured** situation: if the debtor purchases a THIRD tractor, SC would want to have its SI attach to that 3rd tractor as well [b/c then the collateral would be worth MORE than the lien]

* + - * 1. (2) A/Rs as collateral (ie. debtor expects money to be paid in from customers). When the SI is created, the value of that pool is $250k [but these accounts get paid off over a few months—once they are paid, the A/R disappears]. The result is that the value of SC’s collateral can be depleted and become worth almost nothing.

The SI CAN hope over to the proceeds of those A/Rs being paid off

SC wants to replace the original A/Rs with new A/Rs so that the pool of collateral remains at about the same value

Aka a **floating lien** that attaches to the pool of A/Rs as it may be depleted and replenished

* + - 1. How do we achieve the SC’s goals in these two examples?
         1. Use **after-acquired** property clause, permitted in **§ 9-204**
    1. **After-Acquired Property Clauses [§9-204]**
       1. Transactional efficiency benefit: at the time the SC enters into the SI, SC is allowed to say that the SI will attach to collateral that is acquired later [don’t have to go back and draft a new SI]
       2. Example: SC takes an interest in “all equipment now owned or hereafter acquired” OR “all accounts of the debtor, whether now in existence or later created.”
       3. Per **§9-204(a)**, intent to use an after-acquired property clause MUST be provided for in the security agreement. Must be express (use magic words).
          1. Exception to the requirement of express intent 🡪 inventory

SC knows that inventory will turn over (so everyone knows that “after acquired” is included in these SIs)

**SAME exception for A/Rs** (old ones are paid and new ones are generated)

* + - 1. **Example**
         1. If SC knows he is under-secured by two tractors, he would want to use an after-acquired property clause to attach tractors acquired in the future. The second that the 3rd tractor is purchased, SCs interest would then attach. But there could be a priority challenge if the debtor finances that 3rd tractor.
    1. If the Amount of the Obligation Changes?
       1. **Future Advance Clause** [**§ 9-204(c)**]
          1. Example: $200k loan secured by $250k worth of tractors. Now debtor wants to borrow an additional $50k. SC wants to know that its SI will secure the repayment of the initial $200k AND repayment of the new $50k loan. Use a future advance clause in a security agreement to a pre-existing SI in order to automatically secure a new loan, too.
          2. Do this at the time you sign the security agreement for the initial loan [increases the amount of the loan that is being secured]
          3. NOTE: “Advance” means an amount of money that is transferred by the SC to the debtor. At the time the loan is originally executed, the SC will typically make an initial advance. If the D borrows more money down the road, it will be an additional advance.
          4. Phrasing: “To secure payment of all current and future debts to SC, the D hereby grants a SI in the collateral”
       2. It is acceptable to use **Dragnet Clauses**
          1. Which say that ANY obligation of any kind that this D may incur with respect to this SC are covered by this SI
          2. NOT limited to debts arising from a loan – includes any debts
       3. **Non-Advances**
          1. Way of describing obligations to the SC that the D may incur other than money received in the form of a loan

Ie. if the loan agreement provides that the D has to pay the SC’s attys expenses upon default, that amount can be a non-advance (b/c the D owed the SC more money, but NOT b/c of another loan)

* + 1. **§ 9-204(c) & 9-204(a)** relate to the two parts of the SI equation [the value of the collateral on one hand and the value of the secured loan on the other]
       1. Helps the D/SCs agree on how the relationship is going to be maintained
       2. In many business relationships, asset ratios are written into the K
          1. Agree to loan X amount of money conditioned on the fact that average value of A/Rs (as collateral) doesn’t dip below X amount

This ensures that SC is not under-secured

* + 1. **Prob. 9.1**
       1. Issue: Sufficient description of collateral under **§ 9-108**?
       2. (a) YES—“All equipment and inventory”; see **§ 9-102(a)(33) & (48)** definitions
          1. Per **§ 9-108**, if description of collateral is by “type as defined in the UCC,” it is sufficient
       3. (b) skip
       4. (c) YES—“Restaurant equipment located at 123 Main Street”
          1. Equipment alone is a sufficient category, and this is even more specific

But potential ambiguity added by saying “located at” this address?

Ordinarily look for description of the collateral at the time the SI is granted. Does this mean we are granting the SI in whatever equipment was at the location the day of the signing of the SI, or are we saying whatever pool of restaurant equipment ever happens to be at that location?

PROF: but courts approve this type of description all the time & interpret it to mean that it covers whatever is in the location at whatever time the SC is trying to enforce its SI (could be a little bit of a floating category in that way)

* + - * 1. **§ 9-108**: When you use the “equipment” category, have to go by that definition in the UCC [everything failing within this UCC definition is then covered by the SI]
        2. PROF: Surprised to see SCs taking SIs in equipment by location when the restaurant is a chain
      1. (d) NO—“ All the debtor’s consumer goods” as collateral to borrow money to buy a cruise ticket
         1. **§ 9-108(b)(2)**

Description only by type of collateral is an insufficient description of consumer goods if you are in a consumer transaction

Sophistication problem: this is not ok b/c in consumer transactions, may have an unsophisticated D that does not realize that if they don’t repay the loan that they used to buy the tickets, the SC can foreclose on ALL of their consumer goods [potentially huge category of D’s personal property]

* + - * 1. IF the provision said that collateral is “all the D’s assets,” it would be super-generic [and not acceptable] -- **§ 9-108(c)** prohibits this for consumer and business lending

The description here is NOT super generic b/c it specifies “consumer goods”

* + - 1. (e) NO – “All goods other than consumer goods”
         1. Feels like a super-generic

Pulls one category out, but it isn’t a helpful, specific description of the collateral

* + - * 1. PROF: lawyer could argue that this is NOT super generic under **§ 9-1089(c)**, but (c) does also include “words of similar import”
    1. **Prob. 9.2**
       1. Facts: client = a dept store who takes a SI in everything that its credit card holders buy on account. Uses language on the credit card application that says that every time a customer uses the car, customers are granting a SI in all items purchased on the account. Client is worried that this doesn’t work per the ***Shirel*** case. Client wants to take a SI in everything the client buys on credit.
       2. Could look at the items the store sells that they really care about
          1. Ie. don’t include shoes but include refrigerators, washer/dryers [narrow it by type of asset and insert this language into the agreement]
       3. Many stores have used technology and put this language on the receipt instead of the credit card application
          1. Ie. if you buy something at Target on your Target credit card, the back of the receipt says you are granting a SI on the item described on the front of the receipt
    2. **Prob. 9.3**
       1. This is not meant to be a consumer transactions
       2. Facts: loan officer is lending to businesses and wants to describe the collateral as all the debtor’s property.
          1. UCC clearly prohibits this (super generic problem)

Loan officer wants to know why in the context of corporations?

If this were permitted, surely a lot of lenders would try to do it. If there is poor leverage from the borrower’s POV, they may feel that they have to agree. Down the road, this could be a terrible situation for the company b/c they would have nothing left to put up as collateral to other lenders.

Problem that companies may do this w/o realizing it or properly valuing what they are giving up

* + - 1. Analysis: What can loan officer do (that is enforceable) to get closer to the super generic?
         1. **§ 9-108(b)(3)**- if your description uses categories defined by UCC, that is sufficient description

So say “all accounts, equipment, inventory, general intangibles, etc.” – use ALL UCC categories

It gets the SC to the same place, but it gets the debtor to think b/c the debtor would then be looking at these categories—would maybe want to negotiate

* + - * 1. **SC can encumber all of the debtor’s assets**

SC just has to meet the requirements of **§ 9-108**

* + 1. **Prob. 9.4**
       1. Facts: SC has a SI in “crops growing on the debtor’s farm in county … and most farm equipment”
          1. D goes back to SC to ask for more of a loan and SC says no
          2. Debtor approaches SC #2, who says that it will lend money and take current crop as collateral, but SC #1 has a SI in that crop [so won’t lend against it and have a junior SI]
       2. Analysis:
          1. This description **IS sufficient**
          2. Is SC #2 right?

Whatever crop is on the land is covered by the SI, recognizing that the nature of a crop is that it is grown, harvested, then re-grown

Definitions in **§** **9-102**

No category of UCC collateral called “crops,” but there is one called “farm products”

Farm products = goods which are crops grown, growing, or to be grown, etc.

PROF: true that SC #1 could have described the collateral as “farm products”—this would make it clearer that we are talking about ALL crops

But used “crops” instead. Don’t HAVE to use “farm products” or a UCC category for a description to be sufficient, though.

Could argue that SC #1’s use of “crops growing” meant to restrict the SI to the current crop

* + - * 1. If SC #1 wanted SI to be just the current crop, would say “SI attaches to the crop of wheat that is in the ground as of this particular date”

If SC wanted the SI to cover future crops as well, could have been clear and use “all current and future crops…”

* + - * 1. Debtors are saying that they only intended to encumber the then-growing crops. If debtors had intended to include future crops, they would have included an after-acquired property clause.

Argue about the SC’s other contracts and how they phrase description of crops and future crops (contract interpretation)

Could go back to SC #1 and show that they have paid the loan down and then ask the bank to release their potential claim on future crops

SC #1 probably doesn’t have an incentive to agree and would want to keep this valuable asset in the future crops

* + - 1. The real problem: how do you help your clients (debtors) if SC #2 doesn’t think that the description is clear enough and thus doesn’t want to lend?
    1. **Prob. 9.5**
       1. Facts:
       2. Analysis:
          1. SC #1 could argue that it has a SI in the lambs, b/c could argue that they are “crops”?

UCC distinguishes b/w crops and livestock

Thinks they are different

(34)

Webster’s Dictionary: crop is a plant or animal

* + - * 1. Debtors can argue to SC #2 that SC #1 doesn’t have a SI in the lands, but SC #2 would say no if they are really cautious
      1. Through sloppy description of collateral, debtors may have unintentionally encumbered the only assets they have to use to try to get money from someone else down the line
         1. **Moral for debtors**: make sure you have a SI description that is as narrowly tailored as possible
    1. **Prob. 9.6**
       1. Facts:
          1. Description of collateral: “additions, replacement parts, repairs and accessories”

But could also argue that this only pertains to currently owned equipment

* + - 1. Issue: is the additional after-acquired video equipment included under the original description of the collateral?
      2. Analysis:
         1. Didn’t use magic words of “after-acquired”—could have used these if wanted to be exceptionally clear that this equipment was meant to be included
         2. Problem: if you have an ambiguity, it can really interfere down the road
    1. SUM:
       1. Problem that “goods” could be super generic under the spirit of **§ 9-108(c)**
       2. This is ultimately state law
          1. So state courts have implemented certain provisions differently (some more restrictively than others)
  1. Proceeds, Products, and Other Value-Tracing Concepts
     1. NOTE: can use an after-acquired property clause to get an SI in all A/Rs that a debtor ever has
     2. Generally
        1. Issue here is not whether additional items of collateral are added, the question is what if the existing collateral changes form in some way
           1. If you have an SI in the debtor’s tractors but one of the tractors blows up and is replaced by an insurance claim

If your SI only applies to tractors, this does not describe insurance claims

* + - 1. SCs are less worried about the form of the collateral and are more worried about the value of the collateral
         1. If the collateral starts to change form, be disposed of, etc., SCs want to know they still have valuable collateral
      2. Some transformations of certain types of collateral are completed expected
         1. Ie. A/Rs, beef cow (at some point, this will be transformed into hamburger meat)
         2. SC should prepare for this transformation in the security agreement
      3. But sometimes the SC does not expect a transformation
         1. If debtors sells the collateral w/o authorization

Then SC wants to know if the SI attaches to the cash from the sale?

* + 1. Proceeds
       1. Proceeds = what you get upon the disposition of the original collateral
          1. CB says that new Art. 9 contains a broad/ambiguous **§ 9-102(a)(64(C)**, which says that **proceeds** are “rights arising out of collateral”

SC now wants to be very careful that they are catching all possible transformations in their SIs

SC doesn’t want the collateral to be disposed of in such a way that SC is left with an SI in nothing

* + - 1. Old Art. 9 defined proceeds to be only what you get upon the disposition of the original collateral
         1. This is something like the definition we have in **§ 9-102(a)(64)**

“whatever is acquired in … disposition of collateral”

* + - * 1. Only call something proceeds if you get it by PERMANENTLY turning the collateral into something else

E.g. dairy cow will produce milk, but you still have the cow

Under old Art. 9, the milk would not be considered proceeds b/c it was not obtained upon disposition of the cow

E.g. hamburger meat from cow would be proceeds under old Art. 9

* + - * 1. This created a sharp dividing line b/w proceeds on one hand and rents, products, etc., on the other
    1. Value-Tracing Example
       1. SC has SI in “all cows, whether not owned or hereafter acquired” of the debtor.
          1. **Transformations**

Dairy cow

Generate a lot of milk over its useful life (represents part of the value of the cow/collateral)

SC would like to have its SI attach to the cow AND all of the milk produced by the cow

Our SC has NOT done that [b/c SC says “cow”]

To fix this problem, SC could say “all cows and their products” – milk is the product of the cow

Cow could also generate baby cows

SI would capture these, b/c they represent “after-acquired cows”

Could also reach them by using the word “offspring,” which is another value-tracing term

If baby cows are turned into veal chops, then they are not covered anymore b/c they are no longer cows (they would be proceeds)

Will be slaughtered at the end of its useful productive life

Beef cow

Hamburger meat is proceeds of the cow

Proceeds require a disposition of the collateral

Meat could be transformed into an A/R

A/R will be transformed into cash for the farmer

Cash may ultimately be transformed into a new cow

SI would attach to this no matter what b/c the SI says “all cows”

🡪 SC will want his SI to attach at all stages of this process

* + - * 1. To ensure that SC’s SI attaches to all of the proceeds in all of the forms listed for the beef cow:

Security agreement does NOT have to say anything to capture all of these proceeds, b/c **§ 9-203(f)** says that if you have an SI that attaches to a piece of collateral, it automatically attaches to proceeds as provided in **§ 9-315** (“identifiable proceeds”)

* + - * 1. Does SC’s SI ONLY attach to the proceeds? Or can it stick to the original collateral as well, once it has been disposed of?

If the beef cow is disposed of through sale:

Debtor sells it to the buyer in exchange for money

The original collateral continues in existence – does the original SI attach to this in the hands of the new buyer?

If SC authorized the sale, then SI does NOT continue in the cow (only attaches to the proceeds)

If the sale is unauthorized by SC, **§ 9-315(a)** says that the SI DOES continue in the collateral 🡪 “BLOB”: SI can attach to the collateral and the proceeds (and grow bigger)

\*It may be a criminal/civil violation to sell your collateral in an unauthorized fashion w/o submitting proceeds to your SC

If the 1st buyer sells to a 2nd buyer, the original SI continues in the cow AND the proceeds that 1st buyer got from the 2nd buyer

SI is now 3x its original value (cow, proceeds in the hands of the debtor and the 1st buyer)

* + 1. Limits on the Attachment to Proceeds Function & **Multiplication** of SIs
       1. Proceeds have to be identifiable
          1. SC has to be able to show that it was its collateral that became this hamburger meat, A/R, cash, etc.

If there is any question along the line, then SC can’t get its SI

* + - * 1. Examples:

(1) Comingled grain

(2) You have all the beef cows of debtor #1 financed by SC #1 and the cows of debtor #2 financed by SC #2. The cows are pooled together in the slaughterhouse and what comes out is comingled.

Now it is not factually possible to identify which meat carries which SI

**TEST:** at the time the meat was created, if the meat ownership was 60% SC #1 and 40% SC #2, court may look at what meat is left and divide it 60/40 (proportionally)

This is not the same as factually determining whose is whose

The problem is that the SCs will argue that any missing meat will be the proceeds of the debtors that are NOT theirs

Have to come up with some fiction b/c we can’t literally trace the provenance of the missing meat

\*Same problem with money & bank accounts

(c) Money taken from debtor’s A/R and put in a bank account that also contains other money

Once the money is pooled, can no longer tell which money came from my beef cows

The law has to come up with presumptions to determine how to identify collateral in this commingled group

Use **“Lowest Intermediate Balance”** test

This is a legal fiction we apply to trace money proceeds out of deposit accounts

* + 1. PROF:
       1. Think of cow’s milk as a **product** from the collateral as opposed to a right arising out of the collateral
          1. Re: “rights arising out of collateral”, the UCC drafters had insurance claims, etc., in mind
       2. If SC is worried about co-mingling, can put agreement not to comingle into the security agreement
          1. But could also agree that the debtor agrees not to sell the collateral (and doesn’t mean that the debtor won’t do it anyway)
    2. **Prob. 10.1** 
       1. Facts: **Bank has SI in equipment, inventory, and accounts**. [Makes no mention of proceeds, products, offspring, substitutions, additions or replacements]
       2. Issue #1: If equipment covered by SI fails and has to be replaced, the question is where the new equipment comes from:
          1. The new equipment is NOT proceeds of the old equipment unless it comes from the old equipment (ie. acquired due to the exchange of the old collateral)

If it comes from somewhere totally different (ie. bought out of her checking account), then it doesn’t come from the old equipment

To cover this, agreement would have to say “after-acquired equipment”

* + - 1. Issue #2: If old equipment is sold for cash and that cash is used to buy a new piece of equipment, then the new equipment is proceeds (and SI covers it)
         1. Proceeds are automatically covered **[§ 9-203(f)** & **§ 9-315(a)(2)]**

**§ 9-203(f)**: The attachment of a security interest in collateral gives the [secured party](http://www.law.cornell.edu/ucc/9/article9.htm#dsecuredparty) the rights to [proceeds](http://www.law.cornell.edu/ucc/9/article9.htm#dproceeds) provided by **§** [**9-315**](http://www.law.cornell.edu/ucc/9/article9.htm#s9-315) and is also attachment of a security interest in a [supporting obligation](http://www.law.cornell.edu/ucc/9/article9.htm#dsupportingobligation) for the collateral.

**§ 9-315(a)(2)**: SI that attaches to proceeds will automatically attach to all proceeds of that collateral as long as it is identifiable

Watch out for co-mingling

**NOTE**: Other forms (ie. products, etc.) may not be covered unless the agreement explicitly reaches them

* + - 1. Issue #3: If old equipment is traded for new equipment, this would clearly be proceeds and SI would reach the new equipment whether the agreement said anything about it or now
         1. But tracing problem if you trade something of low value (that you had to add money to in order to get the trade)
      2. Analysis:
         1. PROF: it would be wise to include “replacements, additions” as separate categories in the agreement AND use “after acquired” clause
         2. If agreement doesn’t say “additions,” then the SI wouldn’t reach additions (which would represent a fair amount of value)

**NOTE:** But additions to accounts and inventory would be included, b/c the ordinary expectation is that new inventory is covered due to its very nature (this is NOT true of equipment)

* + 1. **Prob. 10.2**
       1. Facts: description of security agreement is same as above
       2. (a) Money now in debtor’s bank account
          1. NOT covered by terms “accounts” as collateral

**§ 9-102(a)(2)**: account is a right to payment of a monetary obligation; does not cover money sitting in bank accounts

Money sitting in bank accounts would be covered by words “deposit account” per **§ 9-102(a)(29)**

* + - 1. (b) Parrot taken in payment of an overdue account
         1. YES, subject to SI b/c parrot is proceeds of the A/R
      2. (d) Myna bird taken in exchange for plumbing work
         1. This may not be covered b/c there never was an account

Account = right to payment of a monetary obligation

If NO monetary obligation ever came into being via intention of the parties, then bird can’t be proceeds of an account

* + 1. **Prob. 10.4**
       1. Facts: Joey contracts to buy a toyshop.
          1. Purchasing assets: leasehold, trademarks, A/Rs, etc. but is NOT acquiring existing inventory b/c a bank has a SI in that inventory.

Bank’s SI says “inventory.”

It **IS** possible that this encumbers some of the A/Rs that Joey wants to buy

* + - 1. Analysis:
         1. Look at the original inventory (that the SI attaches to)

Bank’s SI WILL attach to the A/R b/c store would sell the inventory in exchange for the A/R

A/R are the proceeds of the inventory

If Joey doesn’t want to buy anything that is encumbered by the bank’s SI, then he doesn’t want to buy the store’s A/Rs

* + - * 1. What about the fixtures & furniture? [could they be encumbered by the bank?]

**§ 9-102(a)(48)**: inventory means “goods” but has restrictions – “goods held by persons for sale”

**NOT** other forms of goods, ie. fixtures, etc.

In this case, it **IS** possible that the bank’s SI actually attaches to other property of the store b/c inventory can be sold for A/Rs, then converted to cash and that cash can be used to buy new property/furniture, etc. [if traceable]

Debtor has to be careful, here

**Proceeds of proceeds are proceeds**

Every time inventory is sold out of the pool, there are proceeds

It all depends on traceability

Prove that inventory generated the money that was used to buy the new property (this may be hard to do)

If it can be traced, then the bank’s SI will attach to all inventory currently held PLUS all proceeds from previous inventory

* + 1. **Prob. 10.5**
       1. Lowest Intermediate Balance Test
       2. (a) Copier (collateral) is destroyed by fire. The loss is insured but no insurance check yet. In that moment, SC’s collateral is the right to obtain the insurance claim (don’t actually have the money yet)
          1. This right counts as **proceeds** per **§ 9-102(64)(d)**

Claims arising out of the loss of collateral

* + - 1. (b) The SC was not names as the payee on the policy, so the claim is paid to the debtor. The debtor gets $35k and puts it into a bank account that already contains $5k [this $5k was not subject to the SI].
         1. The SC’s collateral is the $35k in the account b/c the insurance claim is traceable even though it is comingled

NOT factually traceable in that these particular dollars are ours, BUT can show that our $35k went in and nothing else came out

* + - 1. (c) Debtor writes a $2k check out of the account. Collateral is $35k (same as (b)) but now there is only $38k in the account, but your $35k is clearly still in there.
         1. No tracing problem b/c there is still enough to pay your $35k
      2. (d) Debtor writes a check out of the account for $32k to the IRS
         1. NOW there is a tracing problem
         2. Now, SC’s collateral is the $6k that is the balance left in the bank account [the IRS gets the $32k check free of any SI].

This is the lowest balance from when the deposit of your proceeds went in and what it is today

**Lowest Intermediate Balance Test 🡪 SC lost SI in copier and gained SI of $6k in its proceeds due to the traceability problem**

* + 1. **Prob. 10.6**
       1. Facts: legally, the situation is exactly the same as **prob. 10.5**. BUT now the funds from the old copier go out of the bank account to buy a new copier. SC should argue that its SI in the old copier should now attach to the new copier.
          1. But there is no basis for SC arguing this b/c once the check has been written, the SC doesn’t get the new copier b/c of commingling and the lowest intermediate balance test

SC can only trace its interest to the $6k chunk left in the bank account [NOT the new copier]

PROF: this seems really unfair to the SC

* + - * 1. Giving the SC interest in the new copier is not consistent with the **lowest intermediate balance test**
      1. It would have been better for the SC to take an SI in all equipment (rather than that exact copier)
         1. Or include substitutions, replacements, additions to the old copier, etc.
      2. If the collateral is this restricted (ie. specifying VIN # or serial #), then the tracing problem becomes more severe

1. Default: the Gateway to Remedies
   1. Default, Acceleration, and Cure under State Law
      1. Generally
         1. SC would prefer to never have to use these remedies b/c they don’t want the D to default
            1. Default is the triggering event for these remedies, but the UCC does NOT define “default”

The definition of default depends on the loan agreement itself

It is possible to have a loan agreement that doesn’t define default at all

Agreement could just say “I loan you $100”

But business agreements have “events of default” written into the K

For both D and SC, it is good to have specifically articulated events of default 🡪 D wants them to be clear, specific and FEW; SC wants them to be clear, specific, and EXPANSIVE

* + - 1. Primarily default event is failure to pay when due
         1. But other default events are more expansive:

Breach of warranty agreement

**Warranties** are statements about the current condition of the D’s business (aka “the debtor warrants that it has no other debts outstanding beyond those listed in Schedule A … is solvent and has not filed petition for BK … Board of Directors has properly given authorization for this transaction, etc.”)

If the D breaches a warranty (ie. false when originally stated), bad for D

Breach of covenant

**Covenants** are forward-looking promises

Debtor agrees not to incur any additional debt w/o SC’s consent, agrees not to change the major focus of the business, etc.

Debtor dies

Debtor becomes insolvent

Collateral is destroyed

It is an event of default if the SC, in good faith, believes that the prospect of payment is impaired or believes the collateral is insecure

**It can be an event of default even if nothing has happened that is an active failure on the part of the debtor**

🡪 this is a much broader event

* + - * 1. No matter what the actual events of default look like in the agreement, most SCs will seek remedies only when the default in question relates to **payment** (as long as SC is receiving on time all scheduled payments, less likely to seize on some other default event)

The important Q for debtors is WHEN is payment due

* + - 1. Examples of payment structure
    1. **Installment loans** and **acceleration**
       1. Trickiest payment structures
       2. If a payment is due every month, if you miss one it is an event of default (but only default as to that particular month/payment)
          1. Ie. if D defaults in Jan., then the odds of defaulting in Feb. are high, so SC will not want to wait and see. To go after the D right away, SC will want to accelerate (write into the agreement that SC can accelerate future monthly payments/balance of the loan if debtor misses one payment)
          2. **Acceleration is a contractual right that SC does NOT get automatically**

SC can accelerate the “indebtedness herein described AND all other debts owed by this debtor to the SC”

This is called a so-called cross-default provision

If a D defaults under ANY of the agreements, SC can accelerate ALL of them

But right to accelerate has to be in the K

* + - 1. Limits to enforceability of acceleration clauses
         1. They can be harsh on borrowers b/c a little non-payment related default could trigger acceleration, cross-default and other indebtedness

Courts have kind of softened this effect on the D by using the doctrine of **waiver**

* + - * 1. **Waiver**

Ie. the Bank had a right to accelerate but accepted late payments for 4 months in a row, which shows lack of intent to accelerate

Court also use estoppel to mitigate the harshness

Courts are especially likely to use these in the consumer context

* + - * 1. \*Waiver, estoppel and modification: draw on 1st year contract doctrines
    1. Just having the power to exercise certain remedies gives SC a negotiating position with respect to their borrowers
       1. SC may not want to exercise the remedies; may just want to use them as leverage to get more collateral from debtors, etc.
       2. In cases where it is really clear that D is heading to BK, SCs will cut their losses and accelerate everything (do what they have to do)
    2. How a debtor can **cure default**
       1. D can only cure default by paying arrearages BEFORE acceleration is declared
          1. **Once SC has declared intention to accelerate, D can only cure by paying whole amount then accelerated**

This while amount often includes attorneys’ fees that the SC has incurred in starting the foreclosure proceedings

* + 1. Consensual reinstatement
    2. Statutory Reinstatement
       1. Some states have said that in particular contexts, even after acceleration, statutes give borrower a certain period of time where, if it can scrape together the arrearages plus costs/expenses, it can reinstate the loan agreement on its original terms
       2. \*Protection for debtors (usually consumer debtors)
    3. **Prob. 13.1**
       1. Facts: Pat misses two payments on her auto loan
          1. Contract says “missing two payments is a default …” with acceleration clause
          2. Pat sent a check for the overdue payments and bank sent check back, saying it has accelerated the loan

Pat wants to know if bank can do this

* + - 1. Analysis:
         1. If would be a question of whether the bank declared or not [didn’t have to give notice to Pat]

The bank has to declare the full loan amount due and payable (per the K), but we don’t know if they did this before they got her check

If the bank got the check before they declared this, then Pat cured the default

* + - * 1. If bank had exercised its right to accelerate before Pat sent in her checks, Pat is out of luck (she would have to pay the whole amount due to avoid default)
      1. CB references that some courts require notification to the D re: acceleration even if the K doesn’t call for it
         1. PROF: this is NOT the maj. rule. **The maj. rule is only to require actual notification to the D if the instrument calls for it.**
    1. **Prob. 13.4**
       1. Issue: what if the SC had accepted check for 2 back payments and then still accelerated the rest of the balance [ie. can bank keep Pat’s payment of the arrearages AND accelerate?]
       2. Analysis:
          1. SC would argue that these checks were just payments towards her owing of the full amount
          2. Pat could argue that the bank waived the right to accelerate when they accepted her payment of the arrearages

PROF: on the facts, this does NOT look like a waiver

SC is retaining the check and accelerating at the same time—a waiver is the intentional relinquishment of the right, so it is hard to see how they are doing this while they are saying expressly that they are accelerating

* + - 1. In practice, many banks won’t accept payment on loans that are in default (other than a total payment) so they can avoid this type of argument
         1. If they take a monthly check, D may argue that bank waived right to claim payment in full
         2. Even if bank accepted a check that said it was in “partial satisfaction of debt,” it may not alter the rules on the rights of the debtor, so banks are careful
      2. If bank says that notice of acceleration was in the mail to Pay when they got and cashed the check from Pat, bank should still be able to keep the check and accelerate
         1. If Pat received the notice of acceleration and then the bank got the check … keeping the check STILL doesn’t interfere with the acceleration?
      3. **§ 9-623**: Right to Redeem
         1. (b) to redeem collateral (ie. if Pat wants her truck back), has to tender all obligations secured by the collateral plus expenses (whole accelerated amount)
         2. **Comment 2**: if the entire balance of a secured obligation has been accelerated, the entire balance has to be paid to get the collateral back
    1. **NOTE:** Time value of money
       1. A lot of loan agreements will allow prepayment
          1. Ie. ten year loan with interest payments. If debtor chooses to pre-pay and pay the entire principal amount 2 years into the loan term, he won’t owe anything additional (won’t charge debtor with expectancy payments of the additional 8 years interest)
    2. **Prob. 13.2**
       1. Facts: X missed a mortgage payment.
          1. Default provision: an event of default is debtor misses more than one whole payment
       2. Issue: X wants to know how much longer until he is in default
       3. Analysis: X is NOT in default today
          1. Won’t be in default until Nov. 12

He needs to have more than one whole payment outstanding & needs to have been unpaid for more than ten days

This is helpful b/c X gets two months before default

* + - * 1. Being in default in and of itself is not a big problem for X.

The problem is if the bank accelerates. Until acceleration, X can just cure by paying the arrearages.

The issue comes if bank accelerates, b/c then X would have to pay the entire balance of the loan plus fees/expenses that the bank incurred in initiating the foreclosure case [attorney fees can be extensive]

Even if X has a statutory right to redeem, he is going to be paying a lot of money

The statutory right is helpful to debtors, but it is not free

* + - * 1. But X can always remain one payment behind
      1. Can bank accelerate even though D is not in default until Nov. 12?
    1. **Prob. 13.3**
       1. Facts: Client is thinking of pulling the plug on a customer who owes $600k on an inventory loan. Note is payable on demand. If client forecloses, it will take a $200k loss on its loan and wants to know what to do.
       2. Analysis:
          1. Do NOT give a notice of acceleration—from the creditor’s POV, we don’t want the D to sell the inventory and not apply the proceeds of the sales to your loan, abscond with or dissipate the collateral, etc.
          2. If you know your client is going to take a loss anyway, the incentive it to NOT give notice. Pull the plug in the fastest and safest way for your client.
       3. This difficulty is that this can put Ds in a horrible position. If the creditor calls a note or accelerates a loan, it deprives them of capital they need to operate. May not be able to find funds elsewhere. Even if D is teetering, may push them into BK
          1. Think about this balance of power b/w borrowers and lenders

Do lenders owe good faith/fair dealing? Should borrowers have protection b/w arbitrary/overly cautious action on behalf of lenders?

Lender liability actions

* + 1. **Prob. 13.5**
       1. Facts:
          1. **Lender liability**

***Kham & Nate’s Shoes*** (Easterbrook Circuit Ct. decision)—says that whatever rights a SC has negotiated for itself in a loan agreement should be fully enforceable. The D should not be able to enjoy some amorphous protection of good faith/fair dealing

* + - * 1. Loan agreement extends $300k line of credit. Requires the D, at closing, to pull down $42k from the $300k secured loan to pay off an unsecured loan it had previously taken out from the bank. To ensure that the $42k can’t be set aside as a preferential transaction, SC takes other precautions. Agreement says that the bank may at any time demand payment and terminate the line of credit. 5 minutes after the closing is completed (after D took $42k to pay off the unsecured loan, but BEFORE D took the additional funds), the bank called the loan and refused to advance any more funds.

This straps the borrower for funding and puts it on the track for BK

* + - 1. Analysis
         1. Under ***Kham & Nate’s Shoes*** analysis—as written, bank has a right to do all of this, b/c this is what the agreement says (NO added good faith requirement)

PROF: BUT this can’t be right—these provisions on these facts would not be enforced this way against the debtor b/c goes too far and bank had exploited this line of credit to get back the money it was owed on an unsecured basis on a previous loan (this doesn’t feel like commercially reasonable practices/good faith)

Courts can offset unreasonable behavior on behalf of the lenders

* + - * 1. Why would a borrower sign a K like this?

PROF: would like to think that no one would in THIS fact pattern

BUT a borrower may sign a demand note [ie. agree that lender can demand repayment at any moment] b/c they need the money to run their business (the lender has the bargaining leverage)

Lots of borrowers do this – 1/3 of commercial business borrowing is done on demand basis

ALSO, borrowers don’t expect the lenders to enforce these demand rights to the letter (they expect commercially reasonable treatment from their lenders)

This is why businesses like to work with local banks/loan officers

* + - 1. Lender liability is still a live issue across jurisdictions
         1. Some states have developed a more lender friendly approach [Easterbrook—all you have to do is what is in your K], while others rely on basic reasonableness values
         2. UCC **§ 1-304**

Offers more protection to borrowers

“Honesty in fact”

“We as the lender, are pursuing our rights under the K to protect rights of our own – NOT to push this D into BK”

This is a low threshold

“Reasonableness in dealing”

A higher bar

* + 1. **Prob. 13.6**
       1. Facts: client (creditor) wants to call the loan b/c the D has failed to provide the required proof of insurance for 2 years. D hasn’t missed any payments. Client says that he really wants to recall the loan b/c HE is short on cash.
       2. Issue: Can client call the loan? [ie. is the D in default?]
       3. Analysis:
          1. If D does have insurance but hasn’t provided proof, D would STILL be in default
          2. D could argue waiver b/c client hasn’t previously acted on this provision

But there is an **“anti-waiver” provision** in his agreement that says that even if the creditor waives proof one month, he doesn’t waive the right to require it another month

* + - * 1. Good Faith obligations under the UCC

**§ 1-309**

“A term providing that one party may accelerate payment at will or when that party deems itself insecure or words of similar import means that the party only has power to do so if it in **good faith** believes that the possibility of payment is impaired.”

This means that the lender can’t accelerate if it doesn’t have a good faith belief that the payment is impaired

Here, our client is NOT accelerating on the basis of an “at will clause” OR an insecurity clause. He is accelerating based on a default (breach of a promise)

**§ 1-309 does not apply to acceleration based on default (ie. broken promise)**

**§ 1-304**: General duty of good faith

Every K or duty within the UCC imposes an obligation of good faith in performance or enforcement

BUT courts will generally say that if a lender is exercising rights that have been granted to it under the K, this is not a good faith problem

There has clearly been a default here, so the lender has a right to accelerate and demand payment

* + - * 1. If client calls the loan, the borrower will complain b/c borrower is current on his payments & this is a trivial default b/c he does have insurance even though he didn’t send the proper proof. What if the borrower threatens to sue client of breach of good faith?

Borrower can NOT use absence of good faith as a cause of action against the lender

**§ 1-304 comment 1**: this section doesn’t create a separate duty of fairness and reasonableness which can be independently breached [can’t use good faith as a sword—it is more intended to be used as a shield if lender is trying to do something that borrower is trying to kill]

BUT if this goes to a jury, the jury will likely side with the borrower b/c this lender behavior is harsh

* + - * 1. PROF: tell client that it **CAN** call the loan, but ask if there is any other way to find some money b/c this is not a good idea

1. The Prototypical Secured Transaction
   1. Generally
      1. This is an example of Inventory Lending
         1. Borrower needs financing in order to buy inventory that it is then going to sell to end customers
         2. Ex: local car dealer is not going to have cash on hand to go buy 150 cars to put on its lot
            1. This is different than mortgage lending, etc.
      2. Bonnie goes to the bank to get a loan to buy boats. Bank gets a SI in the boats.
   2. Transactions
      1. (1) Floor plan agreement b/w lender (Deutsche Fin.) and Shoreline Boat Co. (manufacturer of boats, NOT borrower)
         1. For Shoreline, this makes its boats more attractive to dealers b/c gives dealers the opportunity to finance 100% of the acquisition of those boats [this is why Shoreline wants to enter into a floor plan agreement]
         2. For the lender, this agreement says that if any boats sold to Bonne (debtor) have to be repossessed, Shoreline will buy the boats back from the lender at 100% of the invoice price (so bank doesn’t have to mess around with the collateral upon foreclosure)
      2. (2) Bonnie’s (debtor) security agreement with Deutsche (lender)
         1. Boats as collateral
         2. Security agreement, statement of transaction, financing statement
         3. \*Bonnie borrows from Deutsche, but Deutsche advances the money to Shoreline
      3. (3) Shoreline sells boats to Bonnie
         1. Bonnie tells lender how many boats she ordered from Shoreline and the lender makes the payments directly to Shoreline
      4. (4) Bonnie then sells boats to retail customers
         1. Customer pays for boat (will want to finance it)
            1. Goes to First State Bank, who said that it would provide financing for all of Bonnie’s customers’ purchases

The bank pays the money straight to Bonnie (purchase price left after down payment)

The retain customer is borrowing from First State Bank, but bank will advance the money to Bonnie

* + 1. (5) Bonnie will then be sitting on the retail price for the boat. She will then need to pay back Deutsche.
       1. What if Bonnie doesn’t pay Deutsche like she is supposed to? Potential conflict of security interests?
  1. Deutsche needs to know that their boats/collateral are still in Bonnie’s boatyard
     1. If anything is going wrong with the boats and Bonnie is not remitting proceeds, then the collateral shrinks and shrinks until Deutsche could be left with nothing
  2. **Prob. 15.1**
     1. Floor checking procedures for a loan that is secured by oil in tanks
        1. Field warehousing refers to the situation where the D is in possession of the collateral, but the SC has the right to stop by and check the collateral at any time
        2. Process: the floor checker arrives unannounced, climbs the tank, puts the pole in the oil to test its depth, tastes the oil and then moves on to the next tank
     2. This problem is based on a real case of fraud
        1. D had tanks of oil as collateral. D floated a thin layer of oil on top of water AND had an underground pumping system that would move the oil ahead of the checker.
     3. The problem for the SC is that if the collateral disappear and the SC is not paid the proceeds, the SC has a valueless SI
  3. **Prob. 15.2**
     1. Facts: Ford dealer in IL who is defrauding 5 banks that provided him with inventor financing.
        1. Dealer double collateralized the vehicles—used the cars as collateral on two or more floor plan loans
     2. Issue: how should the banks have caught this?
     3. Analysis: the 1st time a certificate of title will be issued is when a customer buys the car [SO no cert. of title when held as inventory]
        1. Lenders who wish to take a SI in inventory should be filing public notice of that interest in the form of a financing interest. So before lending against inventory, lender should check the records and make sure that no one else is lending against that inventory.
           1. PROF: bank should then call the other lenders to check which cars are still free to be lent against (cross check the list)
        2. When floor checkers came out with a list and realized that cars were missing, the dealer told the checkers that the missing vehicles were out on test drives or were out on loan to a customer whose vehicle was being serviced [even though dealer had really already sold them and hadn’t remitted the proceeds]
           1. PROF: checker should make dealer call them back in or wait until they come back; go vehicle by vehicle [find them immediately or repeat the entire floor check]
        3. Dealer told customers to bring their cars in for servicing and took off their license plats, so when the checker came in they looked like they were unsold
           1. PROF: checker should check VIN number on his own schedule, notice signs of use
        4. Dealer would make up a customer with fake purchase order, falsify the sales contracts and financial contracts. This is wholesale, document-based fraud.
           1. PROF: have to know something about the real/fictitious customer – aka know your borrower

It makes this situation hard for the bank b/c only the D deals with the retail customer

* + 1. General SI would cover the whole pool of cars in inventory, but dealer would have to send a notice of transaction to the lender re: that specific car that it wanted to buy (so lender would eventually have a list of the cars that had specifically been financed)
  1. **Prob. 15.3**
     1. Why do lenders insist in personal guarantees when they make business loans to certain companies?
        1. When most judgments on personal guarantees are uncollectible b/c of BK
           1. If an individual owns a small biz that is in trouble such that it can’t repay its loans and lender is going after personal guarantor, likely that the owner/guarantor is in financial difficult as well

Owner who plows his own personal wealth into a small biz that he is going to try to get up and running (doesn’t mean that the owner is more financially secure)

BUT although many judgments on personal guarantees may be uncollectible, not ALL of them are

Some guarantors may be independently wealthy

* + - 1. Even if a judgment is not collectible, guarantee can still be useful for behavior-shaping
         1. If borrower gives a personal guarantee, the guarantor will act more efficiently/responsibly to the lender while the biz is going under

Intermediate phase: borrower will pay the lenders that have a personal guarantee first

* + 1. Archer (lender) insists on personal guarantees from owners of private businesses that are being financed
  1. **Prob. 15.4**
     1. Facts: Borrower has sold 5 boats and not remitted the proceeds to the SC (as she is supposed to do under the security agreement). The lender has said that the borrower is in default and has demanded the boats in her inventory.
        1. The SC has the right to the boats under the **contract** AND under the **UCC** b/c of the provision that says that once borrower is in default, SC has a right to possession of the collateral subject to the SC
     2. Issue #1: Borrower wants to know what will happen to her if she lets the lender have the boats.
        1. Analysis: Borrower will be in trouble for the 5 boats that she is out of trust for.
     3. Issue #2: Deficiencies on the remaining boats left in inventory?
        1. Analysis: if lender takes borrower’s current boat inventory and sells them the lender will NOT hit borrower with a deficiency judgment b/c the lender will not be out any money b/c Shoreline will buy the boats back at invoice price.
        2. Once her inventory is gone, borrower has nothing to work with
     4. Lender could report borrower for fraud
        1. IL statute makes it a criminal act for the borrower to do what she did (ie. sell the boats and not remit the proceeds to the lender)
     5. What advice should you give the **borrower** here?
        1. Lender has a right to the boats. Could borrower stall on this and prevent Deutsche from taking the 35 boats away tomorrow?
           1. Borrower could hang out in her boatyard and makes a scene/breach of the peace when the lender tries to take the boats back

Borrower could also file for BK and auto stay would then be in effect and lender would not be able to take the boats

If she threatened BK, borrower could use it to negotiate with the lender (ie. she will hand over the 35 remaining boats w/ no resistance and no BK IF lender agrees not to pursue prosecution under the statute and lender agrees not to pursue for a deficiency for the 5 boats that are out of trust)

Aka threaten lender that borrower can make it easy or hard for them

* + - * 1. Borrower is worried that lender will take all of her inventory AND go to the prosecutor’s office to have her in violation of the statute --- borrower doesn’t want either of these things to happen
    1. The legal rights of the SC upon default often become point of negotiation rather than the clear outcome in the case of default
       1. More common to see strategic re-negotiation between the parties around issues
  1. **Prob. 15.5**
     1. What interest rate paid on outstanding balance?
        1. Go through the docs and try to decipher what are the exact business terms (standard/default interest rates, etc.)
  2. NOTE: Agreement reading problems
     1. Bonnie WOULD violate her agreement is she allowed a customer to take a demo ride without permission (her agreement is very restrictive re: her use of the boats b/c bank doesn’t want the collateral to depreciate)

**The Creditor-Third Party Relationship**

NOTE: there is a ton of detail re: UCC filing system. Know enough about the system to know how it works and what some of the major questions are re: proper perfection of SC [but attorneys don’t need to get too far in the weeds—paralegals deal with the details]

1. Perfection
   1. The Personal Property Filing Systems
      1. **Priority**: Basic Idea
         1. If you have it, it is the right to be paid in full before others are entitled to payment at all (1st priority takes all system)
            1. Example:

1st and 2nd SC

If there is a default and SC wants collateral, all the value of the collateral will go to SC #1 if the value doesn’t even hit the amount of the unpaid obligation under the 1st unpaid lien

* + - 1. This system rejects other rules, like:
         1. Pro-rata distribution

Like with unsecureds, BK

* + - * 1. Equitable distribution

Look at the type of claim (ie. 1st SC is a consumer loan and 2nd interest is a lien arising out of unpaid child support—as a matter of equities, would want to see the child support paid first)

* + 1. **Who** Gets Priority?
       1. General Rule: the 1st person to perfect his lien has priority over everyone else
          1. Perfection v. Attachment

**Attachment** = SI becomes enforceable against debtor

**Perfection** = SI gets priority as against 3rd parties [giving public notice of the claim by a proper method]

\*Move from considering the rights of the SC with respect to just the D to rights of the SC against other people

* + 1. Rationale
       1. Later lenders will know of the 1st lender and adjust
    2. **How** Do You Perfect?
       1. Give public notice that you have a claim to that collateral
       2. Methods:
          1. **(1) Filing**

This is by far the most important method

Public filing systems available so SC can post a notice that it has taken a SI in this particular collateral

* + - * 1. **(2) Possession**

This gives subsequent notice to later lenders if the later lenders ask questions about the location of the collateral 🡪 if a later lender attempts to use car as collateral for a SI, he will ask to see the car. Lender #2 will go to SC #1 and ask why it is in his possession. That SC will inform lender #2 of the SI and lender #2 will not lend the money.

**(a)** Can also perfect by posting notice on the collateral (ie. metal plate screwed on car saying “this serves as collateral for an SI b/w borrower and lender”)

* + - * 1. **(3) Control**

Bank accounts—can in essence give SC control over your bank account, which means that they have also perfected its interest in it

* + - * 1. \*Perfection works no matter which method is chosen (whoever is first wins)
    1. UCC Filing System & Overlapping Filing Systems
       1. Can be though of as message banks
          1. SC #1 will leave a message in the system that is intended to be found and read by any subsequent lenders interested in that collateral

But this won’t work if the message is left in the wrong place

If SC #1 fails to leave the message in the right place, the perfection fails

Also doesn’t work if lender #2 looks in the wrong place

\*If you do it wrong, you don’t have priority

* + - 1. UCC Art. 9 Filing System is the major one
         1. Almost every state also has one that is maintained by the Sec. of State
         2. For cars, there are certificate of title systems that are maintained by the BMV
         3. Most states have separate systems for boats, tax liens, different types of collateral, etc.
         4. Federal government has filing systems for copyrights, patents, aircraft, rail and rolling stock

Particularly mobile collateral have a federal system b/c they move across states frequently

* + - * 1. System is being developed for space satellites and other similar collateral
      1. Basic message: leave your message in the right place. If you don’t, your interest isn’t perfected.
    1. **Prob. 16.1**
       1. Facts: Debtor has a car worth $30k as his only asset. Our client, F, is owed $30k for alimony and child support from D. 3rd party, B is owed $36k for money loaned to D.
          1. F has obtained a judgment on the debt that D owes F
       2. Issue #1: Where does F stand?
          1. Analysis:

Look to state law to determine F’s status

She is unsecured/subordinate b/c she doesn’t have a writ of execution to levy on the car (not yet perfected; she is not a lien creditor yet b/c has not levied)

For **judgment liens**, it is the levy that creates the lien AND perfects it [this is under state law, NOT UCC]

She will not be able to use the value of the car to satisfy the judgment [?]

* + - 1. Issue #2: Where does B stand?
         1. Analysis:

Per Uniform Certificate of Titles Act, have to deliver to the BMV the existing certificate of title, the required fee, etc., **THEN** the BMV will note the lienholder on the certificate of title and the lien will be perfected.

This Act is where we look for B’s status

Bernie IS perfected (his $36k lien on the car)

* + - 1. Issue #3: Could the sheriff be instructed to seize the car anyway and force it to be sold?
         1. Tough question—technically, F has the writ of execution and Sheriff is standing there

But what good would it do her—the car is only worth $30k and Bernie has a right to be paid in full first (F won’t see a dime out of the sale of this car)

Knowing this, F would have to worry about whether this would be seen as a conversion of Bernie’s interest

* + - 1. Concern re: the creation of Bernie’s SI?
         1. D didn’t borrow the money on a secured basis initially—the SI in the car was created 3 months ago. This looks like there are two unsecured debts ($36k to B based on their business together and $30k to F for alimony – BOTH unsecured)

This looks like D was preserving the only value that he had for his business partner rather than leaving it available for his ex-wife

Can D do this? Ie. grant SI for obligations already incurred in the past?

**YES- a SI can secure PAST lending under the UCC**

An unsecured creditor can be converted into a SC after the fact, and sometimes there are reasons to do this (ie. D who wants to borrow more)

But here you could worry that D was trying to screw over his ex-wife

Is this illegal?

What if D had just sold the car? He would now have $30k in cash and he could give to either F or B (L’s actions here would essentially do the same thing)

* + - 1. NOTE: Perfection doesn’t affect the possibility that the D will illegitimately dispose of the collateral before perfected SC gets his hands on it.
      2. 🡪 Look to **§ 9-317** to determine who wins [competition b/w a lien creditor and a secured creditor]
         1. **A SI is only subordinate to the rights of a person that becomes a lien creditor BEFORE the SI is perfected**

If F had levied and therefore become a lien creditor before B’s interest had perfected, B’s interest would be subordinate to F’s [but this didn’t happen]

* + - * 1. F gets NOTHING due to priority
    1. **§ 9-311**
       1. **(b)**: if you comply with the requirements of a different statute in order to perfect your interest, that compliance is equivalent to the filing of a financing statement under Art. 9
          1. This means that we can refer to Cert. of Title statute, and it is requirements were filed, perfection is effective
    2. **Prob. 16.2**
       1. Issue: If you buy an $8k used set of books from someone, is there anything you should do before buying them?
       2. Analysis: Search the UCC filing system to see whether a fin statement has been filed in the name of this D reflecting a SI in this particular collateral
          1. Shouldn’t be different if you on e-Bay

To avoid the risk of being subjected to an unexpected repossession

* + - 1. Reality: people don’t so this
         1. Maybe if you buy a $250k used piece of equipment, people may search – but most people don’t know to search and are thus taking the risk
    1. **Prob. 16.3**
       1. Inequities of the above facts
       2. Facts: S buys a street vendor cart and later gets a note that the previous owner of the cart has filed for BK and a bank is demanding possession of the cart.
          1. A filing statement HAD been properly filed in the filing system (b/w the bank and the BK debtor, using cart as collateral)
       3. Issue: does S have any protection against this bank asserting its SI?
          1. NO- he bought this cart subject to the preexisting SI

S is NOT a creditor, he is a 3rd party purchaser of the collateral

Once the seller/debtor defaulted, the bank had the right to repossess S’s cart and sell it

* + - 1. Analysis #1:
         1. S should have searched against the seller/debtor’s name to see if it had used the cart as collateral in a previous transaction
         2. S would argue that he didn’t know about the existence of the filing system

Maybe he could make a fraud/equity argument here

**§ 1-103(b)**: general principles of law and equity apply unless they are displaced by the UCC

Good faith requirement of the UCC

Can S make a bad faith argument?

If debtor/seller acted in bad faith, this doesn’t help S b/c the contest is with the bank

Would NOT be able to make a bad faith argument against the bank—the bank is just doing what the UCC allows them to do

* + - 1. Analysis #2:
         1. Assume now that the bank has repossessed 3 vending carts in the past 12 months, each time from a defrauded buyer like S

Argue that the bank should have realized that the way they are taking SIs is not adequately protecting third party buyers (should put a SI plaque on the carts?)

But a bad faith argument against bank would be a stretch even on these facts

Practice of fraud in this cart sector that the bank has become aware of that puts a heightened duty on them to be aware of it? Tough argument to make.

* + - 1. Art. 9 can work really harsh against people who don’t know about it
         1. PROF: why do we put up with his? Esp. as against less sophisticated parties?

This is what we give up to get certainty and predictability in commercial transactions generally?

Small fry getting lost in the shuffle is the price we pay to have a low transaction cost system

* + - 1. Advise S to use state’s SoS UCC search to look for previous fin statements on the cart
    1. **Prob. 16.4**
       1. Issue: classify collateral and determine which filing system you would use for that particular type of collateral
       2. (a) Collateral = tools that are used in a service station that the debtor operates [in the context of an ordinary consumer loan]
          1. This is equipment per **§ 9-102(a)(33)**

To perfect an SI in equipment, use the UCC filing system [**§ 9-310**- general filing requirement]

“financing statement must be filed to perfect all SIs”

**§ 9-501(a)**: general filing requirement that says “that except as otherwise provided, if the local law of this state governs perfection, the office in which to file a fin. statement is …”

States shall designate the filing office where the brackets appear in the rule – every state adopting Art. 9 gets to choose the home of its ONE UCC filing system (look to SoS website)

* + - 1. (b) Collateral = patent
         1. Patents are general intangibles-- use UCC filing system

Patent Act only applies to transfers in ownership, so does NOT preempt the UCC in SIs

General intangibles are covered by Art. 9-- the Q is then whether you file to perfect a SI in patents under the UCC filing system OR some other system

**Analogy to a car** [which is personal property covered by the UCC]: BUT to perfect a SI in a car, don’t file a UCC-1 fin statement (use a different statute instead)

* + - * 1. **NOTE: Preemption** 🡪 **§ 9-311**: Perfection of SI

Art. 9 does apply to general intangibles, but if you are looking at WHERE to perfect, the filing of a fin statement is not necessary or effective to perfect an SI in property subject to a statute, etc., whose requirements re: priority preempt the UCC.

Perfection/Filing Requirements may trump the UCC—this doesn’t mean that these objects are completely carved out of the UCC **(Art. 9 applies to ALL personal property)**

* + - * 1. Patents are NOT subject to a different statute that preempts Art. 9 re: requirements for perfection

Patent Act does NOT preempt Art. 9 for SIs in patents

BUT how could the Patent Act/other statute preempt Art. 9?

Supremacy Clause: if a federal statute that occupies a certain field is inconsistent with a state law, it preempts the state law (UCC is state law)

* + - 1. (c) Royalties from books
         1. File in the federal copyright system

***National Peregrine Inc.***- Copyright Act does deal with SIs in copyrights

but there are other cases that come to a different result

Assignment = the outright sale of royalties

If there is a close question, file and search in both

* + - 1. (d) Inventory of automobiles and some autos that are not for sale
         1. (i) Inventory 🡪 file in UCC filing system

Look to definition of inventory in UCC (goods held for sale by dealer)

W/ inventory, perfect a SI by filing in normal UCC-1 filing system

But the problem is that these are cars

**§ 9-311**: filing an ordinary fin statement is not effective if the goods are subject to a statute of the USA …

Can stop, though, b/c the Uniform Cert. of Title Act is NOT federal law (it is state law)

BUT **§ 9-311** **Sec. 2** says that filing an ordinary fin statement is not effective to perfect a SI in a car b/c cars are covered by a statute that required perfection to be noted on the certificate of title

**🡪 § 9-311(d)**: during any period in which that collateral (cars) is inventory, you’re back in the UCC (aka DON’T note lien on certificate of title—file an ordinary fin statement in UCC system)

A certificate of title isn’t even issued until it is sold to the buyer

* + - * 1. (ii) Cars that aren’t for sale, but owned by dealer

Use Certificate of Title Filing system

The problem is how to distinguish an inventory car from a non-inventory car?

Problem would be compounded for used cars

* + - 1. (e) A/Rs from the sale of autos
         1. file in UCC system
      2. (f) Dealer’s rights to trademark
         1. This is a general intangible-- file in UCC system
         2. ***Peregrine*** case distinguishing trademarks
    1. **Prob. 16.5**
       1. Issue: do you file or search first?
       2. Analysis:
          1. If you search first, someone could file before you (ie. if you search today and get results that will speak up-to-date that is three days before your search request, worry about this gap)
          2. This sounds like we are inviting people to file fin statements before they have even loaned money/taken a SI in the collateral

But SC DOES need the authorization of the D to file a fin statement

But SC can get this authority from D from a security agreement, and can get a security agreement before value is given. **SC can file a fin statement even though the SI hasn’t attached yet**.

**§ 9-502(d)**: fin statement may be filed before a security agreement is made or a SI otherwise attaches

* + - * 1. NOTE: priority between **secured** creditors depends on the first in time to file OR perfect.

If all you do is file a fin statement, you do NOT have a perfected SI. To have a **perfected** SI, you first have to have an **attached** SI (which requires value to have been given)

**Effect**: by filing, you reserve your place in line. If you then lend the actual money so your interest attaches, it will be perfected.

* + - 1. Answer: better to FILE first
         1. Put your own fin statement in, wait a couple of weeks, then do a search
         2. To know you have priority, you want the search to show your own fin statement with nothing here before it
    1. NOTE: Steps—
       1. What is my collateral (ie. **§ 9-102(a)**- definitions)
       2. What is the right place to perfect my SI?
       3. Once you know where to file, how do you file? [see (b) onward]
  1. Article 9 Financing Statements: The Debtor’s Name
     1. Standard for Accuracy of a Filing Statement
        1. **§ 9-506(a)**: a financing statement substantially satisfying the requirements of this part is effective, even if it has minor errors or omissions, unless the errors or omissions make the fin statement seriously misleading
           1. Adopts a rule of **substantial compliance** (NOT perfect compliance
        2. See blank fin. statement on CB p. 264
        3. Minor errors/omissions that would mislead 🡪 minor errors in the filer’s name (who cares), BUT an error on other categories might be much more significant
     2. Importance of DEBTOR NAME
        1. The exact accuracy of the debtor name is a particularly important piece of info in a fin statement b/c fin statements are indexed (and thus searchable) under the name of the D
           1. See **§ 9-506(b) default rule** that says that a fin statement that fails to sufficiently provide the name of the D in accordance with **§ 9-503(a)** is seriously misleading

Seriously misleading = ineffective fin statement (won’t perfect SI in collateral)

* + 1. **§ 9-503(a)** Requirements for Debtor Name
       1. Fin statement sufficiently provides the name of the debtor:
          1. (1) If the D is a registered org … have to use the name used on the public organic record most recently filed with that org’s jurisdiction or organization

**AKA** look to the Articles of Incorporation as filed with the SoS’s office in the state of incorporation to find the exact name

Have to use this exact name for the fin statement to be effective

A “registered corporation” is defined in **§ 9-102(a)(71)** & **official cmt to § 9-503**

Registered orgs are created by the filing of a public organic record

Sends you to definition of “public organic record”

**Cmt 2(a) to § 9-503**

Registered orgs ordinarily include corps, LLCs, statutory trusts, etc.

* + - * 1. (4) Individual debtor names [states can choose b/w alternatives A and B]

**Alt. A** – much stricter

If the D has a valid driver’s license, name you have to use is the name on the driver’s license

But many people have names that they don’t use on their licenses (ie. going by middle name or maiden name)

Individual name: any name that a person uses in a particular community for non-fraudulent purposes

People are often known by multiple names in the same community, individual names are hard to determine🡪 **THUS Alt. A** is more straightforward

If person doesn’t have a driver’s license, go with the individual name or surname and first name

But vast maj of people have valid driver’s licenses

Carve out bad faith debtors

\*Almost all states have chosen this b/c it is more commercially efficiency

**Alt. B**

Choice b/w 3 options:

Individual name of the debtor;

Surname and first personal name of debtor; or

Driver’s license name of the debtor

🡪 can use any of these 3 for fin statement to be effective

Why would a state choose one alternative over the other?

Alt. A is best for lenders when focusing in lenders & borrowers in a credit relationship [more straightforward]

Alt. A disadvantages some people:

Lien creditor (like F in F, L and B example) 🡪 someone who pursues judgment for tort damages and levies against assets.

But don’t want to levy against assets that are encumbered b/c can’t fully realize their value

**Alt. A only really works for consensual transactions**

Non-consensual parties may have a hard time getting this formal record than it would be to know the name by which that D normally goes in the community

Purchasers of collateral

Ie. if A wants to buy a tractor (encumbered collateral) from B, B would give A a copy of driver’s license so B can sell the tractor

ANY kind of lender has the leverage in the discussion to ask for info from the borrower (ie. if they know to ask for driver’s license, they can get it)

Trade-off b/w efficiency & predictability v. effects on unsophisticated participants in the world

Amendments re: Alt. A & B wre only made in 2010, so only a minority of states have adopted them

* + 1. **§ 9-506(c)** gives an exception to **§ 9-506(b)**
       1. If a search of the records of the filing office under the D’s correct name, using the filing office’s standard search logic, if any, would disclose a fin. statement that fails sufficiently to provide the names of the D in accordance with **§ 9-503(a)**, the name provided does not make the fin. statement seriously misleading.
          1. **AKA** if the search under a correct name would turn up the fin statement under the incorrect name, it is effective b/c it wouldn’t mislead anyone
  1. Article 9 Financing Statements: Other Information
     1. SEE CHART A attached
     2. **Type of UCC-1 Fin. Statement Info**
        1. Required
           1. **§ 9-502(a)** [absolute basic info that HAS to be there]

To be effective, fin. statement must include:

Name of the debtor;

Name of the SC;

An indication of the collateral covered

* + - 1. Other
         1. **§ 9-516(b)**

Mailing address of the SC **(b)(4)**

Mailing address of the debtor **(b)(5)(A)**

Indication of whether the debtor is an individual or a corporation **(b)(5)(B)**

* + - 1. \*The consequence of missing/erroneous info depends on which category the info falls into (required or other)
    1. If certain info is missing from either category:
       1. Filing officer has a duty to **reject** the filing statement per **§ 9-520(a)**
          1. But can reject only on the basis of the reasons in **§ 9-516** (not based on paper color, etc.)
    2. **(A) If filing officer doesn’t notice missing info/blank in the form and wrongly accepts/files it anyway:**
       1. If fin. statement is missing into from the required category [**§ 9-502(a)**]:
          1. (NOTE: Debtor name sill never be missing)
          2. It is NOT effective

**§ 9-520(c)** – filed fin. statement satisfying **§ 9-502(a)** is effective even if filing officer is required to refuse to accept it 🡪 Implication is that if it doesn’t satisfy **§ 9-502(a)**, it is NOT effective.

* + - 1. If fin. statement is missing info from the “other” category:
         1. It IS fully effective [**§ 9-520(c) cmt. 3**]

Filed fin. statement satisfying **§ 9-502(a)** is effective even if filing officer is required to refuse to accept it

* + - * 1. Why?

If you are a subsequent searcher, the debtor’s name will be there- it will pull up the name of the SC and the indication of the collateral. This is enough to indicate to the searcher that further inquiry is wise. Notice function of fin. statement will have been fully served.

* + 1. **(B) If information is present but wrongly rejected:**
       1. Filing officer is not supposed to do a substantive review of the accuracy of the document before it decides to accept [**§ 9-520**]
          1. **§ 9-516** inquiry is whether the info is THERE, not whether it is correct [prohibited from considering the accuracy]
       2. The wrongfully rejected fin. statement that you tried to file IS effective even though it is not searchable in the database (with one limitation) [applies to both categories of info]
          1. **§ 9-516(d)**- record that is communicated but is wrongfully rejected but is effective as a filed record except as against …

BUT there is a limitation—effective except against a **purchaser** of the collateral who gives value in reliance upon absence of the record

Definition of purchaser: purchaser means taking by … SI ... or any other voluntary transaction creating an interest in property [doesn’t mean just “to buy” – it includes lending against the collateral]

Ie. “I lent on this collateral/bought this collateral in reliance on the absent record”

Subsequent lenders fall within this limitation to the effectiveness (they are “purchasers” who have given value under the UCC)

**Judicial lienholders are not protected by this § b/c they don’t “give value”**

Thus, this fin. statement would be effective as against judgment lienholders

The idea is that these type of people don’t search the filing system

* + 1. **(C) If information is incorrect, but filing is accepted:**
       1. **🡪** This is by far the most common [ie. info is there, but wrong]
       2. If the debtor name is wrong, you’re in trouble (fin. statement is prob. ineffective)
          1. Exception: debtor name can be wrong and still be effective if the search logic of the system would have disclosed the mistaken name with a search of the correct name [**§ 9-506(c)**]
       3. REQUIRED INFO
          1. **§ 9-506(a) standard/test** re: notice to subsequent searcher [“seriously misleading”]

Mistake in SC’s name – effective b/c not seriously misleading [b/c you don’t search by the SC’s name]

Mistake in indication of collateral can be more misleading – but effective unless misleading

See case in CB

* + - 1. OTHER INFO
         1. **§ 9-520(c)** – a filed fin statement satisfying **§ 9-502(a)** is effective, but if **§ 9-516(b)(5)** info is in there but wrong, **§ 9-338** applies [limited effectiveness idea]

**§ 9-338** – SI would be subordinate to a conflicting, perfected interest in the collateral *where value was given in reliance on the mistaken info*. A purchaser who buys in reliance upon the incorrect info is also protected [ie. it is effective, but won’t give your SI priority over other fin. statements that don’t have mistakes]

Does not say anything about info contained in **§ 9-516(b)(4)**

Lender may rely on address

* + 1. **Prob. 18.1**
       1. Issue: You don’t have the debtor’s mailing address
          1. Are you better off leaving it blank or filling it in with address of the vacant lot next to your office?
       2. Analysis:
          1. If you left this portion completely blank, the likely result is that the filing officer would REJECT the fin. statement (would have to reject it) and it would be INEFFECTIVE

If you leave it blank and the filing officer doesn’t notice (and mistakenly accepts the record), it is effective per **§ 9-520(c)**. 🡪 PROF: this is the best possible outcome, but it is not what is supposed to happen

* + - * 1. If you fill in a random address and the filing officer rejects it b/c the address is not recognized by the postal office, this is a wrongful rejected b/c the officer is not supposed to investigate the substance

The filing will be EFFECTIVE, but will give priority only over lien creditors, not over a buyer or SC who gives value in reliance on the absence of a record

This is the risk if you leave it as a wrongly rejected filing

If your filing is rejected, you should correct it and resubmit so the fin statement will be effective against everyone

In this intervening period, you are good against lien creditors, so gives limited effectiveness

* + - * 1. If you put the random address in and the filing officer does what it is supposed to and accepts it:

Fin. statement that is out there (but wrong) is EFFECTIVE but doesn’t establish priority over a subsequent lender who relies on the incorrect info in the filing when it lends

Someone might lend to a debtor in reliance on its address, that it may not otherwise have lent—if there is a creditworthy Bob Smith at Address A and a very non-creditworthy Bob Smith at Address B

PROF: 99/100, no one is going to lend in reliance on that particular piece of misinformation

But would want to go back and fix it by inserting the correct info so there is no chance that someone will subsequently lend in reliance

* + - 1. Ethical issues with putting false info into the statement?
         1. PROF: it is not being done with an intention to mislead anyone

If you were purposely putting the address of the creditworthy Bob Smith when your client is the non-creditworthy Bob Smith, this would be bad b/c you are intentionally trying to mislead subsequent searchers. A random address inserted wouldn’t have this implication.

* + - * 1. PROF: this situation is qualitatively different than directly misleading re: the existence of a SI
        2. These are post hoc rationalizations of why an actor fills in the wrong address
      1. Notes
         1. The fact that the evidence is in the hands of the creditor’s lawyer leaves room for doing things that are not exactly 100% accurate
         2. This situation would arise more so in the case of your own client wanting you to get it done ASAP

Timing aspect—go back ASAP and file an amendment to insert the right address

* + - * 1. Q: the form calls for the actual address

Could you just fill in the city and be rejected?

* + 1. **Prob. 18.2**
       1. Facts: Client is a BK trustee.
       2. Issue: Examine each asset and whether it is encumbered by a SI, such that the value has to go to the SC, or whether it is unencumbered and the value can thus go to the general creditors.
       3. 🡪 **RULE**: Any SI that is not perfected enough so as to give priority over a lien creditor, the trustee can avoid it
          1. Look to see if anything is wrong with these financing statements to make them defective and thus avoidable by the trustee
       4. Analysis:
          1. (a) Address for SC is completely missing

Fully effective

Lien creditor would not win over this SC, so defeats the Trustee in BK

* + - * 1. (b) Indication of collateral in the fin statement … question is whether there is a defect in the fin statement that would interfere with the perfection of the SI

This is a challenge to the indication of collateral in the fin. statement

**§ 9-504**: minimal guidance of what constitutes an appropriate indication of collateral in a fin statement

Provides that it is per se sufficient if: (1) description of the collateral is pursuant to standard for descriptions in security agreements in **§ 9-108 [safe harbor]** or (2) indication that it covers all assets or all personal property

If what is in your UCC-1 fin statement matches the description in your security agreement, you are ok

Generic language is an insufficient description of an after-acquired commercial tort claim

Makes it harder for a company to grant SI in potentially large tort claims

**§ 9-204**: after-acquired property clause 🡪 SI must describe tort claims with greater specific than “all tort claims”

The problem here is that the security agreement description may be ineffective. If it is, then forget about the fin statement not perfecting the interest—it means that the interest never attached properly to begin with

If you are a BK trustee, go look at the security agreement. If trustee thinks that the description violated **§ 9-108**, will say that SC doesn’t have an SI at all

PROF: the trick of this question is that you are looking through the fin statement to a problem with the security agreement itself

If a description is vague in the fin statement, it may be vague in the security agreement

* + - * 1. (c) Mistake re: use of SC’s trade name rather than its true name

If you use only trade name and not true name of the DEBTOR, your fin statement is INEFFECTIVE (have to use the name on the Articles of Incorporation)

Would this error re: SC’s name be seriously misleading?

Purpose of the fin statement is to show you that some previous lender has a SI in this debtor’s collateral

In some ways, using the trade name makes the SC EASIER to find. If you only have their true name, may be even harder to find.

**PROF:** NOT misleading, fully effective fin statement

* + - * 1. (d) Name of SC is completely wrong

PROF: this is a very big mistake

Perturbing for this to be fully effective

**Official Cmt. to § 9-506**: minor errors and omissions

Inasmuch as searches are not conducted under the SC’s name, an error in the name of the SC will not be seriously misleading

Drafters were probably thinking about a misspelling, etc. this case is distinguishable b/c it is a completely different name – PROF thinks that its hard for this case to fit within this **§.**

Ask whether this mistake could actually harm a subsequent lender

Whether the Cmts are persuasive or binding depends on whether they were adopted by the state along with the Art. 9 text

* + - * 1. (f) Irregularity is the complete absence of description of collateral

If the collateral description is blank, then fin statement is absolutely INEFFECTIVE

* + 1. **Prob. 18.3**
       1. Issue: Your client has a judgment against X that says that they have no unencumbered assets. You run the searches anyway, pull up 5 fin statements (with Glacier Bank as the SC). You find that one of X’s stores is NOT on any of these fin statements. You think that you just found an unencumbered asset of X. You want to levy on the furniture & equipment in that store, but are afraid of getting bogged down in litigation if you are in fact levying on encumbered assets.
       2. If you contact Glacier Bank to clarify which stores they are interested in, Glacier Bank is going to run right away to file a fin statement on this ambiguous store (you would be letting GB know that they have failed to perfect)
       3. If you DON’T contact GB, you could get in and take advantage of GB not perfecting, and levy against the assets
          1. If GB goes to perfect, you will be out of luck
          2. If you don’t want to run the risk of putting the SC on notice that they failed to perfect, you can levy on all the stuff instead.
          3. The worst thing that can happen is that it turns out that the search was wrong, etc. so that you have wrongfully levied.

But if you searched properly, you have a good argument that you acted perfectly reasonably no matter what

If you are lucky, GB DID make a mistake

* + - 1. If you are GB and you get this call, don’t lie, but stall
  1. Exceptions to the Article 9 Filing Requirement
     1. Still talking about how to perfect a SI
     2. **§ 9-310(a)**: General rule that except as otherwise provided … a financing statement MUST BE FILED to perfect all SIs …”
        1. 3 Main exceptions to this general rule:
           1. **§ 9-310(b)**: the filing of a fin. statement is NOT necessary to perfect a SI:

(6) in collateral in the secured party’s **possession** under **§ 9-313**;

(8) in deposit accounts, electronic chattel paper, electronic documents, investment property, or letter of credit rights which is perfected by **control** under **§ 9-314;**

(2) that is **perfected** (automatically) under **§ 9-309** when it attaches

* + - * 1. NOTE: the dense part of the material is what is within these 3 exceptions
    1. POSSESSION EXCEPTION
       1. **§ 9-310(b)(6)**: filing of fin statement is not necessary … in collateral in SC’s possession under **§ 9-313**
          1. Sends us to **§ 9-313(a)**: “a secured party may perfect a SI in tangible negotiable documents, goods, instruments, money or tangible chattel paper by taking possession of the collateral”

There are only certain categories of collateral that fit here (it is a limited exception)

Shared characteristic is that these are **tangible—can be possessed in a physical way**

This puts a huge premium on correctly identifying your collateral

* + - * 1. Definitions:

“Goods” [**§ 9-102(a)(44)**]: moveables

“Instruments” [**§ 9-102(a)(47)**]: negotiable instrument … that evidences a right to the payment of a monetary obligation, is not itself a security agreement … and is of a type that in ordinary course of business is transferred by delivery with any necessary endorsement or assignment

ie. a check. Endorsement can transfer right of payment – this idea is what makes something negotiable.

“Chattel paper” [**§ 9-102(a)(11)**]: a record that evidences both a monetary obligation and a SI in specific goods

ie. If seller of boat finances a customer’s purchase. Seller will get a promissory note and the SI in the boat. If seller bundles those two things together and then sells them to someone else, this is chattel paper.

These two things could be sold separately, but then they wouldn’t be chattel paper

Only talking about TANGIBLE chattel paper (ie. a physical document)

* + - * 1. But see **§ 9-330** on the question of **priority**

Can choose to perfect by filing or by possession, but the **party who perfects by taking possession has heightened priority**

There is a preference for a certain form of perfection. You can do either if you want to, but it is better to perfect by taking possession.

\*This is a priority question, not just a mechanics of perfection question.

* + - 1. Idea that possession gives notice
         1. Any sensible lender will ask to see the collateral. If it is in hands of someone other than the debtor, should ask questions

But this theory doesn’t always work out

* + 1. CONTROL EXCEPTION
       1. **§ 9-310(b)** sends us to **§ 9-314(a)**: “a SI in investment property, deposit accounts, letter of credit rights, electronic chattel paper or electronic documents may be perfected by control of the collateral under sections … **§§ 9-104, 9-105,** or **9-106**”
          1. These can’t be physically possessed
          2. **§ 9-104**: control of a deposit account

Definition of “deposit account”- **§ 9-102(a)(29)**: bank account

* + - * 1. **§ 9-105**: control of electronic chattel paper

Definition in **§ 9-102(a)(31)**: chattel paper evidenced by a record or records consisting of info stored in an electronic medium

* + - * 1. **§ 9-106**: control of investment property

Definition of investment property in **§ 9-102(a)(49)**: a security (stock), whether certificated or non-certificated; security entitlement; securities account, commodity contract or commodity account

Certificated: physical stock certificate

Uncertificated: electronic record on the books of an intermediary that reflects our ownership

\*Divide between possession and control depending on the kind of security (tangible or not)

* + - 1. But see **§ 9-328** on the question of priority
      2. Example: Control of a deposit account under **§ 9-104**
         1. **(a)**: a secured party has control of a deposit account if:

**(1)** the secured party is the bank with which the deposit account is maintained;

**(2)** the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent of the debtor; or

**(3)** the secured party becomes the bank’s customer with respect to the deposit account

* + - * 1. If SC has control under this **§,** the interest is perfected
        2. This gives notice b/c subsequent lenders will be suspicious if the account if in the name of someone other than the debtor.

BUT if the SC is the bank, this is kind of invisible.

Notice function is served differently in the 3 prongs of the test

* + - * 1. **(b)**: a secured party that has satisfied **(a)** has control even if the debtor retains the right to direct the disposition of funds from the deposit account [ie. the SC doesn’t have to have EXCLUSIVE control in order to perfect]
    1. “AUTOMATIC PERFECTION” EXCEPTION
       1. **§ 9-310(b)(2)**
       2. **§ 9-309**: the following SIs are perfected when they ATTACH [no fin statement required]:
          1. **(1)** Purchase money SI in consumer goods [automatically perfected upon attachment]

“Consumer goods” [**§ 9-102(a)(23)**]: goods that are used or bought for use primarily for personal, family, or household purposes

So you don’t have to worry about this exception if you are dealing with a corporation

“Purchase money security interest” [see **§ 9-103**, or not]

**Method #1**: Seller sells item to buyer. Buyer pays partly in cash, and partly by executing a promissory note agreeing to pay the seller the rest in the future. Seller takes a SI in item to secure that obligation. **That interest is a PMSI**.

If customer buys boat, partially in cash, with SI. The SI is a PMSI b/c it secures the customer’s obligation to repay the money they used to buy that piece of collateral.

If the customer already owned a boat, went to a bank and used the boat as collateral for a college loan, this is NOT a PMSI b/c doesn’t secure a loan of the money used to buy that item

**Method #2**: Buyer goes to lender to borrow money to purchase item from seller. Lender lends the money and takes a SI in the item to secure buyer’s repayment obligation. The interest is a PMSI.

Lender has to be careful where the buyer spends his money – if buyer doesn’t use the proceeds of the loan to buy the collateral, it wont be a PMSI. So the lender will likely want to disperse the loan proceeds straight to the seller of the item.

* + - 1. NOTE: a PMSI can be taken by a 3rd party lender or the seller of the item itself
      2. Notice is the problem here—this is totally invisible b/c no possession, etc.
         1. The auto perfection is limited to CONSUMER GOODS

**It is only a PMSI in consumer goods that received auto perfection**

Ie. if a set of books was used in lawyer practice, it is NOT a consumer good

* + - 1. This is one of the many provisions in Art. 9 that is meant to facilitate commercial transactions for the LENDERS
         1. **Thus, companies like Sears that sell tons of consumer goods don’t have to file financing statements every time**
      2. A piece of collateral can be security for both a purchase money loan AND a non-purchase money loan
      3. REMINDER re: when a SI ATTACHES
         1. Attaches when the creditor has given value, the debtor has attained rights in the collateral, and the agreement has been authenticated
         2. The second it attaches, it is **also perfected** under this section
    1. **§ 9-309 Cmt. 3**: no filing is required to perfect a PMSI other than goods such as automobiles that are subject to a statute named in **§ 9-311**
       1. **§ 9-311**: fin statement is not required for perfection if there is a preempting statute or a statute covering autos, which provides for SI to be indicated on certificate of title
    2. **§ 9-310**: Must perfect via a financing statement UNLESS:
       1. Your collateral is a kind covered by a certificate of title under **§ 9-311**, a federal statute that preempts Art. 9, OR falls within the above exceptions
    3. SEE PERFECTION METHODS TABLE [CHART B]
    4. **Prob. 19.1**
       1. Issue: How should you perfect a SI in each type of collateral?
       2. (1) Cash in the debtor’s cash register
          1. MUST take possession of it per **§ 9-312(b)(3)** to be perfected

BUT this could be bad b/c it takes the collateral out of the control of the debtor (and is no longer a productive asset in debtor’s hands)

Esp. b/c a SI is only a contingent right (SC doesn’t need to get its hands on that money unless D has defaulted on its underlying obligation)

* + - * 1. How?

Is there a way to take “possession” of this money under **§ 9-313** w/o physically taking it out of the cash register?

As a SC, don’t have to be in actual physical possession per **§ 9-313(c)** 🡪 but if SC wants to leave it in the possession of the debtor, it is problematic (b/c need to show that SC is now in possession)

BUT if the possessor executes an authenticated record that it holds the collateral for the SC’s benefit, can be in 3rd party possession

Can use this to posses under **§ 9-313** w/o physically taking the collateral away

**UCC Cmt**. discussing escrow/agency-type relationships: 3rd party holding collateral for the benefit of the SC

* + - * 1. **Law Answer**: taking a SI in money, have to perfect by taking possession
        2. **Practical Answer**: possible to possess w/o literally having the money in your hand
        3. **In the World**: people do not take SIs in money (very rare)

It is easy and common to take a SI in a bank account (capture the value of money via a bank account)

* + - 1. (2) Negotiable Promissory Note
         1. This is an instrument
         2. Can either file under **§ 9-312** or possess under **§ 9-313**

Possession is preferable b/c **§ 9-330(d)** says that priority of someone who has possession of the instrument is superior to someone who has merely filed against the instrument

* + - 1. (3) Money in Debtor’s Bank Account
         1. This is a deposit account
         2. **§ 9-314**: HAVE to take control of it in order to perfect

Can get control if the bank account is placed in the bank that is the SC; whole account can be put in the SC’s name; or an agreement can be executed

* + - 1. (4) Shares of stock in GM in which the debtor has a stock certificate
         1. Certificated Security

Before it is called a certificated security, it is “investment property” under Art. 9 types of collateral [**§ 9-102(a)(49)**]

B/c there is a difference b/w certificated security (tangible object that can be possessed) and electronic security that can’t be possessed at all—Art. 9 handles them differently

* + - * 1. **§ 9-328(1)**: priority of SIs in investment property

Control methods are preferred

* + - * 1. Reality: most of the time, we don’t get stock certificates anymore—we have our name registered electronically with an intermediary that runs the records for all kinds of investors
      1. (5) Obligations of used car buyers to pay for their cars when the obligation is evidenced by a promissory note and SI in the cars purchased
         1. This is NOT an instrument. This is chattel paper b/c it a monetary obligation bundled with a SI.

Can either file or possess to perfect in chattel paper

But under **§ 9-330(b)**, possession is preferable

Keep the distinction b/w possessable/tangible chattel paper and electronic chattel paper

* + 1. **Prob. 19.2**
       1. Facts: X sells its franchise. Receives part of the purchase price in a document that represents a monetary obligation. Your client is about to lend to X against this obligation as collateral.
       2. Issue #1: What is this document that your client has gotten from X?
       3. Analysis:
          1. An A/R under **§ 9-102(a)(2)** used to mean (no longer) a right to payment for goods sold or services rendered that you haven’t yet been compensated for – this is the core kind of accounts we have out in the world.

Under this def., X clearly didn’t sell a good, so doesn’t feel like a classic account

* + - * 1. NEW def. of A/R 🡪 right to payment of a monetary obligation for property that has been sold

Property is much broader (so becomes ambiguous re: whether this document is really an account or not)

PROF: very possible that this could be an A/R under this new definition. If it is an account, have to perfect by filing a UCC-1 fin. statement with SoS.

If it is NOT an account, it is NOT an instrument or chattel paper

* + - * 1. ANSWER: If you are unsure re: what type of collateral this document is, you should file a fin. statement describing it AND take possession of it. Assume by doing both of these things that you have covered all of your bases to perfect [PROF says that this is a totally fine thing to do]

PROF: doesn’t look like a classic account. Could fall into the bucket of general intangible?

* + - 1. Issue #2: If X perfected a SI properly at the time of the sale? Does this change your answer?
         1. PROF: although it looks like the book is leading you to think that this is chattel paper, PROF is not sure at all that it is—chattel paper talks of a SI in GOODS and this is a SI in a franchise, which sounds more like intellectual property rights
         2. You would need a lot more info re: what is being transferred here
         3. **If they assert they are transferring IP, it is NOT a good**

**If they are transferring their deep fryer, it IS a good**

* + 1. **Prob. 19.3**
       1. Facts: Received a negotiable promissory note that is an instrument under **§ 9-102**. Can perfect by filing or can perfect by taking possession.
          1. Clearly better to take possession--but debtor has already borrowed against this instrument, has given this SC #1 a SI in the instrument, and SC #1 has taken possession of the instrument.
       2. Issue: what should your client (SC #2) do to perfect its interest?
          1. Make SC #1 an agent for you (SC #2), so it stays in possession?

If the instrument is worth $100k and SC #1 only has an unpaid obligation of $40k. SC #1 would be secure in its 1st position and is fine if a subordinated interest is layered on top. But can SC #1 possess for both itself and SC #2 at the same time? Conflict of interest—feels problematic.

* + - * 1. **Make an escrow agreement**

Come up with a 3rd party escrow agent and have him hold this instrument BOTH on behalf of SC #1 and SC #2 and come up with ground rules for what happens if there is a foreclosure or something like that.

* + - 1. NOTE: When perfection by possession is preferred or exclusive method, it makes it harder for the debtor to use the collateral as collateral for more than one loan
         1. It is possible, but difficult (less flexible than perfecting via fin. statement)
      2. **SC #2 would definitely want to perfect in case a 3rd SC comes along**
  1. The Land & Fixtures Recording Systems
     1. Real Estate Recording System: Generally
        1. Localized
           1. Every county, not every state, has its own individual real property recording system
        2. Much more comprehensive re: docs you put into them (when compared to UCC)
           1. Not just notice of SI—file the actual SI itself

**UCC:** just file the notice of the SI (via the fin. statement)

**Real estate**: have to file the actual mortgage itself

* + - * 1. Covers SALES/TRANSFERS of land, too (even if there is no mortgage involved)

UCC-1 filing system only reflects SIs—don’t have to file if you sell a piece of equipment

* + - 1. Indexing
         1. Not only by the name of the debtor, also by tract (description of property)

Easier to find stuff if you know where the land is that you’re looking at

* + 1. Searches in the Real Property System
       1. Few searching problems (unlike UCC system) 🡪 if you run a search for a common name and don’t find anything, wonder why you are not finding the house that you know the debtor owns. You know you missed something if nothing comes up.
    2. FIXTURES
       1. Ex: D is a grocery store that needs a new refrigerator case. When the case is sitting in the manufacturer’s warehouse, it is a moveable good and would be governed by the UCC. But once the D receives it and attaches it to the walls of the store, it becomes a fixture and becomes more like real property.
       2. Ex: A house is kind of a fixture, b/c it is built out of moveable goods/personal property
          1. But once it is attached to land, we treat it like land (no longer treat it like personal property)
       3. But definitional problems 🡪 what about a mobile home? It can be removed, does this mean that it is not a fixture? What about a fridge case that is in the store but not bolted to the wall?
    3. How to Perfect a SI in a FIXTURE [2 ways]
       1. (1) Record a mortgage covering the land under the real property system; it will cover fixtures [**§ 9-334(b)**]
          1. Automatically covers any fixtures on that land
       2. (2) Recording a “fixture filing” in UCC system complying with **§ 9-502(b)**
          1. Under Art. 9 rules, but filed in the real property system- NOT SoS
          2. Filed here per **§ 9-501(a)(1)(B)**
          3. Scope of Art. 9 encompasses SIs in fixtures

Fixtures are covered both by UCC and real property law

In the middle, there is an overlap where it is possible to perfect the SI under either real estate law or UCC

* + - * 1. **§ 9-502**

**(b)**: to be sufficient, a fixture filing covering goods that are or are to become fixtures, must satisfy **(a)** and ALSO **(1)** indicate that it covers fixtures; **(2)** indicate that it is to be filed in real property; and **(3)** provide description of the real property to which the fixtures are related; and **(4)** provide the name of a record owner if the D doesn’t have an interest of record in the real property

**Key**:do NOT file in SoS—file a fixture filing in the REAL PROPERY office [**§ 9-501(a)(1)(B)**]

**§ 9-502** adds additional requirements and changes place of filing

A fixture filing does NOT cover the underlying land (only covers the fixtures)

Ski Lift Ex: one lender had a SI in the underlying land and seller of chairlift wanted to take a SI in just the chairlift (this would be a fixture filing)

* + 1. NOTE: Frustrating, b/c Art. 9 also seems, but NOT excluding it, to permit an ordinary financing statement
       1. Nothing anywhere in any of these sections does it say that if your fin. statement is related to fixtures/real property, you have to make a fixture filing (so seems to permit perfection via ordinary fin statement under **§ 9-501(a)(1)** as well – but people don’t use this b/c of the priority problems that come with it)
    2. **Prob. 20.1**
       1. (a) How to perfect in the D’s 1/3 interest in a 160-acre tract of land?
          1. This is clearly property—NOT a fixture
          2. Sub issue is the way the D holds the interest in the land (as a 1/3 interest)

Direct ownership in land is real property ownership, but many types of **indirect ownership** are not real property ownership (ie. if a corporation/partnership owns land and you own 1/3 of the corp/partnership—ownership of shares in the corp. is **personal property**)

🡪 The form to which title to the property is held matters re: whether there is an overlay of personal property

**Direct** ownership would be in real property system

* + - 1. (b) SC wants to make sure it is perfected as against the pine trees growing on the land mentioned above. The trees were planted in clean rows for easy harvesting.
         1. **§ 9-102(a)(44)**: definition of goods – goods means all things that are moveable when a SI attaches. The term includes “standing timber that is to be cut and removed under a conveyance or K for sale and crops grown, growing, or to be grown”

Two possible ways that these trees are goods (they are “standing timber to be cut and removed” IF there is a K for their removal OR they could be “crops”)

Perfect against crops (form of goods) by filing a public fin statement

Perfect against timber to be cut (if you do find that here is a K for sale) with a **UCC-1 fin statement**

**§ 9-501(a)(1)(A)**: filing office provision (tells where to file UCC-1 fin statement)

**If the collateral in question is “as extracted collateral (aka minerals) or timber to be cut,” have to file your UCC-1 fin statement in the real property system**

AKA we connect timber to be cut to how we treat fixtures (but NOT actually a fixture filing—separate from that category)

Timber is so connected to the land that we want people searching for the land to be able to find it

* + - 1. How to perfect against trees that naturally grow on the land?
         1. Real property – mortgage would cover them automatically
      2. (c) How to perfect in a parcel of land just west of the acreage mentioned above?
      3. (d) Mortgage does not have to mention the naturally growing trees that are on the land – covered automatically
         1. Implication of this Q is whether you could make extra sure by mentioning the trees, just in case

PROF: you could, but it might raise the implication that your mortgage doesn’t cover other stuff on the lane

* + - * 1. If the pine trees have been planted in straight rows for easy harvesting (as in (a) and (b)), the implication is that they weren’t part of the land originally and there was no intention that they were going to stay there permanently
      1. (e) **General Doctrine**: trying to get at the once-removed problem, where we have someone who has an interest in real property and uses that interest to borrow and create a mortgage in the real property—that is clearly perfected by filing in the real property system. The bank that holds that mortgage may want to use the mortgage itself for collateral for future lending.
         1. **§ 9-109 cmt. 7** Example

Mortgage holder lends O money. O gives mortgage holder a promissory note coupled with a mortgage on the real property. To perfect its SI, mortgage holder goes to the county recorder’s office b/c this is a real property transaction. But if MH gives a SI in the promissory note to secure MH’s own obligation to X, and offers the mortgage as collateral, this is realty paper. MH then gives X a promissory note of its own with a SI in the obligation from O.

How do you perfect the transaction b/w MH and X?

Some used to say this is not personal property (and thus is not governed by UCC 9) b/c this gives a SI in something that is itself secured by real property/a mortgage

Others say that Art. 9 does apply b/c this is an instrument

**Cmt. 7**: if MH gives a SI in the note to secure MH’s own obligation to X, Art. 9 applies to the SI thereby created in favor of X. The SI in the promissory note is covered by Art. 9 even though the note is covered by a mortgage.

**§ 9-203(g)** attachment

Attachment of a SI secured by a promissory note secured by a mortgage is also an attachment of a SI in a mortgage … of personal OR real property

\*Granting an SI to X in this interest reflects a payment obligation means that the interest attaches to both the promissory note AND the mortgage that secures it (**aka if you are attached in the promissory note instrument, you are attached in the mortgage**)

How to perfect in this promissory obligation AND the underlying mortgage

**§ 9-308(e)**: if you are perfected in the promissory note instrument, you are also perfected in the mortgage

* + - * 1. What if O is paying MH, but MH is in default to X?

X will want to foreclose against MH. X can then take whatever rights MH has to payment from O AND can take the security of the mortgage.

* + - * 1. **MH is really using his expectation of a cash flow as collateral to X**
        2. Where to Perfect?

This is NOT an instrument or chattel paper

B/c Art. 9 doesn’t have a separate section for realty paper)

Could be an account or a general intangible

General intangible: perfect by filing a fin statement in the UCC system

**§ 9-308** says that if you properly perfect in the general intangible, you are also perfected in the mortgage (DON’T have to ask yourself or worry about how to perfect yourself in a mortgage in the UCC system)

* + - 1. (f) Actual Question from (e)
         1. Facts

Mark = owner

Pac Interest= mortgage holder

SLP = X (2nd lender)

\*Use previous example

* + - * 1. Analysis

Art. 9 tells us that perfection should be accomplished under Art, 9 even though this interest relates to real property

**So** we need to know what this note is (is it a general intangible, an account, etc.)—**promissory note isn’t part of our perfection categories, so have to analogize**

Could perfect in both ways –take possession AND file a fin statement

* + - 1. (h) “Store fixtures” offered as collateral (shelving, cash registers, and similar terms). Some are bolted to the building and some are free standing.
         1. Issue: Is this stuff really fixtures?
         2. Analysis: Art. 9 foes not answer this – it sends you to real property law to define fixtures (it is a fixture when it is so related to property, that …)

Have to go to state law and see what is says re: when something becomes a fixture

* + - * 1. **Chairlift case TEST**—3 prong test (HAVE to have all 3):

**(1)** Is the property annexed or attached to the realty;

**(2)** Is the attached property adapted or applied to the use of the reality; and

**(3)** Intended for thing to be permanently attached to the realty

* + - * 1. The problem here is that we have some things that are free standing

**“Integrated Industrial Plant Doctrine”**

If something is essential to plant’s proper functioning, machinery can be a fixture even if it is not bolted to the wall

* + - * 1. But if the lease says that they can be taken away when you move, it doesn’t feel like an intention for it to be permanently there—not a fixture

Line b/w fixture (w/ real property implications) and personal property

* + 1. **Prob. 20.2**
       1. Issues:
          1. What is the minimum necessary to create a SI; and
          2. What is the minimum necessary to be an effective fin statement under UCC; and
          3. What is the minimum for effective mortgage under real property system
       2. Facts: note written on napkin
          1. (a) Enough to create a valid SI?

**§ 9-203(b)**

Authentication?

Pick at the description of the collateral—is it sufficient here? There is no address or exact, etc.

Will you be able to find it? It could be fine to describe it if there is only ONE Marlin facility

Missing the dollar amount of the secured obligation

Would normally want to see this

Want to see the relationship b/w the particular collateral and the particular debt

But if there was evidence that there was ONE preexisting loan and everyone knew the amount, then saying that you are “securing my loan to you” would a good enough description b/c it would be understood

* + - * 1. (b) If it is ok as a security agreement, it authorizes SC to file a fin statement

W/o getting D’s signature again

* + - * 1. (c) Almost certainly NOT sufficient as a mortgage b/c most state laws require much more formality [GET FACTS]
      1. NOTE: UCC 9 is relatively relaxed—real property system not so much so
    1. NOTE: To have something that is chattel paper, has to involve a SI in GOODS
       1. With real estate, you have something that is like chattel paper but called realty paper

1. Maintaining Perfection
   1. Maintaining Perfection Through Lapse & BK
      1. Generally
         1. Especially deals with perfection via filing and losing perfection over time
      2. Idea of **Cancellation**
         1. Once a secured obligation is paid off, you would expect that the filing you used to perfect the SI somehow goes away. Otherwise there would be a public notification out there that says that a SC has a SI in this collateral even though the debt has been paid.
            1. We need some way to terminate existing filing when the debt has been repaid

**Satisfaction** [Real Estate system]

Means that a mortgage is no longer active b/c loan has been repaid

This doesn’t wipe out the old mortgage, just adds to it

In most states, the SC is obligated to provide a satisfaction document once the debt has been paid in full (w/ no action by the D)

Otherwise the title would remain clouded

**Termination** [Art. 9 - full cancellation of a fin statement]

**§ 9-513**: after loan has been paid, SC has to provide a termination statement either by filing it itself or by giving it to the D to file

Automatic in consumer goods, in other contexts the D has to ask for the termination statement once the loan has been paid in full

* + 1. Release Part of the Collateral that is Covered by the Filing w/o Actually Cancelling it Outright?
       1. **Release** [Real Estate system]
          1. HAS to be provided for in the K

There is no automatic right to release

You could ask for release if the bank is really over-secured even if it’s not in the K, but bank doesn’t have to do it

* + - * 1. Ex: Development of subdivisions

Use the proceeds of a sold lot to pay down part of the mortgage obligation in exchange for that lot being released from the mortgage

* + - 1. **File an Amendment** if you want to release some collateral from your fin statement[Art. 9]
         1. This amendment would change the description of the collateral
    1. Automatic Termination
       1. UCC 9- Fin statement is only good for **five years**
          1. Automatic termination of your fin statement if you have it out there for more than 5 years ad you don’t **continue** it

A SC who wants to keep perfection more than 5 years has to file a continuation statement when it is due, and it will buy the SC 5 more years

* + 1. **Prob. 22.1**
       1. Facts: client is a bank that has perfected SI in equipment
          1. Fin statement was filed on 12/30/2001. Continuation statement filed on 7/7/2006. Today is 3/22/2010.
       2. Issue #1: Did bank file the continuation statement at the appropriate time?
          1. **§ 9-515**: deals with duration of fin statement

**(d)** Continuation window opens up **6 months** before the fin statement would otherwise **lapse**

Can’t file the continuation statement too early (have to wait until 6 months before lapse); but DON’T file it after it has already lapsed

* + - 1. Analysis #1: This continuation WAS timely
      2. Issue #2: When can bank file the next continuation statement?
         1. The effectiveness of the continued fin statement does not track from the day you actually file the continuation—**it tracks from the effectiveness period of the original fin statement**

Even though bank filed the continuation statement in 7/2006, you DON’T measure the next 5-year period from that date—STILL measure from 12/30.

* + - 1. Analysis #2: Next continuation statement is DUE during the window of 6/30/2011 to 12/30/2011 per **§ 9-515(d)**
      2. Issue #3: Does the filing of a BK petition here change your answer?
      3. Analysis #3: NO- BK has no impact on the obligation to file a continuation statement
         1. **BK § 362(a)(4)**
         2. **BK § 362(b)(3)**: Auto stay (including perfection)
         3. We want to see a provision that says the auto stay doesn’t affect this as long as you are perfected before the BK petition is filed

**BK § 546(b)(1)(B)**: SC can still continue in order to maintain perfection once a BK petition is filed (as long as was perfected before BK)

This makes sense b/c the auto stay is trying to keep people who should be in the general creditor pool from converting themselves into a SC (here, the SC is already perfected)

* + - * 1. HAVE to file continuation statements during BK if SC intends to remain perfected
    1. **Prob. 22.2**
       1. Facts: You did a deal over 5 years ago for a creditor client and you filed a fin statement for a SI in some equipment. Now you check your records and find that no continuation statement was filed. There are still amounts outstanding under the loan and you are worried about the status of your client’s SI.
       2. Issue: What do you do?
       3. Analysis:
          1. The effectiveness of the initial fin statement has already lapsed, so there is nothing to continue (thus **cannot** file a continuation statement)
          2. If you can file a **new** financing statement, the impact on your client’s interest will be:

A newly filed fin statement would only perfect your client’s interest as of that date

Worry that now your client is in a bad position re: potential priority challenges

* + - * 1. As the lawyer for the creditor, you can’t just fill out a new fin statement b/c under **§ 9-509** the D has to authorize the filing of the fin statement

**Difference** between an initial fin statement, continuation, and amendment

To be an amendment, the form would have to refer back to the original statement (“relates to and alters some aspect of this original fin statement” with the index number, etc. of the original)

Thus, this would NOT be an amendment b/c the initial statement has already lapsed—there is **nothing** to continue or amend

* + - 1. PROF: The only option is to file a **new** initial fin statement
         1. **§ 9-509**: You may file an initial fin statement only if the D authorizes the filing in an authenticated record or pursuant to **(b)** –

**(b)** By authenticating/signing a SI, a D authorizes the filing of an initial fin statement and an amendment

It is not clear whether this would cover a 2nd initial financing statement. The intent of this subsection is to say that the D is authorizing the 1st one.

PROF: **(b)** probably doesn’t cover us, so we would have to go to the D to get permission

**If the debtor says no, we are in trouble b/c we need his cooperation to fix this problem**

Maybe if D is in default, use this as leverage to get permission from the D

* + - 1. Your client is not going to be happy about this, b/c they wouldn’t know that a continuation statement needed to be filed and that they would now be unperfected in their interest
         1. **If you fin statement lapses, you are unperfected retroactively all the way back to the beginning against another SC who has perfected** (so not just an issue of SCs who jumped in b/w the lapse and today—this is a potentially large problem for the creditor)
      2. Continuation is the lawyer’s responsibility forever as long as this is his client [you have to calendar this]
         1. If your client leaves you, give them the documentation and tell them to give it to their new lawyer
         2. Failure to maintain perfection is malpractice
      3. Proactive **avoidance** of this problem of having to go back to the debtor
         1. Put a clause in the security agreement itself saying that the D authorizes the filing of continuations, amendments, etc., and anything necessary to maintain or restore perfection of the creditor

This would cure the lapse problem, but would prevent you from having to go back to the D and ask for new authorization

* + 1. **Prob. 22.3**
       1. Facts: Circus has filed Ch. 11 BK. Your client (Ryerson) holds a $1.2 mm 1st SI in most of the circus assets.
          1. Associates Fin. Partners also holds an interest in the property (filed fin statement 2nd)

But Associates claim that they were perfected 1st b/c they had possession of the circus assets at the time both filings were made

* + - 1. Issue: Is this a problem for your client (aka Associates’ possession)
      2. Analysis: legal possession v. physical possession
         1. How (as a practical matter) could Associates have taken LEGAL possession of these assets (tents, etc.)?

Circus could still own the assets, but Associates could have some kind of agreement – feasible that they had legal possession

* + - * 1. If Associates really was in possession, does this matter for your client?

Re: order of perfection, Associates would not come 1st b/c they perfected via possession (THEN Ryerson- our client- perfected)

* + - * 1. But at some point Associates gave up possession of the goods after they filed a fin statement

This does NOT affect the timing of Associates’ perfection [their perfection does NOT have a new start date at the time of the fin statement]

Perfection looks back to the date of perfection (perfect one way and then perfect in another way with no gap – and be continuously perfected)

Per **§ 9-308(c)**, which talks about continuous perfection re: two methods of perfection w/o an intermediate period when it was unperfected

\*It is important that Associates still had possession when it filed the fin statement (so there would not be a perfection gap)

* + - 1. NOTE
         1. You can perfect a SI in this circus stuff by possession b/c it is goods
         2. Priority rule when we are in a contest b/w one SC who perfected by possession and later filed, and a 2nd SC who perfected by filing:

NOT that 1st to file wins

**§ 9-322(a)(1)**: in a conflict, the 1st person to file OR be perfected wins

ASSOCIATES WOULD WIN as long as their perfection was continuous

* + - 1. Lesson: if you are Ryerson (our client), you have to check out the collateral before you lend against it
         1. But this is really hard (it is easy to search for a fin statement, but harder to go out and investigate the location of the collateral and understand that maybe someone has a **secret SI**)
    1. **Prob. 22.4**
       1. Lender (EIG) holds a mortgage against a 16-lot subdivision. The borrower is selling one of the lots. Borrower wants to keep some of this cash and give some to the lender in exchange for a release of part of the mortgage.
       2. Lender does NOT have to accept a proportionate pay down of the loan or release the lot unless they agreed to it in the K
          1. If the mortgage says that it encumbers the ENTIRE lot, then borrower would not be entitled to a release

But a lack of this type of clause in a mortgage instrument would make this type of development impossible (no one would purchase the lots)

* + 1. **Prob. 22.5**
       1. Facts: Bank’s SI covers 12 forklifts, stamping machine, etc. Its fin statement covers “equipment.”
       2. Issue #1: Debtor wants to go to a different lender to borrow against other stuff not in Bank’s agreement (drill presses)
          1. Debtor is asking bank for a release b/c the fin statement covers too much – wants a release for the drill presses

To change the fin statement to make it clear that it does not cover the drill presses, you would file an amendment to the existing fin statement

* + - 1. Analysis #1:
         1. The Bank (SC) does NOT have to agree to this release [unless there is some agreement in the underlying documentation]

Bank can refuse to file an amendment

* + - * 1. Bank does NOT have a SI in the drill presses

The fact that the fin statement covers equipment does NOT give an SI in the drill presses

The problem is that the bank’s description in the fin statement is broader than what we actually have a SI in

* + - * 1. But the fin statement is accurate—it is just overbroad
        2. The lender may want the fin statement to say equipment b/c in the future, the D may want more money and ask to borrow against new types of equipment (& wouldn’t want to file a new fin statement every time if you have this current one on file)
      1. Issue #2: What happens if down the road the bank (SC #1) decides to take a SI in these drill presses even though a 2nd SC took a SI in the presses?
      2. Analysis #2:
         1. Even if SC #2 took a SI in the presses before bank (SC #1), SC #1 would have **priority** under **§ 9-322(a)(1)** b/c SC #1 filed its fin statement 1st
      3. **The outcome** is that the borrower is not going to be able to borrow against the drill presses from anyone other than SC #1 b/c no other lender will want to take the risk of being 2nd in priority.
      4. Does **§ 9-210** help?
         1. **(a)(3)**: Debtor could request a list of what the collateral is

This **§** is NOT helpful b/c SC #1 would tell SC #2 what they had a SI in [ie. forklifts] and SC #2 STILL wouldn’t lend b/c of the priority problem—even if SC #1 didn’t have a SI in the drill presses TODAY doesn’t mean it won’t cause a problem in the future.

* + - 1. But SC #2 could come to a “**subordination agreement**” with SC #1 and have SC #1 agree that SC #2 would have priority if they lend against the drill presses (there is no problem w/ lenders agreeing among themselves re: different priority rules)
         1. But SC #1 would NOT have to agree to this subordination agreement
      2. **§ 9-509**
         1. A person (creditor) may file an initial filing statement … GET MORE

Could argue that the fin statement is only authorized as “forklifts” b/c of the security agreement BUT this is not the how the UCC sees this

UCC: as long as you are choosing the appropriate category, you are not going beyond the bounds of what this **§** permits

* + - 1. PROF: to avoid this problem, when the SA is entered into, the D could explicitly state that it is authorizing the filing of a fin statement re: X [ie. just forklifts]
         1. But many Ds are uninformed

The UCC would say that the D has to be careful here, but that is a bad answer b/c we can’t expect Ds to know what this will be a problem down the road

* + - 1. NOTE: If the fin statement described the collateral as including “inventory,” this would exceed its authorization and SC could be forced to amend (but that is NOT the case here).
      2. NOTE: if there is nothing on the horizon suggesting that SC would want to preserve priority position for future lending, banks will usually release/amend.
         1. Although this problem deals with release/amendments, this also sneaks in a priority rule in **§ 9-322(a)**.
  1. Maintaining Perfection Through Changes of Name, Identity, and Use
     1. NOTE: NOT talking about changes over **time**; we are talking about-
        1. Changes in **name**
           1. Ie. marriage
           2. Individual or corporate debtors
        2. Changes in **use of the collateral**
           1. Ie. SI in inventory, then D pulls one item out of inventory and starts using it as its own equipment. Does this render the fin statement ineffective in that thing?
           2. Ie. Collateral transformed into proceeds. Sold old copier and bought new one.
     2. Bright-Line Rules that could have been adopted but were **not**:
        1. (A) A fin statement that is effective when it is filed is effective forever; or
           1. This would be easier for the filer and hard on the searcher
        2. (B) If the change of circumstances means that if it were filed today this fin statement would be ineffective, then it is automatically ineffective
           1. Easy for searchers and hard for filers
        3. \*The real rule puts the burden in the middle
     3. RULES re: Changes of the **DEBTOR**
        1. Changes in name of Debtor [**§ 9-507(c)**]
           1. Intermediate rule re: burden on initial filer and burden on subsequent searchers

If there is a name change, the fin statement becomes seriously misleading … [GET MORE HERE]

Creates a grace period

If the name of the debtor changes such that the existing fin statement is seriously misleading, you have **4 months** to amend the fin statement to put in the new debtor’s name

* + - * 1. Example

Jan. 1- SC takes a SI in equipment now owned and after-acquired property and files a fin statement

Feb. 1- D changes its name from Acme to Beta

This makes the fin statement seriously misleading b/c the D’s name is critical under our previous rules

The SC does not **HAVE** to re-file. Continued effectiveness w/ respect to a lot of the collateral

**§ 9-507(c)**

If SC doesn’t fix the fin statement, the existing statement will be effective as against after acquired collateral within the grace period, but NOT as against collateral obtained outside of the 4 month grace period

April 1- D acquires ten additional copiers on top of the 25 already owned

SC’s fin statement IS effective

July 1- D acquires another 15 copiers

SC’s fin statement is NOT effective

* + - * 1. This rule requires diligence for future lenders b/c it allows SC #1 to maintain this utterly misleading fin statement
        2. **Distinguish**: Change in name of debtor v. change to a new debtor

May have a new debtor if an individual starts operating as a sole proprietorship, then starts a joint partnership with someone else. This is NOT a name change, but a new debtor.

Merger is another example: not a name change—a new corporation has become the D w/ respect to the SI

Under Art. 9- **Debtor is NOT the person who owes the money [this is the obligor]. Debtor is the person who owns/has interests to the collateral to which a SI has been granted.**

* + - 1. If the change in question is really a change to a NEW debtor and not just a name change of the existing debtor, have to use **§ 9-508** instead
         1. Ie. if Alpha is acquired by Beta

The fin statement will be effective to perfect a SI in collateral acquired by the new D … NOT effective against collateral outside of the 4 month grace period

Treats it the same way re: the 4 month grace period but its NOT a name change of the D. It is viewed as a transfer of the collateral to a new D – definitional distinction re: who the D is.

* + 1. RULES re: Changes Affecting the **COLLATERAL**
       1. (1) Same collateral, but put to different use
          1. (A) Is SC’s SI in the collateral still **attached?** YES
          2. (B) Is SC’s SI in the collateral still **perfected**? Only perfects if the existing fin statement is still effective

**§ 9-507(b)**: the fin statement is NOT rendered ineffective even though the description of the collateral it contains may not be misleading

Ex: D grants SI in its inventory of mobile homes. SC perfects by filing a fin statement. D now starts using one mobile home as equipment.

This fin statement is **not ineffective** even though there is no fin statement out there covering equipment if a subsequent searcher looked for one (and this mobile home that was being used as equipment **IS** covered by the inventory fin statement)

This is a problem for searchers [but both fin statements would have to be filed in the same place]

But your search would turn up something, which would lead you to want to follow up

But there is a limitation on this **§ 9-507(b)** latitude for initial filers – this **§** only talks about a misleading description. If your fin statement needed to be filed in a different place, **§ 9-507(b)** does not excuse that

Ex: Fin statement that is misleading in terms of description AND the fact that a lien to perfect on a mobile home that is driven around has to be noted on the certificate of tile (filings outside of Art. 9)

Would need to look outside of Art. 9 to look to the other law at issue, ie. the Motor Vehicle Act and hope that it says something about continuous perfection/grace period, etc.

This rule makes sense b/c a different location for the search would make the statement much more misleading

Floor check/compliance: puts burden on SC to check up from time to time to make sure that inventory boats are not being used for personal use, etc.

* + - 1. (2) Original collateral is disposed of and now there’s something else in its place
         1. (A) Original collateral is exchanged for something else

NOTE: This is unusual b/c usually in a commercial context you don’t just barter (you usually sell one piece of collateral and then buy a new piece)

**(i)** SC’s SI **IS** attached to the new collateral b/c it’s proceeds [**§ 9-315(a)(2)**]

**(ii)** SI still perfected in the new collateral?

**§ 9-315(c)** says YES – SI in proceeds is a perfected SI if the SI in the original collateral was perfected

**(iii)** Will it remain perfected? Not necessarily

This depends on **§ 9-315(d)**

Alternative tests in **(d)(1)** and **(d)(3) 🡪**

**(d)(3)**: if you had a perfected SI in the original collateral and you perfect your SI in the new collateral though a new act, as long as you do that within **21 days**, your interest remains continuously perfected

**(d)(1)**: 3 prong test

If you have a filed fin statement covering the old collateral and the new collateral was not gained with cash proceeds of the old (e.g. barter exchange situation) and the new collateral is of the type that you may perfect in the same location, then you are perfected [don’t have to do anything else even though the new piece of collateral is something totally different than the old collateral]

* + - * 1. (B) New collateral is purchased using CASH proceeds of the old collateral

SI is attached to the new collateral

Yes, under **§9-315(a)(2)**, but in the cash/comingled bank account situation, “identifiable” may be more of a problem

SI in the new collateral is perfected, BUT:

Different from type (A) only b/c the sub-condition that the new collateral was NOT obtained with cash proceeds of the old is NOT met with option (B). This option for maintaining perfection is not available in this purchase scenario as it was in the barter scenario.

* + - 1. SEE COLLATERAL CHANGE CHART [CHART C]
    1. Example: Inventory turned into patents
       1. This would be seriously misleading
          1. But **§ 9-507(b)** excuses this misleading-ness

Fin statement is still effective

BUT you don’t have anything on file in the appropriate office, so you are no longer perfected

* + 1. Unauthorized Sales
       1. In an authorized sale, your SI does NOT attach to the proceeds (ie. the boat that was sold to the customer)
          1. If the D does what he is supposed to do and remits his cash to the inventory lender to pay down the debt, then the SI is no longer required/effective
          2. The SC may WANT a SI in that cash if the D doesn’t pay down the inventory loan like it is supposed to

If the D (unauthorized) uses this cash to buy an air conditioner, then the SC would be in the part of the chart on “purchase of new collateral with cash proceeds of the old collateral” re: whether they are perfected

* + - 1. **§ 9-315(a)(1)**: SI continues in collateral, notwithstanding sale, etc., unless the SC authorizes disposition free of the SI
    1. Example: Farmer who borrows against his crops. Farmer grants a SI against all crops now grown or to be grown in the future. Then one year the gov’t says there is an oversupply of wheat so tells farmer that it will pay it a subsidy to NOT grow. Is this subsidy proceeds of the crop?
       1. Only in a weird factual way b/c you don’t have an actual crop that you are selling in exchange for the cash. But you could argue that the subsidy is a “right arising from the collateral,” so could argue for inclusion.
       2. Play with the definition of proceeds.
    2. **Prob. 23.1**
       1. Facts: Bonnie, owner of Bonnie’s Boat World, in violation of her security agreement, has taken one of the boats out of inventory home and used it for her own personal use.
       2. Issue #1: Would your client (SC) remain perfected?
          1. This collateral is the same but put to different use

The collateral has changed from inventory to equipment (maybe). Prob. not consumer goods b/c Bonnie is an individual but the corporate entity (Bonnie’s Boat World) is the debtor. This is not a household use type of situation.

* + - * 1. The original fin statement does NOT cover this collateral, so it is NOT a **type 0** change
        2. To file a fin statement to perfect in inventory, same office as equipment [UCC-1 fin statement]—so this is a **TYPE 1** change

Right place even though the fin statement is now misleading

🡪 The fin statement is still effective even though the collateral has ceased to be inventory

* + - 1. Issue #2: What if Bonnie’s Boat World trades one of the boats out of inventory for a forklift?
         1. Is the SC’s existing fin statement covering inventory good to cover this new forklift?

This is a trade of collateral

This is a **TYPE 1** change

Forklift is equipment

**§ 9-315(d)(1)** says still effective

* + - 1. Issue #3: What if Bonnie’s bought the forklift with cash it had received from a customer who had bought a new boat?
         1. File to perfect a SI in inventory in SoS’s office. File against equipment in the same place.

So this is a **TYPE 1** change

* + - * 1. \*Using the chart, **§ 9-315(d)** says SC has to re-file to maintain perfection SI after 21 days

PROF: but what about the unlikelihood that an SC would realize this within the 21-day grace period?

These rules are not helpful if a SC has an unscrupulous debtor who is diverting money from him in this way

B/c of this, SCs put provisions in the security agreements [but debtor will still violate this, likely, if having severe cash flow problems]

* + - 1. Issue #4: Storm damage to two boats with SI. Lender must be named as loss payee under insurance policy but was not.
         1. Is there also a perfected SI in the claim against the insurance company?

The insurance claims are proceeds of the inventory b/c the inventory has been damaged and exchanged for these rights to obtain an insurance pay-out

SI **IS** attached to these insurance claims

Remaining perfected in these insurance claims depends on the chart analysis

If you are asking the Q now--where does one perfect a SI in an insurance claim--the problem is that **§ 9-109** says that insurance claims CAN’T serve as original collateral under UCC Art. 9

Filing a fin statement in SoS office is NOT what you would do to perfect an SI in insurance claims

If anything, this is a **TYPE 2** change (whatever you did to perfect in the inventory is NOT the right thing to do if you are trying to perfect a SI in insurance claims)

To perfect in insurance claims – look to state law for how to do this

PROF: has no idea how to do this; but there won’t be a separate filing system for insurance claims

But maybe a law re: how to use an insurance claim as collateral?

Under Art. 9? If the SC is not named as the loss payee, there is no SI in insurance claims

**A SI in collateral only attaches to “identifiable” proceeds of that collateral**

Hard with cash that is in a co-mingled bank account

* + 1. **Prob. 23.2**
       1. Name change (explained above)
    2. **Prob. 23.3**
       1. Facts: Lent $500k taking a SI in all debtors’ assets. UCC search comes back clean besides a SI in one kind of inventory. New lender physically inspected the collateral and finds only $25k of this type of inventory is attached to this preexisting SI.
       2. Issue: Can the existing filing cover more than just this relatively small $25k inventory?
          1. Ie. should your client worry?

Watch for if part of this inventory was exchanged for anything

Maybe not likely? But D could have sold this type of inventory previously and the proceeds were sitting in a bank account (and this would be covered by the preexisting and perfected SI)

* + - 1. MORAL: Description of collateral in fin statement only takes you so far. You have to investigate into other assets of the D. Ask if it’s possible that the other assets flowed from the covered assets?
  1. Maintaining Perfection Through Relocation of Debtor or Collateral
     1. Choice of Law Rules – Questions:
        1. (1) In which state should the fin statement be filed to begin with when SC is seeking to perfect?
           1. UCC filings are state-by-state: need to know WHICH state to file in (this a choice of law problem)
        2. (2) Once SC has successfully made the initial filing, what happens if the debtor/collateral moves to a different state?
     2. **Q 1**: Choice of Law Rules for Initial Filing
        1. If the D is an IN registered corp. whose place of business, chief exec. office and all assets are in IN 🡪 don’t even have to ask this question (assume that IN is the right place to file)
        2. But if your D is a corporate debtor that is registered in TX, collateral is in NY etc., wonder where the UCC-1 fin statement goes (choice of law problem)
           1. General Rule: **§ 9-301**—except as otherwise provided, while a D is located in a jurisdiction, the local law of that jurisdiction governs perfection of a SI in that collateral [aka follow the state where the **debtor** is located, **NOT** where the **collateral** is located]

Ie. if a D is located in MI, look to MI’s version of Art. 9 to tell you how to perfect

MI’s version of **§ 9-501** will have brackets filled in to say where to file the fin statement

* + - * 1. To pick the right state, have to know where the D is located

These rules are in **§ 9-307**: runs through a list of definitions depending on type of D

Individual D is located at that individual’s principal residence

SC should ask these types of Ds where they live

(b) D that is an organization and only has one place of business, is located at its place of business (only applies to un-registered orgs). If multiple places of business, it is located at its chief executive office.

But where its chief executive office is depends on where the chief executive officer is?

For corporations, we don’t care where their place of business is, we only care about where they are incorporated.

* + - 1. GENERAL RULE – Law of the Debtor’s State:
         1. Step 1: identify your debtor
         2. Step 2: identify the location of your debtor
         3. Step 3: file fin statement in the state of that location
      2. EXCEPTIONS to this General Rule:
         1. (1) When you have a possessory SI

Ex: pawnshop

**§ 9-301(2)**: go with the law of the state in which the COLLATERAL is located (not where the D is located)

* + - * 1. (2) Fixture filings

Fixtures are associated with real property. To perfect a SI in fixtures, file a fixture filing – go with the real property recording system

**§ 9-301(3)(a)**: governed by the law where the fixtures/real property is located

* + - * 1. (3) Control-type SI

Ex: bank account (deposit account)

Way to perfect in a deposit account is by taking control of it

**§ 9-304(a)**: choice of law rule for deposit accounts—follow the law of the BANK’s jurisdiction (NOT the bank or the collateral’s jurisdiction)

**§ 9-304(b)** determine what the bank’s jurisdiction is

This is interesting, b/c lets the private parties choose the jurisdiction re: the governing law (this is unusual)—it would affect 3rd parties, as well

* + 1. **Q 2**: What happens if the debtor moves?
       1. Does your existing SI maintain perfection in the collateral or do you have to re-file?
          1. You will have to re-file in order to maintain perfection, but you will have a grace period.
       2. **§ 9-316(a)**: A SI is properly perfected pursuant to jurisdiction in **§ 9-301** remains perfected until, the earlier of:
          1. **(1)** GET FROM SLIDE
          2. **(2)** Grace period of four months after a **move**/change of location

This is the grace period to perfect in the new state. If you don’t you become unperfected.

* + - * 1. **(3)** Once year grace period after a **transfer** to a new owner

If you are an individual debtor who moves to a new state, the individual is the same debtor. Corporations do not move like this b/c they are chartered under the laws of a certain state.

A corporate debtor moves by merging into an existing corp. in another state. This means that it is essentially ceasing to exist in the old state and becoming something new in the new state. Is now a NEW debtor (not a moved debtor). This kind of move is not covered by the 4 month grace period 🡪 **this is covered by the one year grace period**

Corporation can also “move” by transferring all of its assets to a new corp. this is also covered by **(3)** and the one year grace period

Also applies to straight-up sales of collateral to a different person

The buyer becomes a new D in the new state. The collateral is still subject to the SI and the SC would have the one year grace period to re-perfect

* + - 1. **§ 9-316(b)**: Consequence of either taking the correct steps within the grace period or not
         1. If a SI described in (a)— ie. one that is subject to a move/transfer—becomes a subject to the law of the new location before the expiration of your grace period, it remains perfected thereafter (aka you have continued perfection – priority dates back to the date of perfection in the original state)
         2. If it is NOT perfected by the end of the grace period, you are unperfected and is deemed NEVER to have been perfected as deemed **against a purchase of a collateral for value**

This means that if a SC comes up against someone else who perfected at ANY time (even before the D moved), SC loses to them (retroactive)

Severe consequence for not accounting for these types of moves

Ie. if you miss this 4-month grace period, you are deemed NEVER to have been perfected (this is the retroactivity)

And it is within this 4 month grace period that a 2nd SC would be likely to file, b/c wouldn’t see anything in the new state’s filing system (but if SC #1 re-files within the grace period he is fine; otherwise SC #2 wins)

**But even if SC #1 didn’t re-file in time, he would still be perfected as against a lien creditor (b/c NOT a purchaser for value)**

* + - 1. Example: individual debtor moves from IN to MI. 4 month grace period—as long as you are properly perfected in IN .. without retroactivity
      2. “Purchaser for value” – check definition in UCC
         1. Someone who buys the collateral AND someone who lends against the collateral and takes a SI in it are BOTH purchasers for value

Ie. ask if you are giving money in exchange?

* + - * 1. A lien creditor is NOT a purchaser for value
    1. **Analogy: § 9-515(c)**: The effectiveness of a filed fin statement LAPSES on the period … aka if you don’t file a continuation statement your fin statement lapses
       1. Upon lapse, your fin statement ceases to be perfected
       2. If the SI becomes unperfected upon lapse, it is deemed NEVER to have been perfected as against a purchaser of collateral for value
          1. This is similar to the retroactivity in the context above
    2. What about RELOCATION of the **COLLATERAL**? [as opposed to move of the debtor]
       1. Does movement of the collateral have an effect on perfection of the SI if the D himself is not moving?
          1. Ex: If an individual D lives in IN and has a vacation home in FL. Moves some personal belongings to FL home. If SC is trying to lend against those personal belongings in FL, SC would perfect against ALL of debtor’s stuff in IN b/c this is the debtor’s primary residence.

The move of stuff from IN to FL does not matter to any creditor as long as the debtor’s primary residence is still IN

No subsequent debtor would be misled in any way

* + - * 1. **For the most part, the movement of collateral has NO salience whatsoever**

Doesn’t affect the existing fin statement b/c doesn’t trigger a choice of law

This is the beauty of the debtor-controlled provision

* + - 1. Movement of collateral will trigger a change in applicable law if there is a possessory interest (then you would to worry about movement of collateral)
    1. **Prob. 24.1**
       1. Facts: Filing fin statements on behalf of your client (SC). Collateral is the equipment, inventory, etc. of Shatner Engineering
       2. (1) 1st Q: who or what is the debtor, here?
          1. Implication is that this is not a corporation. Therefore, not a registered org. Prob. some type of unregistered org—could be a partnership, sole proprietorship, etc. (totally ambiguous from this fact pattern). Could also be just Shatner.
          2. If the D is Shatner Engineering and conclude that this is some type of unregistered org, have to ask where its place of business is (if there is only one, this where you file. If more than one, file at chief exec. office)
          3. To be safe, file all over the place (Kansas, MO, AZ to cover the possibilities)
       3. **§ 9-307 official cmt.**: An individual D is located in the state of his residence with respect to both **personal and business** assets
          1. Which means that a person who runs a business with business assets is treated as an individual debtor
       4. (2) He now formed a NV corporation—NOW file in NV (b/c it is a registered org.)
       5. (3) If the business is unincorporated and his ex wife owns an interest in it—would be unregistered org so file accordingly
       6. (4) If some equipment is fixtures, file real property filing in the county where the fixtures are located
       7. If the loan is a $25mm loan, you care more and monitor more
          1. To monitor, monitory physical places (aka drive by to see if he’s still there); monitor place of incorporation for Shatner Engineering, **monitor tax records**, monitor location of chief exec. office, etc.

Won’t do this for just a $250k loan

* + 1. **Prob. 23.3**
       1. Facts: SC lending to D. Secured by collateral (inventory) that D recently acquired from another corporation.
       2. Issue: What should you ask as the SC?
       3. Analysis:
          1. Search BOTH names

The company from which the assets are bought may have lent against them in a different state

* + - * 1. How do you know where to search?

B/c they are registered orgs, there is a trail—look at articles of incorporation (see that they were only incorporated in this state 2 months ago and investigate further)

Other than the history of the corporations, should try to obtain info re: whether the SELLER to your client got the assets (ie. where the assets came from before they came to your client); provenance of the collateral

To be ultra careful, have to do these steps back- step back until you are really sure that you have seen the history of this valuable collateral AND the history of this corporate debtor

All of this checking is expensive and time consuming—you will only do it with regard to a big loan

B/c of grace period

* + 1. **Prob. 23.4**
       1. Location of D question
       2. Facts: SC #1 loans $1mm to an Afghanistan Corp. (under the laws of Afghanistan), whose HQ is in NY
       3. Analysis:
          1. **§ 9-307(e)**: registered org that is registered under the law of that state … fin statement must be filed in that state

Afghanistan is not a “state” under this b/c under **§ 9-102(a)(77)**, a “state” means a state of the USA

UCC does NOT use “state” to mean country

* + - * 1. Must file fin statement in NY

Other option would be filing in DC

* + - * 1. **§ 9-307(b)(3)**

Debtor that has more than one place of business

BUT everything is in NY, so we are in **§ 9-307(b)(2)**: debtor that is an org and has only one place of business … is located at its place of business

**Thus, this is a NY debtor even though this is an Afghan corp.**

All filing and searching has to be in NY and that’s it

* + - 1. These choice of law rules rely on the STATE, not the city, county, etc.
         1. If you have multiple places of business that are all within the state of NY, could argue that it falls under **§ 9-307(b)(3)**, and that chief exec office would govern

BUT here, the chief exec office is in NY, too, so it doesn’t matter

* + - 1. **PROF**: the point of this problem is to make the point that the exception in **§ 9-307(c)** that leads to Washington DC default for certain foreign corps applies only if the D’s actual place of business and chief exec office is located outside the USA.

1. Priority
   1. The Concept of Priority
      1. Generally
         1. Look to STATE real estate law procedures for real estate, etc.
         2. Using the UCC as an example here (but only governs personal property)
         3. **Priority** determines the order in which creditors will be paid if the collateral isn’t valuable enough to pay all of them
            1. The lesson is clearest in the context of foreclosure and sale of the asset

This conversion of the asset into money and deciding where the money goes

* + 1. Rules Governing FORECLOSURE
       1. **(1)** Sale discharges the lien under which the sale was held and all subordinate liens [**§ 9-617**]
          1. There has to be a foreclosing creditor that initiates the foreclosure action

If there are multiple SCs, determine which level of SC is initiating the sale

\*The sale will ultimately discharge the foreclosing lien and subordinate liens; but will NOT discharge superior liens

* + - 1. **(2)** This means that the buyer will take subject to any prior [superior?] liens
      2. **(3)** The proceeds go first to: [**§ 9-615(a)**]
         1. The expenses of sale;
         2. Then to satisfy the obligation of the lienholder under which the sale was held;
         3. Then to any subordinate liens;
         4. Then the rest goes to the D (NO money goes to the senior lienholder, whose lien is NOT discharged here)
    1. TWO Cardinal Principles:
       1. **(1)** Any lienholder can foreclose against the collateral subject to his SI if the D has defaulted on his loan. It doesn’t matter if you are a junior lienholder.
          1. **(2)** But you don’t HAVE to foreclose

SC could use his right to foreclose as a leveraging/bargaining chip

But what if you have multiple creditors (D is in default across the board) and some creditors want to foreclose and others don’t?

Important to figure out which lienholder is forcing the sale

* + 1. **UCC Rules Govern the Foreclosure and Effects of Foreclosure on Personal Property**
       1. Sometimes there is friction b/w the UCC system and the real estate property system
       2. ***Bank Leumi Trust Co. v. Liggett***
          1. Incongruous result if the court hadn’t interpreted the statute the way that it did

Court read the state law in a way that it was not drafted to say that the statute also applied to the mortgage liens in the distribution of assets

* + - * 1. Under ALL systems, the **core idea** is that if your lien is being discharged, you should be obtaining (in order) some of the proceeds of the collateral

It can’t happen that you are ineligible for proceeds if you are being discharged (but there is still the possibility that you can get $0 if there is not enough left over)

* + 1. **Right to Possession Among Lienholders**
       1. Right of replevin is a way in which you can exercise a SI under UCC
       2. What if you are trying to repossess the collateral but you are not the only person with an interest in it?
          1. If you go seize the collateral and a senior lienholder objects?

Problem in ***Grocer Supply***

Junior lienholder took possession and senior complained

One problem is that the senior lienholder hadn’t foreclosed

Senior lienholder was exercising its right to ride it out (say that they could foreclose, but didn’t want to – would rather use it to negotiate with the D)

But the junior creditor also had a right to foreclose and wanted to know how long it had to wait

Felicia, Leonard & Bernie problem—L has one only one valuable asset but has two lienholders against it

F has the right to go forward with the seizure of the car, but a senior lienholder (B) had a right that exceeded the value of the car—so should F have a right to foreclose or not?

***Frierson v. United Farm Agency, Inc.***

A SC cannot refuse to exercise his rights under the SI if doing so impairs the status of other creditors [ie. can’t refuse to foreclose if doing so blocks the rights of junior lienholders]

This takes a different tack from ***Grocer Supply***

If the loan isn’t in default, it changes the situation b/c then the superior lienholder doesn’t even have a right to foreclose

* + 1. **Prob. 26.1**
       1. Facts: Client is investigating an upcoming foreclosure sale b/c is interested in bidding
          1. Value of collateral = $25k
          2. Sale is initiated by 1st junior creditor who is owed $10k
          3. A 3rd subordinate lien out there secures a $29k loan
          4. Most senior mortgage = $17k
       2. Issue #1: How much should your client bid?
          1. $8k

Subtract the most senior mortgage from the value of the collateral b/c the sale will NOT discharge this $17k lien. The sale WILL discharge the 2nd and 3rd liens, but client will buy the property subject to a $17k lien.

Once client buys the property, client will pay off the $17k lien

Then she will have spend $25k for property that is worth $25k

* + - 1. Issue #2: From the POV of the D forcing the sale
         1. The $8k that client bids will be allocated:

First to the $200 expenses of sale; then

The rest of the $7800 will go to the lienholder who forced the sale [he will be left with a deficiency of $2200]

Partially “underwater”

The 3rd junior lienholder [who is owed $29k] will get $0

Completely “underwater”

They are still owed $29k, but they are now in the position of an unsecured creditor who is owed $29k [b/c their SI is extinguished]

Would now have to go to court, get a judgment, and try to pursue the debt via the debtor’s other assets

* + - * 1. This order of allocation doesn’t say anything about the bidder having to pay for the expenses of sale over and above what it wants to bid—ie. the bidder is not concerned with who gets what

Lienholder forcing the sale is the one concerned with the expenses of the sale

The question for the BIDDER is: what am I buying and how much is it worth?

* + - 1. A debtor CAN default under a junior loan and not under a senior loan
         1. But it is more usual that you would also be in default under the senior loan, too
    1. **Prob. 26.2**
       1. Facts: personal property – 1990 car that is worth $75k
          1. Car is seized to satisfy an $8k judgment (the most junior lien)
          2. Subject to a 1st SI of $60k and 2nd SI of $30k

Neither of these SCs objected to the sale

* + - 1. Issue #1: What do you expect the highest bid to be?
         1. The car is under-secured, so expect the highest bid to be $0

The most junior creditor is forcing the sale, so theirs is the only lien that will be discharged

Whoever buys this car will buy it subject to $90k in liens (and car is only worth $75k—no equity in this car)

* + - 1. Issue #2: If the lienholder who forced the sale is there, do they have an incentive to bid?
         1. What happens if no one bids & thus no buyer?

It still cost this junior lienholder $200 in sale fees.

Does this give the lienholder an incentive to bid for the car himself?

If the lienholder bought the car, she would get the car subject to the $90k in liens

Once she has the car, is the lienholder worse off?

The worst thing that could happen is that the 2 other creditors (with liens worth $90k) could take the car. They can’t force her to pay anything else.

This lienholder does NOT owe these creditors $90k—she is NOT the obligor. She is just driving around the car that is subject to their SIs. They can’t force her to pay—they can just come get the car

* + - 1. Analysis
         1. PROF: this junior lienholder/initiator of sale SHOULD bid $200 and take the car [if there are not other bidders]

$200 was the cost of sale, and even though the car is not worth anything, she does NOT owe the $90k.

If she will have to pay the sale expenses anyway, might as well take the car for a couple of weeks

It would take a while for SCs to repo the car if she doesn’t want them to repo it.

**As a buyer, you do NOT assume the underlying debt. You just take the asset subject to the SI**

* + - * 1. What if this lienholder takes the car and crashed it?

She can’t fraudulently deprive another creditor of an interest she knows that they have in the car

But this is NOT fraud—she has right to bid and take the car

It is the senior creditors’ fault if they didn’t show up at the sale to get the car for $201, etc.

* + 1. **Prob. 26.3**
       1. Facts: We represent DH bank, who is owed $270k as a 1st interest in mobile equipment worth $400k
          1. We hear that a 2nd (junior) lienholder is forcing the sale of this equipment
          2. Default at the junior level, but NOT at the senior (DH) level
       2. Issue #1: Should we worry about this? Aka that the equipment may potentially be sold at sale?
          1. Probably not – b/c DH’s lien will not be discharged with the sale. The buyer at the sale will take subject to DH’s lien.

But DH will NOT get any proceeds from the sale. Its SI will stay with the collateral after the sale

* + - * 1. Esp. b/c the collateral is worth more than DH’s loan (there is an equity cushion)—should just monitor the situation
      1. Issue #2: Is there a danger here that nonetheless DH should be somewhat anxious about?
         1. If DH did properly perfect this SI and there has been no change (ie. no movement to a new state, etc.)—is there a concern arising from the fact that that the collateral is now owned by some other person?

Concern is that DH doesn’t have a security agreement with this buyer (just has the agreement with the D—ie. that it will notify the SC if debtor moves, etc.)

Similar to car scenario from yesterday—can’t control what the buyer does with the equipment. Even though it is worth $400k today, is it going to continue to be worth $400k?

Is this buyer an irresponsible person who may deteriorate the value of the collateral? SC has no way of knowing this – SC didn’t choose this person

What if the buyer doesn’t insure the collateral? SC can’t require insurance once it is out from under the contractual provisions that the actual debtor agreed to – less control over what happens to the collateral

SC may be concerned that the equity cushion will deteriorate

* + - * 1. Once DH gets notice of this sale (which they WILL get), think about whether it can protect its position by just bidding in and buying this equipment so they know where it is?

They can NOT credit bid

A SC is entitled to credit bid to the extent, and only to the extent, that the SC would be entitled to the proceeds of the sale

You can only credit bid if the proceeds would be coming to YOU

SO to bid, DH would have to bid out of its own pocket [probably wouldn’t want to do bid b/c of this]

Throwing extra money would have to be CASH if it can’t credit bid

* + - * 1. DH CAN’T try to stop the sale

B/c can’t show that DHs right should trump the junior creditor’s right. DH has no right to foreclose b/c doesn’t have right to possession of the collateral b/c the D is not in default under DH’s loan.

If DH DID have a right to possession, could argue that its right should trump b/c it’s senior

* + - * 1. PROF: one potential solution for DH would be to pore over docs and find a default (ie. failure to submit insurance documentations, etc.)
      1. DH has to have notification of this sale so it can deal with the continuation of its SI
         1. If there is a NEW debtor, will have to track the movement of the debtor/name changes, etc. [is this buyer a new debtor?]
      2. DH could have written into its security agreement that D can’t grant any competing SIs in the collateral at all.
         1. Could also use a **cross-default** provision, which says that any default under any junior lien secured by the collateral is an event of default under the senior lien

This would trigger DH’s right to foreclose here

* + - 1. Look at expansive default provisions as example in Assn. 13
    1. **Prob. 26.4**
       1. Facts: Friend wants to borrow $100k from you and offers you a 2nd mortgage lien on her house (house is worth $1.2 mm and subject to a $800k 1st mortgage)
       2. Issue #1: If she defaults on YOUR junior lien, what is your situation?
          1. You could force a foreclosure sale. You could assume that a bidder would bid up to [$1.2 mm - $800k] b/c there is an equity cushion here
       3. Issue #2: What is your position as a junior lienholder if the default is under the senior loan?
          1. Senior lienholder will foreclose. If the sale doesn’t bring in at least $900k, you will not get any proceeds. Your lien will be extinguished no matter if you get any proceeds or not.
          2. The 1st mortgage holder is the most likely entity to bid

They are likely to only do a credit bid for $800k

MAYBE if there is someone else out there bidding, 1st lienholder may bid a bit more b/c confident that the house can be some for X amount of money.

If this is all that happens, you as the junior lienholder are out of luck **(this is the risk for the junior lienholder)**

* + - 1. It is more common that the risks rest on the junior lienholder
         1. That the proceeds from sale won’t be enough and junior lienholder will be discharged w/o seeing proceeds
      2. What could junior lienholder do to protect itself from this risk?
         1. Make debtor agree that if this collateral turns out to not be enough, he agrees to offer me more collateral in XYZ
      3. 🡪 **The real risk for the junior lienholder is if the D defaults under 1st mortgage but NOT under the junior lien**
         1. Is there any way you could prevent her from defaulting under the senior lien? Aka ensure that D pays her first mortgage on time to the 1st lienholder?
         2. Contractual device to mitigate the risks that attend junior status:

Tell D to send her mortgage payments to you as the junior lienholder. Then YOU would send the payments to the bank (1st lender).

**Wrap your mortgage around D’s 1st mortgage (“Wrap-Around”)**

If any month that check doesn’t come from the D, YOU make the payment to the 1st lender

You would have a clause saying that this event would be a default under YOUR loan (then you could initiate foreclosure proceedings)

* + - 1. NOTE: Link b/w the ability to credit bid and entitlement to proceeds

1. Competitions for Collateral [aka Individual Priority Contest]
   1. Lien Creditors Against Secured Creditors: The Basics
      1. **Generally: Lien Creditor**
         1. **§ 9-102(a)(52)**: “Lien creditor” means … a creditor that has acquired a lien on the property involved by attachment, levy, or the like …
            1. Generally, this describes an unsecured creditors to whom money is owed (could be an unsecured loan, or unpaid alimony, claim arising out of a tort, etc.) who has won a judgment against the debtor for the unpaid amounts
            2. Non-consensual
         2. **§ 9-102(a)(73)**: “Secured party” means … a person in whose favor a SI is created … under a security agreement
            1. Consensual
         3. **§ 1-201(B)(35)**: “Security Interest” means an interest in personal property or fixtures which secures payment or performance of an obligation
         4. **§ 9-109(a)(1)**: this article applies to transactions …
            1. The whole point of Art. 9 is to govern consensual, contractual SIs
         5. A lien creditor starts out unsecured, then levies on property and becomes a lien creditor
         6. BK terminology is different b/c uses the word “lien” as the umbrella concept (consensual AND non consensual)
            1. **In Art. 9, a lien is NOT the same thing as a SI**
      2. Competition: **Lien Creditor v. Lien Creditor**
         1. Both people have obtained a lien on the same collateral by levying, attaching, or the like
         2. How to obtain lien creditor status? Do whatever the relevant law tells you to do.
            1. CAN:

(1) Get the sheriff to LEVY on the collateral;

(2) Serve a WRIT OF GARNISHMENT on a 3rd party;

(3) Record notice of your judgment in an appropriate filing system;

ie. can do this in real property system

(4) Remember also that a trustee in BK has the rights of a hypothetical lien creditor

When looking at competition of lien creditor v. someone else, it is not a lien creditor here, it is a trustee that is occupying the status of lien creditor

* + - 1. **RULE**: The 1st creditor to obtain lien creditor status wins (gets priority)
         1. Look at each creditor and ask when the sheriff actually levied on the assets

Puts some control in the hands of the sheriff, b/c he has a reasonable time to levy; if the sheriff doesn’t do it right away and another one gets levied first, SOL

* + - * 1. The date you obtain your money judgment is irrelevant
    1. Competition: **Lien Creditor v. Secured Creditor**
       1. NOTE: this is like the F, L and B problem
       2. **RULE- § 9-317(a)**: SC wins **if** it does one of two things:
          1. (1) IF SC perfected its SI before the creditor becomes a lien creditor (ie. levies); OR
          2. (2) It met one of the conditions specified in **§ 9-203(b)(3)** [obtained an authenticated security agreement or took possession of the collateral in order to create a SI] **AND** filed a financing statement covering the collateral

SC would win even though SC is not yet perfected (b/c doesn’t have to have given value – the point is to treat SC’s initial advance of value the same as any subsequent advance)

* + - 1. Difference b/w options (1) and (2) under **§ 9-317(a)**:
         1. To perfect, SI has to attach AND had to take steps to give notice of it

To attach, have to have a security agreement, value must be given, and the D needs to have rights in the collateral [**§ 9-203(b)**]

* + - * 1. **§ 9-317(a)** permits a SC to win even though, not only is it not perfected, but it is not even attached at the time the lien creditor becomes a lien creditor [hasn’t even loaned the money yet]

You only earn the SC label if you have an attached SI

The way these competitions come up is usually if you have a creditor who does all of the above things but hasn’t yet loaned the money. An unsecured creditor then intervenes/attaches and becomes a lien creditor, THEN the first creditor lends the money and the first security agreement is completed.

* + 1. Competition: **Lien Creditor v. Mortgage Creditor**
       1. Outside of Art. 9
       2. E.g. Holder of a judgment against a debtor who attempts to levy against fixtures that are governed by a mortgage
       3. **RULE:** holder of the 1st lien created has priority
          1. Ask if the LC levied before the mortgage was created
          2. It is not required that the mortgage creditor record its mortgage in order to prevail—only required that the mortgage was created
       4. Some states have recording requirements that change the result of this rule
          1. A minority of states say that a mortgage holder only prevails over a LC if the mortgage is recorded
    2. Competition:  **Lien Creditor v. PMSI Creditor**
       1. PMSI is a particular type of SC
          1. **§ 9-103**: a PMSI is a SI in collateral that secures the repayment of the loan used to finance the purchase of that collateral

e.g. secures the acquisition of that actual piece of collateral

* + - 1. **RULE**- **§ 9-317(e)**: PMSI creditor wins if it files a fin statement within 20 days of the debtor receiving the collateral/PMSI created
         1. If somewhere in this 20-day window, a LC levies, the LC would probably win under the normal rule under **§ 9-317(a)**, but the PMSI creditor would win

🡪 This is a special rule b/c it says that even though the SC didn’t do what was required under **§ 9-317(a)**, SC can still win

* + - 1. **Consumer Goods**: PMSI in consumer goods are automatically perfected (wouldn’t even need this 20-day grace period b/c don’t need a financing statement to be perfected)
         1. Thus, this special protection for PMSI holders in **§ 9-317(e)** is only really needed for **non**-consumer goods
         2. Without this protection, PMSI lender wouldn’t hand over the tractors, sold collateral, etc. that it had financed until it had filed its fin. statement
      2. Why this special protection for PMSI?
         1. E.g. Debtor is a large-scale construction outfit that buys tractors from John Deere—it is the role of the purchase money lender that allows the assets to be in the hands of the debtors in the first place (thus, PMSI creditor argues that if it hadn’t been for its credit treatment, the assets would be available for levy by other creditors in the first place—so PMSI should get the preferential treatment of the grace period)
         2. For consumer goods, eases the sale of refrigerators, etc. (so Sears doesn’t have to file a fin. statement)
    1. **Prob. 28.1**
       1. (a) Real property: competition b/w a mortgage holder and a LC
          1. Facts:

Mortgage holder takes the mortgage on June 1

June 2, the other creditor/competitor levies

* + - * 1. Analysis: the mortgagee has priority b/c mortgage was created first. Judgments are not protected under most recording acts.
      1. (b) If collateral was personal property
         1. LC would win b/c at time of the levy, the other creditor hadn’t perfected or filed a fin. statement
      2. SHOWS that the result is different in real property v. personal property system
    1. **Prob. 28.2**
       1. Facts
          1. D wants to borrow $20k from P
          2. March 7- P obtains SA from D, files a fin. statement but doesn’t actually disperse any money
          3. March 10- 2nd competitor (LC) levies on the assets
          4. March 11- P gets a clean search back from filing officer
       2. Issue #1: right now, is P’s interest perfected? NO
          1. P has a SA and a filed fin. statement, **and** D has rights in the collateral, **but** until P has given value, her interest is not even attached under **§ 9-203(b)**—if it is not yet attached, it certainly can’t yet be perfected
          2. Short of actually making the loan, is there any way that P may have given value?

P could give $1 (this would count as **“value”**)

**P could also just make a commitment to lend** **(this also counts as value)**

If P says “I make an absolutely binding commitment to lend contingent on getting a clean search from the filing office”, she has given value

But lots of SCs don’t want to do this b/c they want to be able to decide at the last minute

* + - * 1. Assuming that P made no binding commitments to lend money, her interest is not attached and therefore not perfected
      1. Issue #2: if P lends money after 3/11, does she have priority over LC? YES
         1. **§ 9-317(a)(2)**: even if P is not yet perfected, she would still win over LC if P has filed a fin. statement and met one of the requirements in **§ 9-203(b)**

This lending converts P into a SC—w/o the giving of value she has no interest in the property

* + - * 1. LC loses b/c SC filed a fin. statement before LC levied (even though SC wasn’t perfected yet upon levy)
    1. **Prob. 28.4**
       1. Facts: our client specializes in lending to companies in fin. distress. Procedures it uses:
          1. (1) 1st file a fin. statement against assets in question
          2. (2) Then search filing system
          3. (3) Then verify that the assets are in the D’s physical possession
          4. (4) Typically disperses value within 2 weeks of filing and within a few days after receiving search report
       2. Issues: are these procedures good enough or can a LC get in ahead of our client?
          1. Not worried about a competition with another SC, but a competition with a LC
       3. Analysis:
          1. Our client doesn’t want to lend money upfront, so should not only verify the location of the assets at the outset but they should also (once the search comes back clean), check on the location of the assets one more time before giving the money

PROF: upfront, should not just file a fin. statement, but take a security agreement. If client does both, it is meeting the **§ 9-317(a)(2)(B)** prong of the test

This will **not** protect the client sufficiently against another **secured** creditor

Best thing for client to do is to first file a fin. statement, then search

This would protect against most other SCs

* + - 1. NOTE: a levy transfers immediate possession (does not immediately transfer ownership)
      2. Lesson: even if you don’t perfect your SI, you can still get priority over intervening LCs if you have a fin. statement, etc.
    1. **Prob. 28.3**
       1. Facts:
          1. Sheng is an unsecured creditor that is owed money by Conda.
          2. Our client is another unsecured creditor of Conda. We are worried that Sheng will try to beat us to the assets of Conda, leaving nothing for us to levy on.
       2. Issue: can we get priority over Sheng?
          1. NO—unless our client becomes a SC
       3. Analysis:
          1. We are likely to lose in LC v. LC competition b/c whoever becomes a LC first wins (and Sheng is way ahead of us in the process of becoming a LC b/c it already has a judgment and is trying to execute/levy—we don’t even have a judgment)
          2. If we become a SC, our client’s odds go way up b/c a SC **can** win against a LC as long as it perfects a SI or files a fin. statement before the LC levies

We could ask Conda to grant us a SI

This won’t work b/c Conda has no incentive to do this. It already owes our client money and would be happy to keep it as an unsecured creditor

We could offer Conda something (ie. knock money off the debt, lower interest rate, etc.) as an incentive to grant our client a SI

Conda may be willing to do this (but **won’t** if it is teetering on the edge of BK anyway)

If our client gets a SI first, then we win

Get the SA and file fin. statement and that’s it (we wouldn’t even have to lend additional money—the fact that Conda already owes us money is enough)

* + - 1. Lesson: in a race b/w an unsecured creditor and another unsecured, can improve your position by becoming secured
      2. NOTE: in most states, it is the date that the sheriff actually levies (gets possession) that determines the date that you become a LC
         1. If a sheriff waits so long to levy and so derelicts his duty, you can use immersement (seek this writ, which says that the sheriff has to pay b/c he didn’t discharge his responsibilities properly)
    1. **Prob. 28.5**
       1. Facts:
          1. Bonnie’s boat world sells $70k boat; takes a SA; drafts fin. statement but has not yet filed it; takes a promissory note for the remainder of the loan
          2. The boat is seized as it rolls out of the boatyard (the sheriff levies on it to pay Orville’s interest)
       2. Issue: does Bonnie’s interest take priority?
          1. **This is a competition b/w Bonnie (PMSI) and Orville (LC)**

Bonnie is a PMSI SC b/c she is financing the purchase of this boat and taking a SI in this boat to secure this loan

* + - 1. Analysis: Bonnie (PMSI SC) will win
         1. Does Bonnie have to file a fin. statement here to perfect her SI?

If the boat is a consumer good, Bonnie doesn’t ever have to file a fin. statement (and it does look like the boat is a consumer good under these facts)

Bonnie would be perfected before the levy and would absolutely get the boat back from the sheriff right away

Assuming, arguendo, that the boat is **not** consumer goods:

As of right now (aka the date the sheriff is taking the boat away), Bonnie is not perfected. But b/c of the PMSI rule, she has a 20-day grace period to file the fin. statement—if she does this, Bonnie wins

* + - * 1. If Bonnie’s SA is **not** signed by the borrower:

Bonnie is unsecured and so unperfected—has **no** status at all

The LC will win the moment he levies on the boat

Bonnie should **not** fill in the signature after the fact (this is not consistent with ethics rules)

* 1. Lien Creditors Against Secured Creditors: **Future Advances**
     1. Overview
        1. A SI can secure not **only** a loan that is made at the time the SI is granted, but also future loans that the creditor may extend to the D
           1. **§ 9-204(c)**: SA may provide that collateral secure future advances

But SA doesn’t **have** to do this

If SC wants this SI to attach to an advance, would have to take out a new SA to cover it if there is nothing in the original SA to cover the new loan (aka the SA would have to **say** that it also covers future lending)

* + - 1. May use SA to secure other amounts that the D may incur **not** in the form of borrowing – aka NONADVANCES
         1. Ie. “in the event of your default, I will incur collection expenses in trying to collect the unpaid loan, and my SI in your farm equipment also secures the repayment of those collection expenses, attorneys fees, etc.”
         2. **“Advance”** refers to the lending activity itself; a non-advance is more money that the D owes—not additional money borrowed
      2. **EXAMPLE**: Loan agreement—(1) SC lends initial $1k advance 🡪 (2) judgment lien of $3k (levy has happened) 🡪 (3) SC makes an additional advance of $2k
         1. **1st priority** competition b/w lienholder and SC w.r.t. 1st and 2nd transaction

SC will win

* + - * 1. **2nd priority** competition b/w lienholder and SC w.r.t. 2nd and 3rd transaction

This is what we deal with in this assn.

* + - 1. Debate about theoretical approaches to this 2nd priority (above) problem
         1. (1) Unitary Theory

Any SI that arises out of a single loan agreement **relates back** to that loan agreement (is part of that original transaction), so should be treated in a unitary way

Any SI securing any loans that relate to that original transaction are treated as part of the original transaction

Attaches from the outset

Ie. the first advance under the line of credit

No priority issues if we use this theory

Use the rules in prior assn. w.r.t. priority of original SA

* + - * 1. (2) Multiple Theory

**Each advance gives rise to a new SI**

Even though your loan agreement provides for it, this says that the 2nd advance is a new interest b/c now your SI is attaching to secure a new loan and we should recognize that this is a new loan

It didn’t happen when the initial advance happened—it is a new relationship

If you accept this theory, you need special priority rules to determine how the 2nd priority competition above will come out

* + - 1. UCC has adopted the **Multiple Theory** in the context of future lending
         1. Every time you have a new obligation that becomes secured, it is like a new little SI that we have to deal with (the issue is **how** UCC deals with it)

Future advances are treated differently, but what priority rules should govern?

The choices of priority treatment could be as follows:

(1) Deal with it in chronological order

In the above example, map priority by saying that SC’s interest securing the initial $1k loan gets the senior position

**Next** comes the LC’s $3k as 2nd most senior

**Last** comes the additional advance of $2k by the SC

(2) First comes the $1k lien of the SC, **then** the SC’s additional advance

Even though this additional advance is a new interest under the Multiple Theory, it relates back to the initial lien, and for commercial purposes we want to encourage SCs to make advances

LC will be in the **3rd** (most junior position)

**This is essentially what the UCC adopts in § 9-323(b)** – this **§** provides huge protection to SC and not a lot to lien holder

\*This matters if the collateral isn’t worth enough to satisfy all of the interests

* + 1. Future Advance v. Advance Made Pursuant to Commitment
       1. Future advance = future lending that is secured by a preexisting SI [a future advance is **always secured**]
          1. **§ 9-204(c)**- perfected whether or not the future advance is pursuant to commitment [why perfected?]

**Not pursuant to commitment** = optional, but still a future advance if secured by a preexisting SI

Only would be **pursuant to commitment** when the original LOAN instrument says “I agree to lend you $20k today AND should you within the next 2 years require up to $20k more, I **promise** to lend you up to $20k more provided that you are not insolvent, etc.”

* + - * 1. NOTE: this distinction b/w FA pursuant to commitment and FA that is optional is important for priority rules
        2. **Loan agreement** can be the same document as the **security agreement**, but often is not

Loan agreement would say “I owe you $20k with X interest and due date”

Lender would agree to lend the money, etc.

**The commitment to loan more money belongs in this document, whereas the future advance stuff belongs in the SA**

Security agreement creates the SI to secure the unpaid loan obligation

Very often IS a separate document

* + - 1. Not all loans are future advances 🡪 if you conclude that a loan is truly a future advance, you then need to know whether it was made pursuant to a commitment or not
         1. To call something a future advance does **not** automatically mean that it was made pursuant to a commitment
      2. How to know if something is a future advance:
         1. Starting point of any loan is that it is unsecured unless a SI is granted to secure it

If SI says “I agree to grant you a SI in equipment to secure the $ you loaned me today”

If two years later the D wants more money from the SC and SC lends an extra $10, this $10 is an **unsecured** loan b/c the previous SI does not cover it

It could accurately be called an **unsecured advance**, but it is not a future advance b/c if were described as a future advance you would be saying that it is a new loan that is secured under the original agreement (it would only be secured under the original agreement if it was mentioned in the original SA)

**§ 9-204(c)-** A SA may provide that collateral secures future advances

**Notion of calling something a future advance is always talking from the POV of the original SA**

* + - 1. **Dragnet Clause**: this loan and any other loan
         1. SA could say that this collateral secures this $20k loan AND any loans in the future

If D asks for future loans pursuant to this SA that are more than the value of the collateral, the law doesn’t care about this (but the SC cares about this)

* + 1. Priority Rules Re: Advances
       1. **Personal Property -- § 9-323(b)**
          1. A SI securing an advance that is made after another person has become a LC is **subordinate** to the rights of that LC, UNLESS:

(1) SI secures an advance made within **45 days** after the creation of the LC’s lien; OR

PROF: this is a flat grace period that says if you make your additional advance no more than 45 days after the lien is created, you have priority

(2) If SC’s advance was made without knowledge of the judgment lien; OR

(3) If this advance was made pursuant to **commitment** entered into without knowledge of the lien

This relates back to the original SA—if the original SA obliges the SC to make additional advances under certain circumstances, then all of those additional advances get priority over intervening LCs even if the advance was made in full knowledge of the existence of an intervening LC

* + - * 1. NOTE: this gives a SC a lot of chances to get priority over the LC
      1. **Real Property** 
         1. NOTE: even more protective of the SC
         2. ***Shutze*** case

RULE: “For priority purposes, the lien securing the future advance takes its date from the recording of the original mortgage and reaches forward to secure the advance made after intervening rights became perfected”

This is like the **unitary** theory

**Says that any lien securing a future advance takes it date from the filing of the original mortgage**

We don’t even need to know when the advance was made and/or if it was made with knowledge of the intervening LC

* + 1. **Prob. 29.3**
       1. Chronology: SC lends $50k and takes a mortgage in some real property. Then a LC obtains a $100k judgment and records it in the real property system. SC then lends additional $25k. D defaults and SC incurs fees and expenses of $5k pursuing collection. [this is in the real property context; interest and fees are secured by the mortgage].
          1. NOTE: mention of LC, here, technically means an unsecured creditor who obtains a $100k judgment, thereby becoming a judgment creditor. Becomes a LC by recording his judgment in the real property system. **This moment of recording creates LC status**.
       2. Priority mapping:
          1. (1) **Most senior lien**: the initial $50k lien of SC
          2. (2) Apply the real property rule from ***Shutze***

Stack the advances that the SC has made under the initial mortgage

So the **next senior lien** is SC’s $25k advance

* + - * 1. (3) SC’s fees and expenses will come **next**—as long as they were provided for under the original instrument/mortgage, they should enjoy the same treatment and go with the rest of the SC’s interests

**All of SC’s unpaid amounts are thus lumped together**

NOTE: but this is not very complicated here, b/c under the unitary theory in real property law, the secured obligations of the SC always go together (& **non-advances** are included)

Fees and expenses are more complicated under the multiple theory

* + - 1. Total protection for the SC
    1. NOTE: even with regard to real property, not all jurisdictions follow the ***Shutze*** rule
       1. Some (min) only give priority to **obligatory** advances, and **not** to optional advances
       2. **But the maj position** is that in real property, **all** advances relate back to the priority of the original lien
          1. **\*This is what we should focus on**
          2. But here has to be a clause in the original instrument re: future advances. If there isn’t, then it is **not** a future advance b/c it is not contemplated in the original agreement

If the original agreement only says “I agree to lend you $100k” and four years later, the SC says to the same D “I agree to lend you $40k,” this **wouldn’t** trigger these rules or be a future advance—it would simply be a **new agreement**

* + 1. **Prob. 29.4**
       1. Facts: same as above in **29.3** but in the **personal property/UCC** context
          1. So instead of a “mortgage,” say SI and instead of “records,” say levies
          2. 60 days between LC levying and SC advancing additional $25k
       2. Analysis
          1. Priority

1st- SC’s $50k lien

2nd- LC’s $100k

3rd- SC’s $25k advance

This was made **with** knowledge, **w/o** commitment and **outside** of the 45-day window—so no exceptions apply for the SC

* + - * 1. **NON-ADVANCES**: The fees are not advances, they are **non-advances** b/c they are not loans

The Q then for the UCC drafters is to ascertain the priority of these non-advances

***Uni Imports***: a few possible approaches

Talks about court rationale from the ***Dick Warner*** *case:*

***Dick Warner***: drafters didn’t intent to include non-advances in **§ 9-323** at all—thus, a unitary approach for non-advances (relation back to the original agreement). If they **do** relate back to the original agreement, these non-advances would be inserted before the LC’s $100k (lumped with SC’s original lien).

**But** the ***Uni Imports*** holding criticizes this unitary approach and says that these non-advances should not be squeezed in before the LC. But this result has been endorsed, so agree that non-advances shouldn’t be treated as advances.

***Uni Imports*** court: we want to distinguish non-advances relating to advances made **before the levy** and non-advances related to advances made **after the levy**

Divvy up the fees and expenses and ask what they relate to (ie. if they relate to before or after the levy)

The hard part is that many of the fees (attorneys’ fees, etc.) are going to happen after the default (and after the 2nd advance [?])

Is a portion of the fees ascribable to the initial $50k loan?—You could argue YES

* + 1. **Prob. 29.1**
       1. LC v. SC
       2. Facts: Boat (collateral) is worth $32k. Deering lends $1k to friend and takes a SI in his boat and files a fin. statement (thus is a SC). Then BCA wins a $45k judgment against the owner of the boat and levies on it (becomes a LC). Now the owner of the boat is saying that the LC is about to force a sale of the boat and he doesn’t want this to happen—wants SC to lend an additional $31k b/c thinks that will avoid foreclosure of the boat.
       3. Analysis:
          1. (a) If a sale of the boat is forced:

1st priority: $1k SC loan

2nd priority: $45k LC loan

If LC forces sale of the boat, the 1st priority lien will survive (buyer will buy the boat subject to the $1k SI)

But buyers will still bid up to $31k

NOTE: **if LC is not paid the full amount, it is not technically called a deficiency**—but will have an unsecured claim for the additional amount

* + - * 1. (b) If SC does make an additional advance of $31k to D

Whether this SC advance gets priority over the LC depends on the original agreement b/w the SC and the D

Need to know if the initial SI that SC got said that the collateral secures the $1k loan AND any other future amounts

This is what distinguishes future advances from plain old lending

Assuming that the original SI **did** include future advances:

SC’s advance **will** get priority over the LC’s lien

If the advance is made within 45 days of the LC’s lien, it gets priority no matter what

So SC could know perfectly well that the LC’s lien had been created AND SC had no commitment to lend any additional money to D –and SC advance would still get priority

Priority:

1st- SC’s $32k total

2nd- LC

NOW- **no one will bid** if LC forced the sale

B/c the boat is worth $32k and would be sold burdened with $32k in liens

This is what the D wants

Is this fraud?

Even though D only wants this loan from his friend in order to protect his asset, it would be hard to use the weak fraudulent conveyances laws to prove that this was actual fraud b/c SC and D’s initial relationship permits these future advances

* + - 1. LESSON: SCs really do win over LCs even when SC has no obligation to lend and knew about the LC’s lien
         1. This was just like the Felicia problem (F worried that her husband granted a SI to someone else and thus shielded the assets)
      2. NOTE: if SC wasn’t friends with this D, this behavior would be crazy for SC b/c D looks untrustworthy
    1. **Prob. 29.2**
       1. Facts: same issue as above, but from the POV of the judgment creditor (as opposed to the SC)
       2. Analysis:
          1. Judgment creditor knows that a SC is out there—trying to figure out if he, as an LC, should proceed against this asset (aka will LC get money out of it?). All he knows now is that SC has a SI in the boat. He needs to know what the outstanding obligation is today and whether that SI also covers future advances.

Hard to figure out b/c all that is on file is the fin. statement

Don’t know about how much of the collateral the SI secures or whether it contemplates future advances

Makes it hard for judgment creditors to proceed against assets that are already encumbered by SIs

**Easier to proceed against unencumbered assets**

* 1. Trustees in BK against SCs – The Strong Arm Clause
     1. Overview
        1. When D declares BK:
           1. (1) BK estate is created

All assets of the D are pooled; trustee then assesses

* + - * 1. (2) Automatic stay

All the creditors no longer can take any collection actions against the property in the BK estate

* + - 1. Creditors want to say that they are not an unsecured creditor that has to wait until the end of the process, but that they are a SC that has a particular claim on property in the estate (and thus can get that property out of the estate or the value of that property)
         1. Ie. mortgage creditor wants the house to be for his benefit alone
         2. Ie. GMAC wants the care to be for his debt alone
         3. Some assets in the estate are unencumbered
      2. The whole role of the trustee in BK is to maximize the value of the estate for the general/unsecured creditors
         1. Hoping that at the end of the BK process, there be some value that can be liquidated and paid to the general creditors
         2. Trustees in BK are charged with making sure that anyone out there claiming to be a SC really is a SC (that they have done everything they need to do to validate their claim as against the other general unsecureds)
    1. **“Strong Arm Power”** 
       1. BK law give trustees the power/right to **avoid** unperfected SIs and liens
          1. Ie. can be avoided if mortgage was not recorded (ie. not perfected)—now the house is part of the BK estate that is part of the pool for general creditors
          2. Not saying that these people **aren’t** SCs—saying that if you are secured but unperfected, your interest can be avoided in BK

Value of the collateral remains in the BK estate to benefit the whole unsecured group

* + - 1. In BK, you have to have a PERFECTED SI
      2. Important because:
         1. **(1)** In practice, it is not very common to find a competition b/w a SC and an actual LC b/c a LC really wants to find **unencumbered** assets of the D [faces complications with encumbered assets—like the growth of the SI/$ owed to SC and wrongful levying]

Due to the way the BK code creates this strong arm power, gives the trustee the status as a hypo LC—**BK is where you see operation of the rules re: priority b/w SC and LC**

See **§ 9-317(a)(2)**; **§ 9-323(b)** [LC v. future advance]

You really use these rules in BK

* + - * 1. **(2)** Trustee can avoid unperfected SIs, but we have learned earlier that SCs don’t **have** to perfect (only need to perfect re: competitions with **other** creditors, not the D)

BK is another **major** competitor for the SC to worry about

If the D declares BK and SC has not yet perfected, SC is sunk

**It is the BK rules that create the strongest incentive for lienholders to perfect their liens**

* + 1. BK Code gives the trustee (3) hypothetical statuses re: avoiding liens [we look at two]:
       1. Mechanisms used to actually apply the **Strong Arm Power** 🡪
       2. **BK § 544(a)**
          1. Personal property & fixtures context

Trustee shall have as of the commencement of the case, the rights of a creditor that obtains a judicial lien on all property on which the creditor could have obtained such a lien

**Pretend that as of the moment the BK petition is filed, the trustee is in the shoes of a lien creditor who has levied on ALL of the assets inside the BK estate**

Then SC by SC, ask if each SC would prevail in a competition with a LC

If yes, SI remains

If no, the SI is avoided

* + - 1. **BK § 544(a)(3)**
         1. Real property context

Gives trustee the status of a bona fide purchaser of real property who buys that property at the time the BK petition is filed

Ie. bank has a mortgage on house and as of the date the BK petition is filed, treat the trustee as someone who buys that house and immediately records a mortgage.

Ask if a buyer like this would defeat the interest of the bank or not

If yes, then the SI can be avoided

* + 1. **Prob. 30.1**
       1. Facts: Company filed BK on April 15. Now, trustee reviews the SC’s claims and asks if he can avoid each one.
       2. (a) Bank takes a PMSI in equipment but fails to file a fin statement
          1. SI attaches on Nov. 15. BK is filed on the next April 15.

At the moment the BK is filed, the bank is **not** perfected

Trustee gained LC status on April 15

Competition b/w LC who levied on April 15 at a time when a SC was still unperfected?

Apply **§ 9-317(a)** rule w.r.t. LC v. SC—SC has to show that it is perfected or has a filed fin. statement + SA

**SC will lose here; trustee can avoid the lien of this bank**

The value of the machinery is in the estate for the benefit of the other unsecured creditors

* + - * 1. NOTE: PMSI is a loan used to purchase the thing that is also serving as the collateral

If the SI secures a loan that was used to acquire the collateral, the loan is called “purchase money”

**When it says that the bank “financed the new machinery,” PROF says that this insinuates a PMSI**

This is **not** a PMSI that is automatically perfected b/c it is **not** a consumer good

* + - 1. (b) Same as (a), but bank **did** file a fin. statement on April 14 (1 day before BK was filed)
         1. Trustee **can’t** avoid this SI b/c trustee doesn’t become a LC until April 15 (after bank has already perfected)
      2. (c) Different SC lists the debtor by name but omits all of the info required by **§ 9-516(b)(5)** [ie. the type of org—trade name, partnership, registered org., etc.].
         1. Issue: does this defect give the trustee in BK the power to avoid the interest?
         2. Analysis: fin. statement is still effective, though, b/c of **§ 9-520(c)** [says that fin. statement is fully effective if info is missing but filing officer wrongly accepted the filing]

Filing officer should have refused this fin. statement under **§ 9-520** b/c **§ 9-516(b)** says what needs to go into the fin. statement

But now it is just as effective as if that info had not been missing

* + - * 1. **Answer:** trustee **can’t avoid** this SI b/c this incorrect fin. statement was **effective**
        2. PROF: if this SC had gotten the name of the debtor wrong, this would have been a big problem

**§ 9-506(c)**- safe harbor w.r.t. seriously misleading problems—if a search under the correct name of the D would have pulled up the wrong fin. statement, then the mistake in the name is not enough to make the fin. statement ineffective

**§ 9-503(a)-** says that a fin. statement sufficiently provides the name of the D, if the D is a registered org. [we don’t know if this is a registered org. or an individual using a trade name or a sole proprietorship, etc.] only if the fin. statement provides the name that is stated to be the orgs name on the public organic record

**§ 9-506(b)** – financing statement seriously misleading

Starting point is that if the name of the D is wrong on the fin. statement, fin. statement is seriously misleading

* + - 1. (d) Glasco files fin. statement; 5 years go by and fails to continue (lapses on July 15). BK was declared on April 15.
         1. **Answer: § 9-515(c)** & **§ 9-317(a)**- this SI can **not** be avoided

**Sum:** as long as SC was perfected when trustee became a LC, SC wins

Lapse happened **after** BK petition was filed

SC was perfected at the moment the BK petition was filed (even though it later lapsed)

NOTE: The only way the SC could lose is if operation of the rule made the lapse retroactive—but **§ 9-515(c)** says that it is only retroactive with respect to a purchaser of the collateral for value (which a trustee is **not**)

Ex of purchasers for value: another SC who lends against the collateral and takes a SI; someone who buys collateral with money (a LC is NOT a purchaser for value)

**Unless it is a purchaser for value, unperfection is prospective only**

Trustee became a LC when BK petition was filed on April 15

**§ 9-317(a)**- a SI is subordinate to a LC who becomes a LC before the SI is perfected

But SC **was** perfected on April 15, and the fact that the SC became unperfected down the road doesn’t matter. Run the competition on the day the LC status arose (April 15)

And **§ 9-515(c)** doesn’t make this unperfection retroactive, here

**But** SCs would care about curing the lapse anyway if there are other SCs on the scene (would worry about their enhanced priority over you even though you don’t have to worry about the trustee’s strong arm power)

* + - * 1. HYPO: but if the BK had been filed now (after the lapse on July 15 instead if before), trustee **would win** and be able to avoid the SI b/c the competition would be b/w a LC (trustee) and unperfected SC (Glasco)

From July 15 forward, this SC is now unperfected (unless it files a new fin. statement—then would be perfected as of the that new filing date)

* + - * 1. If SC lets its fin. statement lapse, it would have to file a new fin. statement—wouldn’t be able to file a continuation statement at hat point
        2. **Auto stay** bars any actions taken to perfect an unperfected SI

**Filing a continuation statement does not violate the stay**, b/c you are just maintaining perfection that you already have

**But** what if you were perfected the day BK was filed, then lapse, then you file a new fin. statement after BK?

Could make an argument that this new fin. statement doesn’t violate the stay?

But BK trustee would argue that the fact that you are trying to become perfected again is problematic under the auto stay

PROF: even though you are not taking something away from the general creditors b/c you **were** perfected when the BK petition was filed

* + - 1. (e) Bank makes a secured loan and filed fin. statement, but SA lacks description of the collateral. BK petition filed on April 15. On April 24, Benny fills in the blank.
         1. Analysis: at the time of BK filing on April 15, the SA is **not** effective w/o the description, so the SI did not attach. Unless it is attached, can’t be perfected. This is **not** a perfected SI. It is actually not a SI **at all** (SC doesn’t have a SI in this collateral)
         2. **Trustee will win over the bank**

Benny would be in big trouble for violating the auto stay (he filled in the blank after BK was filed)

Grace will be in trouble b/c she revealed confidential info that she shouldn’t have disclosed

* + - 1. (f)
         1. Facts: April 6- SA authenticated, car delivered. April 15- BK. April 25- SC’s application delivered to DMV (perfection).

SUM: 9 days before BK, Gargantuan buys a Lexus. Ten days after BK, bank delivers to DMV an application for title noting its lien on the car.

* + - * 1. Avoidable?

20 days have elapsed before the application for a certificate of title is delivered. BK is filed in the interim (9 days after SA)

If trustee levies on the car on April 15, will it prevail over the SC?

**NO b/c this is a PMSI that has a grace period. SC should win.**

**§ 9-317(e)**: if a person files a fin. statement w.r.t. to a PMSI before or within 20 days after the D receives delivery of the collateral, the SI takes priority over LC which arise between the time the SI attaches and the time of filing

**aka 20**-**day grace period**. SC took SI on April 6, so SC had until April 26 to file a fin. statement covering the car (SC will have priority over a LC who takes an interest in the intervening time period)

**Cmt. 8 to § 9-317** [w/ cross reference to **§ 9-311(b)**]—**Can use this § even though perfection in the car is done by applying for notation of title to the DMV (not by fin. statement)**

**§ 9-311(b)**- provides that compliance with the perfection requirements of a statute (like the motor vehicles statute) is equivalent to the filing of a fin. statement. A person who perfects via this statute files a fin. statement within the meaning of **§ 9-317(e)**.

**BUT NOTE**:the exception when interest in car IS perfected by fin. statement 🡪 when the car is held in **inventory** by the dealer (ie. hasn’t yet been sold to an owner), you **perfect via fin. statement** (but this is not the case here)

Perfection is retroactive to the date of attachment [?]

* + - * 1. We know this is a PMSI b/c SA is from the bank, who also financed the purchase
        2. PROF: the tricky part is that if you look at the Motor Vehicle Statute itself, it only has a ten day grace period

“As long as your lien is noted on the title within ten days,” your perfection will be deemed retroactive to the date of attachment of SI

Tension b/w these ten/twenty day grace periods

but b/c of the special UCC treatment of PMSIs, our SC will prevail here

* + - 1. (g) Competition b/w sheriff who levies on April 17 on behalf of some other judgment creditor and a BK trustee (one LC [trustee] v. another LC [real])
         1. Not enough info to answer this problem b/c need to know, under the law of the actual state, do you become a LC on the day you actually levy, or do you become a LC on the day you deliver your writ to the sheriff?

B/c looks like this real LC had delivered its writ to the sheriff on April 8—it **this** is the salient date, then this real LC will win over the BK trustee

But if only the **actual levy** gives LC status, then the trustee will win

* + 1. **Prob. 30.3 GET FROM SLIDE**
  1. Trustees in BK against SCs: **Preferences**
     1. Overview
        1. During BK, noting can be done by the D or anyone else to preference one unsecured creditor over another (they have to wait)
           1. But what if you have a D that knows that he is going to file BK on Thurs. and on Wed. starts granting SIs to come creditors?

Those unsecured creditors would now be better off than all of the other unsecured creditors, and this seems illegitimate b/c seems like the D is doing it knowing that BK is around the corner [seems incompatible with the idea that all unsecured creditors are treated a like in BK]

**So we look back 90 days to look for preferences**

If we have a preference like this (ie. SI given), trustee can avoid it and put the “SC” back in the unsecured pool with everyone else

* + 1. **BK § 547(b)**: The trustee may avoid any **transfer** of an interest of the debtor in property:
       1. **NOTE**:transfers can be a straight cash transfer to creditor or the creation of a SI (which is a lien on particular property)
       2. **(1)** To or for the benefit of a creditor
       3. **(2)** For or on account of an antecedent debt
          1. These **two** elements say that in order to be preferential, the transfer has to be related to a **preexisting debt** (ie. giving preference to someone who already is an unsecured creditor of the D. If there is no antecedent debt, you can have transfers that aren’t problematic at all)

Ie. ten days before BK is filed, D sells furniture and gets $300. This is not a transfer that is any way preferential—it is just a new transaction. Even if D finances this transaction and grants a SI in this furniture, it is not preferential.

* + - 1. **(3)** Made while the D is insolvent
         1. ie. debts exceed its assets

Otherwise, D could have “preferenced” all debtors b/c if solvent could satisfy everyone

* + - * 1. BK creates a **presumption of insolvency** during this preference window

B/c people don’t tend to be completely solvent on one day and insolvent the next

* + - 1. **(4)** Transfer made—
         1. **(A)** On or within 90 days before the date of filing …
         2. **(B)** Between 90 days and one year before the date of filing … if such creditor … was an insider

**Insider** = if a corp., an officer of a corp. or a relative of an individual debtor (b/c these transfers are more suspect)

* + - 1. **(5)** That enables such creditor to receive more than such creditor would receive if the case were … liquidated under Ch. 7 and the transfer had not been made
         1. **aka the creditor has to be made better off by the transfer**
    1. **When is a transfer made**?
       1. NOTE: critical to know whether the transfer was made within the preference period (90 days before BK), b/c if not—none of this is an issue
       2. **BK § 547(e)(2)**: When is a transfer made?
          1. **(A)**- exception to **(B)**: at the time such transfer takes effect b/w the transferor and the transferee (aka granted in Art. 9 terms), if such transfer is perfected at, or within 30 days after such time …

**Aka if perfected within 30 days, the whole transfer will be considered to have been made on the date that it was granted**

This helps if the date of the transfer/grant is outside of the preference period

Art. 9 compatibility: a transfer

* + - * 1. **(B)-** Basic rule: a SI is transferred to the creditor when it is perfected (NOT when it is granted) if such transfer is perfected after such 30 days

This is relevant b/c sometimes these two dates happen outside and inside the preference period (ie. if perfected within the preference period, would be avoidable)

* + - 1. **BK § 547(e)(1)**: for purposes of this section --
         1. **(A)**- Transfer of real property … is perfected when a bona fide purchase cannot acquire an interest that is superior

If you have a SI in land, you need to **record** in order to prevent a bona fide purchaser from acquiring a superior interest to yours

**Aka perfected when you record**

**If SI was recorded in 30 days or fewer from the moment it was made, then use the date it was made as the moment of the transfer**

* + - * 1. **(B)**- Transfer of a fixture or property other than real property is perfected when a creditor … cannot acquire a judicial lien that is superior

**Aka for personal property, have to defeat a LC (to be perfected for BK purposes)**

File a fin. statement prior to levy (which means you have perfected)

OR take possession

Then you have perfected, and as long as you have done it within 30 days of grating the SI, the date of the SI governs

OR you could have a fin. statement on file and have a SA (this beats a LC, so is perfection for this purpose of the BK code)

* + - * 1. NOTE: this just helps us determine the date the transfer was made
      1. **NOTE: BK § 547** doesn’t use “attachment” and other Art. 9 talk b/c it deals with all kinds of SIs, including real property, mechanics liens, etc., where we don’t use the same language
    1. **Prob. 31.1**
       1. Facts: we represent the trustee in BK. Case was filed in Sept. 1.
          1. We are deciding whether to attack transactions as preferences.
          2. Need to know from what date does the preference period runs

June 3 (count 90 days back from Sept. 1)

* + - 1. (a) Wooden borrows $300k on secured basis from Firstbank on Aug. 15. On that day, bank gets SA, fin. statement and loan proceeds are dispersed. Files fin. statement the next day (Aug. 16). Was the granting of this SA to Firstbank a preferential transaction?
         1. When was the transfer made? Aug. 15 b/c SI took effect b/w the parties on the 15. As long as it is perfected within 30 days (which it was), we consider it to have been made on the date it was granted
         2. Was this transfer made on account of an antecedent debt?

The debt was created on Aug. 15; the transfer was also made on Aug. 15

So **not** made on account of antecedent debt (the debt arises at the time of this transfer)

* + - * 1. This is **not** a preferential transaction b/c this SI was not made to someone who otherwise would have been an unsecured creditor stuck in the general pool. This was a transfer in order to obtain **new** financing.

Could also argue that maybe the debt arose seconds before the SI was granted

Ie. what if the loan money had been dispersed first, then a whole day later we have the SA & fin. statement?

**BK § 547(c)(1)** provides an exception – trustee may not avoid the transfer if it was intended to be a substantially **contemporaneous exchange** and was in fact a CE

If there is like a day gap when the intent of the parties was for it to be contemporaneous, the BK code doesn’t worry about it

* + - 1. (b) Wooden borrows $300k from 2nd bank unsecured on Feb. 7. On July 11, Wooden granted a SI and 2nd bank perfects. BK filed on Sept. 1.
         1. Avoidable? **Yes** per **BK § 547(e)(2)(A)**

This WAS a transfer arising out of antecedent debt (within the preference period)

Classic case of preferential transfer

2nd bank was already a creditor, but was unsecured

* + - 1. (c) Wooden borrows $300k unsecured from 3rd bank on Feb. 7 (SA, Fin. statement, and loan given). Fin. statement that SC tried to file was lost in the mail and was not actually filed until July 11. BK filed Sept. 1.
         1. Avoidable? **Yes**

Not perfected until inside the preference period **and** more than 30 days after creation of SI

* + - 1. (d) Wooden borrows $30k purchase money from 4th bank on July 21 to acquire some new equipment from EMS. D took possession of the property on July 22. 4th bank filed fin. statement on Aug. 4. BK filed Sept. 1.
         1. **Unavoidable**

**BK § 547(c)(3)**- BK code’s own special PMSI exception

Trustee may not avoid a transfer that creates a SI in property acquired by the D to the extent such SI secures new value that was given to enable the D to acquire such property AND in fact used by the D to acquire such property as long as that interest is perfected on or before THIRTY days after D receives possession of such property (**NOT a preference at all**)

Aka talking about a special type of transfer (PMSI)

**A transfer of a PMSI is not problematic for preference purposes** b/c it is not going to be for an antecedent debt—it is taking a SI to secure the loan that you give today to enable that D to acquire this new collateral

BK trustees don’t really worry about PMSIs

* + - * 1. This is not consumer goods, so no automatic perfection

But not a preference at all b/c fin. statement was filed within 30 days of when D took possession of the property

* + - 1. (e) Would there be a difference if 4th bank had dispersed to Wooden and Wooden had used **different** funds to buy the collateral (aka **not** a PMSI, just a regular SI)
         1. **Unavoidable**

SI transfer occurred (under BK rules) on July 21 -- b/c was created on July 21 and was perfected via fin. statement on Aug 4, which was within 30 days of July 21

Thus—everything happened on the same day, which means that there is no antecedent debt

So not preferential even though it was made during the preference period

* + - * 1. This is why SCs disperse money straight to the sellers of the collateral (not the debtor)
      1. (f) Wooden borrows from Elsa, who lends on March 9. Intended to be secure, but takes over a month to actually secure it. SA signed and fin. statement filed on April 12 (this is when SI is created). BK filed on Sept. 1.
         1. Avoidable? **Yes**

Elsa is an **insider**, so use longer (one year) preference period

The loan was antecedent between March 9 and April 12

So preferential

* + 1. **Prob. 31.3**
       1. Deals with inventory
          1. The issue is that the pool of assets is constantly changing. Know that this happens during your preference period. Constant flow of SIs being granted on account of antecedent debt—trustee can’t avoid all of these (otherwise you would have no inventory lenders)
       2. **BK § 547(c)(5)**
          1. A transfer that creates a perfected SI in **inventory** can’t be avoided

EXCEPT

To the extent that the aggregate of all such transfers caused a reduction as of the date of BK filing of any amount by which the debt secured by such SI exceeded the value of all SIs for such debt on the later of

**AKA [TEST]**

1st step: determine the amount of loan outstanding 90 days prior to BK filing and the value of the collateral on that day

Value of collateral = $1.2 mm

Loan outstanding = $2.5 mm

\*This is an under-secured creditor ($1.3 mm under-secured)

2nd step: when BK is filed, still under-secured (but by less—only by $800k)

Which means they have gotten some preference here

The value of transfers of new inventory during the preference period has made the creditor better off

**So $500k is avoidable**

The preference amount by which the creditor is better off

**Compare how unsecured the creditor is at 90 days before BK filing with how unsecured creditor is at time of BK filing**

* 1. Secured Creditor against Secured Creditor
     1. Overview
        1. This is the most frequent type of competition
        2. Get SUMMARY FROM CB
     2. **§ 9-322:** SC v. SC
        1. (a)(1) If both SIs are perfected, first to file OR perfect wins
        2. (a)(2) Perfected SI wins over unperfected SI
        3. (a)(3) If both SIs are unperfected, first SI to attach or become effective wins
     3. **Prob. 32.1**
        1. Facts:
           1. Aug. 1- Bank #1 files a fin. statement against D’s equipment
           2. Aug. 5- Bank #2 takes SI, lends and files against D’s equipment
           3. Aug. 7- C-Dogs becomes a LC (levies on equipment)
           4. Aug. 10- Bank #1 takes SI in equipment and lends
        2. Analysis:
           1. **Bank #2 v. LC**

To determine priority of LC, look to 2nd part of **§ 9-317**

LC would lose to Bank #2 b/c at the time the lien was created, Bank #2 had already perfected

* + - * 1. **Bank #1 v. Bank #2**

**§ 9-317**: SI is subordinate to the rights of a … under **§ 9-322**

**§ 9-322**: priority among conflicting SIs is determined according to the following **rules**:

**(a)(1) Conflicted perfected SIs rank in time of filing OR perfection** [THIS IS THE GENERAL RULE: use it as long as both SIs are perfected]

Bank #1 and #2 **are** both perfected

The creditor who either files of perfects first wins

Bank #1 **wins** (has priority even though it didn’t even have a SI until after Bank #2—all it did was file its fin. statement first)

* + - * 1. **Bank #1 v. LC**

At the time C-Dogs became a LC, Bank #1 was **not** perfected (all it had was a fin. statement)

**So LC beats Bank #1** under **§ 9-317**

* + - * 1. THIS IS CIRCULAR PRIORITY

B/c if you map this, you find that Bank #1 beats Bank #2, Bank #2 beats LC and LC beats Bank #1

If this has no utility if you are trying to figure out who gets the collateral

This circularity comes from the fact that you can obtain priority via filing OR perfection (and the way we define priority is measured differently depending on LC v. SC and SC v. SC—something short of perfection will prevail over another SC but not over a LC)

* + - 1. This is an unsolvable problem
         1. But this is uncommon b/c an unsecured judgment holder trying to levy on an encumbered asset is rare

Courts don’t know what to do

Some look to basic premise in Art. 9 that prefers SCs, or prefer SC if LC didn’t something wrong

PROF: but really no satisfactory answer to this Q

* + - 1. Lesson: difference between **§ 9-317** and **§ 9-322**
    1. **Prob. 32.2**
       1. Facts:
          1. 3/21: Bank #1 lends money to Airco, takes SI in flight simulation equipment and files a fin. statement against Airco covering that equipment
          2. 7/21: Bank #2 lends money to Flightco, takes SI in Flightco’s flight simulation equipment and files fin. statement against Flightco

So far, no competition

* + - * 1. 11/4: Flightco sells one of its simulators to Airco and deposits the proceeds of sale into bank account that is held at Bank #1
      1. Analysis
         1. (A) **Bank #1 v. Bank #2** (SC v. SC)

Who will have priority w.r.t. this sold equipment?

Bank #1’s interest attaches to this b/c when it took a SI in Airco’s equipment, says “hereafter acquired.” When Airco acquires this equipment, Bank #1’s SI attaches to it

Bank #2 has priority, though under **§ 9-325**

**§ 9-325**: priority when the piece of collateral is transferred from one debtor to another

**If at the moment Airco took possession of the equipment it was already subject to a perfected SI by another creditor, then this “another” creditor wins**

So it transfers subject to the SI

**So Bank #2 wins**

Bank #2’s concern would be that pieces of its collateral could be transferred out to another D and fall under a different SI that would have priority

Bank #2 doesn’t care if Bank #1 also has a SI in the same equipment—Bank #2 just wants to have the **senior** SI

Bank #2’s SI did come first in time (so some logic that Bank #2 should win)

NOTE: This is an exception to the general rule that as between the two SCs, first to file or perfect wins

* + - * 1. (B) When Flightco sells the equipment, puts the proceeds in a bank account held with Bank #1

Competitors w.r.t. these proceeds:

**Bank #2** has a SI in the money as proceeds of the equipment

Is Bank #2’s SI in that money perfected?

The equipment has been transformed from equipment (fin statement needed) into cash

**§ 9-315(c)**- basic rule on PERFECTION IN PROCEEDS 🡪 a SI in proceeds is a perfected SI if the SI in the original collateral is perfected. **AKA SC does not have to worry about transformations of collateral if SC has a SI in the original collateral.**

BUT **🡪**

**§ 9-315(d)**- perfected interest in proceeds becomes unperfected 21 days later UNLESS proceeds are identifiable cash proceeds

**\***This is the type of proceeds that is auto perfected and stays perfected as long as it is identifiable cash proceeds

**In reality, cash doesn’t stay identifiable for very long**

Bank #2 is a competitor b/c has perfected in the proceeds (b/c had a perfected interest in the equipment)

**Bank #1** has a SI in the deposit account (NOT the proceeds as proceeds)

Automatic control and perfection b/c took control of this account (this is the bank where the account is maintained)-- **§ 9-104**

NOTE: the proceeds were not really transferred. We are just looking at the proceeds in the hands of the original debtor (b/c in its bank account)—no transfer of collateral so can’t use **§ 9-325**

* + - * 1. **SPECIAL RULE**: Use **§ 9-327-** priority of SIs in deposit accounts

SC with control over deposit account has priority over other creditors

Preference for SC with SI over whole deposit account (over SC who may have SI over portions of money that may be dumped into that deposit account –like Bank #2)

**Bank #1 wins**

Why do we do this?

Practical reasons of not having to constantly trace which money is which

SC in Bank #2’s shoes could protect itself by forcing the D to put the proceeds money into a segregated account in ITs bank

This is a pretty easy rule for SCs to cope with

* + 1. **Prob. 32.3**
       1. Facts:
          1. ONB lends $75k to company and takes SI in company’s computer and files against equipment
          2. Later, ONB thinks about lending more to company, takes a SI in company’s dry cleaning equipment
       2. Issue #1: does ONB need to file another fin. statement?
          1. Initially, ONB takes a SI in one computer. THEN takes a totally separate SI in equipment.

Question if whether fin. statement on file is good enough –**it is**

As long as the description in the filed fin. statement covers the collateral in which you are now trying to take a SI, you are **GOOD**

* + - 1. Issue #2: how do you date the priority of the 2nd SI?
         1. If another SC comes along in between ONB’s two SIs and lends/takes a SI in dry cleaning equipment and files a fin. statement

**ONB’s priority relates back to its first SI and wins** (b/c first to file OR perfect)

* + - * 1. This is why a 2nd SC will not want to lend against any equipment of this borrower when SC #1’s fin. statement describes broadly “equipment” [like previous problem re: broad fin. statement]

PROF: this rule has broad implications for fuure lending that the debtor may need

This rule is ok, though, per UCC drafters b/c any new/subsequent lenders would run a search that would find this fin. statement (it would be on notice to be careful to lend against particular equipment)

* + - 1. NOTE: if an LC **and** this SC #2 were interposed b/w ONB’s SIs, LC would win over ONB (b/c not perfected when LC levied), but ONB would win over SC #2
         1. This is the circularity problem that comes with the interplay between **§ 9-317** and **§ 9-322**
      2. NOTE: SC doesn’t need D’s signature to file an effective fin. statement. Only has to show that the D has authorized a SA (SA carries with it authorization to file fin. statement)
         1. **AKA D could give away authority re: description in fin. statement w/o a signature**
    1. **Prob. 32.4**
       1. Facts: SC #1 lends $1k to friend and takes SI in boat. Properly files fin. statement covering it. Another SC (#2) lends $45k to that friend, takes SI, and files.
          1. D is now in default to SC #2. SC #2 repos and is about to have a sale.
          2. If SC #1 lends $31k to D, will this forestall the foreclosure sale?
       2. Relative priority:
          1. If SC #1 lends more, will the additional loan be placed subordinate to SC #2’s loan or will it have the priority of SC #1’s initial #1k advance?

(i) SC #1 definitely filed first; future advance—so SC #1’s new lending gets the priority of SC #1’s first $1k lent

(ii) If it is **not** a future advance (in the orig. SA it only says that SC #1 is taking SI in boat to secure the $1k lent today—no mention of also securing future lending)

Same result as (i)

**It does NOT matter whether this was a future advance or not**

The description of the collateral in the existing fin. statement of SC #1 covers this 2nd SI, so it is effective and the priority of SC #1’s 2nd lending has priority of the first $1k

NOTE: this result is different from the earlier assignment b/c this is a **SC** –interposer in earlier problem was a LC (and filing is not enough for SC v. LC contest) 🡪 theory is that SC will search (and if they lend after they see the fin. statement on file they are stupid). LC doesn’t even search and doesn’t rely on that initial fin. statement in the same way.

* + - 1. SUM: if an SC is in place, makes a loan but has filed a fin. statement covering much more valuable collateral, additional lending by that SC will take priority as of this original loan. Even if the loan is not made pursuant to commitment, this SC can completely defeat another, interposing SC
    1. **Prob. 32.5**
       1. Facts: BCA comes back to try to prevent what happens in **prob. 32.4**
          1. BCA says that it sometimes does want to lend against collateral that is already subject to a SI. Can’t always insist on being the only SC—
       2. Issue: BCA does accept that there may be other SCs out there, but how to avoid being squeezed out after the fact by additional lending from the original SC?
       3. Analysis: BCA could ask for a **subordination agreement** from the original SC (saying that even if under the rules, this SC would have priority, this SC agrees not to assert it)
          1. This subordination agreement will really be covering the **additional lending** (NOT the original $1k)

This should be super easy to get in this type of situation

Back to the moment when BCA makes its loan (it knows that it is junior to the $1k loan; it is worried that down the road there will be an additional loan)

When BCA goes to make its loan, THEN ask SC #1 (Carol) to agree to the subordination agreement (Carol will say yes b/c she doesn’t have any intention **at that time** of making any more loans)

She will have no incentive to agree once she already makes the additional loan

* + 1. **Prob. 32.6**
       1. Facts: Manufacturer of speakers (Sarah) is selling to retailers. As soon as the manufacturer sells the speakers to the retailers, they are falling under the after-acquired property clauses of the inventory lenders of these retailers.
       2. Issue: How can this manufacturer get priority over these inventory lenders?
       3. Analysis: Sarah (manufacturer) should get a PMSI in the speakers
          1. Sarah needs to provide value (does this by virtue of allowing the retailers to buy the speakers on credit), retailers need to have rights in the collateral, and Sarah needs to get a SA

TO ATTACH: Sarah needs to get a signed SA from the retailers/borrowers to get a PMSI (b/c she is lending the money that is being actually used to acquire the collateral)

TO PERFECT as a purchase-money lender: has to file a fin. statement (b/c speakers are inventory in the hands of the retailer). Can be automatically perfected in PMSIs (BUT this doesn’t help Sarah b/c auto perfection only works for consumer goods]

**§ 9-324**: rule to resolve a contest b/w a perfected PMSI in inventory and competing SI

* + - * 1. **RULE 🡪** Sarah (PMSI holder) v. Inventory lender (SC in its own right)

**9-324(b)**: a perfected PMSI in inventory **has priority** over a conflicting SI in the same inventory IF:

**(1)** The PMSI is perfected when the debtor receives possession of the inventory (a timing Q); AND

**This means that Sarah can’t deliver the speakers until after she has filed her fin. statement**

**(2)** PMSI-secured party sends an authenticated notification to the holder of the conflicting interest which is received within 5 years before the debtor gets possession of the inventory

The point of this is that Sarah doesn’t have to go through this process every time she sells a speaker. She just has to put all of these inventory lenders on notice that she intends to take a PMSI in all of her speakers that she sells [if inventory lenders are on notice, then inventory lenders probably won’t advance any funds related to those particular speakers]

The advance notification helps the inventory lender know what is going on so it can decide whether it wants to advance funds

Has to be in advance (b/c at the time the inventory lender/other creditor is determining its financing)

* + - * 1. It is likely that a SA b/w the retailer and his inventory lender will say “if you (retailer) grant a SI in your inventory to anyone else, that is an event of default.” If this is in the inventory lender agreement, retailers cannot grant a PMSI to Sarah (who is a supplier of one kind of equipment). Retailer’s relationship with inventory lender is much more fundamental to their financial health.

To avoid this **default** problem, Ds typically refuse to grant PMSIs to their suppliers like Sarah

So the UCC gives Sarah a mechanism to avoid being defaulted upon, but the reality is that inventory lenders won’t want this to happen so retailers won’t let it happen—so this is not utilized very often (Sarah/one suppler doesn’t have sufficient power to achieve her desired result)

One supplier **may** have enough leverage to do this in **some** cases (ie. say you HAVE to grant this PMSI in order to float my stuff), but it is not common

* + - * 1. In order to send these notifications, Sarah has to know who these inventory lenders are (finds this out by doing a search in SoS’s office)
  1. Sellers against Secured Creditors
     1. Overview
        1. Major way this conflict arises: seller of collateral comes into conflict with an existing SC with interest in the collateral (like an inventory lender)
           1. In general, an existing creditor who has an interest that includes an after-acquired property clause
        2. One type of problem: **Fraud**
           1. (A) May be something wrong with the sale transaction itself

If the seller sells a new tractor to the D, the D pays for it with a check. As soon as the D takes possession of the tractor, it falls under the **after-acquired** property clause of the **existing creditor**. Two days later the farmer’s check bounces. The seller is now back wanting his tractor back. But the SC is saying that the tractor now has a SI attached to it (the seller can take possession of the tractor subject to this new SI)

* + - * 1. (B) Or D purchases the tractor from a thief

True owner says that this is his tractor and D says that he bought the tractor from someone for full value and that D’s SC now has a SI in it

* + 1. **Void Title Rule**
       1. Someone who actually steals property does not obtain title to it, and thus cannot pass title on to anyone else
       2. **Prob. 35.1**
          1. Facts: diamond sold to a museum; is stolen and then fenced to X. X says that she paid reasonable value for it.
          2. Issue: if a rep from the museum asserts ownership as against X, who wins?
          3. **Answer:** museum wins

**In a contest b/w a true owner and someone who bought it for good value and in good faith from a chain relating back to the thief, the true owner WINS**

* + - * 1. SC HYPO: if X borrows money from a friend and gives that friend a SI in the diamond.

SI holder does NOT win, b/c X can only grant a SI in what she owns/has title to. She cannot grant a SI b/c she doesn’t have title.

True owner has all the rights; SC cannot assert any rights

* + - 1. **Prob. 35.1(b)**
         1. Facts: same, but before museum finds the diamond—X now takes the diamond and “entrusts” it to the jewelry store. The store then turns around and sells the diamond to another customer (this is theft from X). This customer overpaid for the diamond (looks like a purchase made in good faith).
         2. Issue: If the museum sues to recovery from X or from the new customer?
         3. **Answer:** museum wins (same result as problem above)

Entrustment doesn’t make a difference b/c the theft is what started out the whole chain

It was **stolen**, so no one in that chain is acquiring good title of the diamond (it is **void title**)

* + - * 1. HYPO: entrustment would make a difference if there was NO THEFT

If X owned the diamond outright, she entrusts it to the store and store then sells it

The good faith customer has **voidable title** (but not void b/c no theft here—the entruster is the one who acted badly)

If someone buys the property from the entruster (store) in good faith and for value, they do obtain good value

**X would be out of luck**

But X would then have a cause of action against the store

If X owns the ring and entrusts it to a disreputable jewelry store, she is the one who chose to do business with it

When asking where the loss should fall (on X or on the good faith customer), should fall on X

This is why it is different than the outright theft scenario

The assumption here is that there is a difference b/w choosing to deal with a party who turns out to be a thief and not choosing to deal with them at all

Assume that you could find something out about the entruster (this is a big assumption but this is the assumption that the law makes)

* + 1. **§ 2-403**: Entrustment
       1. NOTE: if the jewelry store is robbed, then they didn’t transfer true owner’s rights to a “buyer in ordinary course”
          1. Then X would still have title even though she entrusted
    2. **Possible devices that sellers can use to make sure that until he is completely paid for his item it won’t fall under another SC’s SI (ie. other SC’s after acquired property clause)**
       1. The fact is that none of them (mentioned below) work.
          1. Sellers will **lose**
       2. Possible devices
          1. (1) Retain title in the goods until payment has been made

Refuse to sell on credit; do lay-away plan

This won’t work b/c anything that is intended to work as a SI is a SI

* + - * 1. (2) Take a PMSI

Technically, seller can do this –but inventory lenders will never go for this, so not viable

* + - * 1. (3) Consignment

Don’t actually sell the goods, but let the retailer put the speakers on its shelves. When retailer finds a buyer for the speakers, SC will sell it directly

This won’t work b/c **§ 9-109(a)(4)** treats this as a SI

Art. 9 focuses on substance over form

* + - * 1. (4) Equitable subordination & unjust enrichment

Fairness based idea to say that the inventory lender is unjustly enriched if all equipment supplier sends feeds the lien of the inventory lender

Courts don’t buy this (inventory lender has every right to do this under their SA)

* + - * 1. (5) Right of reclamation

**§ 2-702**: if the D is already insolvent when it acquires the goods, the seller has a right to get them back

The problem is that this section makes the right of reclamation subject to any competing SIs

So you have a right to possession of your item, but it is now subject to a SI (so not helpful)

* + 1. **Prob. 35.2**
       1. Issue: when the customer in the cartoon sues the airline to whom his luggage is sold by the 1st airline, who wins?
       2. Entrustment: this is sort of the situation in which a customer entrusts his luggage to the first airline. The customer chooses to do business with this airline
       3. Can the airline sell his luggage and customer not have a claim against the buyer? Ie. does the purchaser have to return it to the original owner?
          1. **§ 2-403(2)**: “any entrusting of goods to a merchant who deals with **goods of that kind**, gives him the power to transfer all rights of the entruster to a buyer in the ordinary course of business”

To challenge the airline’s ability to transfer this customer’s rights in this luggage: argue that airline doesn’t normally sell luggage (not a merchant who deals with goods of this kind)

* + - * 1. But problem says that airlines in the US sell lots of luggage all the time to dealers in lost luggage—does this make them into merchants selling “goods of this kind”?

PROF: not convinced that airlines are merchants of this type

Other examples: rental companies selling their cars (this is different b/c is a totally in the ordinary course of business)

But other courts have said that these car sales are incidental to their real line of business (which is rentals), so they are NOT in the business of selling used cars (**so extrapolate to argue that airlines are NOT in the business of selling luggage**)

* + - * 1. It IS entrustment when we give our luggage to airlines
      1. Lesson: shows that an airline CAN sell your stuff (and apparently they can sell it and thus make money)
    1. **Prob. 35.5**
       1. Facts: Harley is a loan officer for Swiss Bank; says that have exposure on this merchant GOL
          1. Calls it exposure b/c GOL owes $950k that is secured with collateral (inventory) that is only worth $400k (underwater for $550k)
          2. Could declare the demand note due now, but GOL will likely say that they can’t pay the whole thing and can only give the value of the collateral

Or SC can wait until Xmas season (GOL will borrow a little bit more money, will buy inventory on credit from suppliers. This means that the value of the inventory will grow to $700k). SC will be better off if it waits until this point to call the note (will only lose $300k rather than $550k on the transaction)

* + - 1. Analysis: Would want to know who the inventory suppliers are with whom we are dealing here
         1. If the inventory suppliers take a PMSI in the inventory, then our client (bank) will not have priority

We would know if inventory suppliers are taking/took a PMSI by asking OUR client if it got any notifications from any inventory lenders that they planned to take a PMSI

If there are no notifications of PMSIs, it looks like this plan will work

New inventory will come in, the bank is not acting fraudulently, and will put our client (bank) in a better position

* + - * 1. Potential glitch depending on what moves happen next:

This SI in this collateral could be avoided if the next move is BK

The trustee in BK can avoid any preferential transactions that took place in the 90-day period before the BK petition was filed

Problem mentions that the period over which the inventory will increase is TWO MONTHS

Possible that the increase will happen within the 90-day period

If SC calls the loan, which causes distress and thus BK, cam create this preference period problem

The extent to which the bank’s position was improved within the preference period could be avoidable as a preference

So $250k is the improvement and could be avoided by the BK trustee

Advisement re: BK is important b/c it may be your client’s action that pushes GOL into BK (so it is important to advise your client on this)

* + 1. LESSON: **sellers really don’t have a way of establishing priority over SCs who have SIs in after-acquired property.** 
       1. **Sellers will basically be making unsecured loans**.
  1. Buyers against Secured Creditors
     1. Overview
        1. Does the buyer take the item subject to the SI or free of the SI?
           1. If you take it subject to the SI, you have to either pay it off to clear or worry that the collateral will be foreclosed upon
        2. Expectations of buyers
           1. When you buy an item, do you expect it to be subject to a SI or not?

Most DO expect this when you buy a house

* + 1. **General Rule for Real Proeprty** 🡪 FIRST IN TIME
       1. If mortgage is created before the buyer buys the property, then the buyer takes subject to the mortgage
       2. If a buyer purchases the property before the mortgage is created, the buyer takes free and the mortgage-holder has no rights in the property
       3. NOTE: have to look at whether the recording statute in your state changes this result
          1. Most say that even if the SC came first by creating a mortgage, if didn’t record it, then the buyer takes free of it

This **changes** the first in time rule

This makes sense

* + - * 1. Some say that an unrecorded deed is void as against a subsequent mortgage holder

AKA if you buy your house, taking the title from the seller, but don’t record the deed, and the seller subsequently grants a SI in this house, then this mortgage holder will have a valid SI even though you are the true owner

* + 1. **Personal Property**
       1. MAIN RULE: SIs survive the sale of collateral
          1. **§ 9-201**: SA is effective … against purchasers of the collateral
          2. **§ 9-315(a)(1)**: A SI … continues in collateral notwithstanding sale …
       2. EXCEPTIONS to main rule
          1. **(1)** If the SC authorizes the sale of the property free of the SI, then the buyer takes free of the SI

This makes sense for things like inventory (the lender knows that the D is going to sell the collateral and will sell it free of the SI)

Authorization does not have to be express

If SC knows that the D is selling its collateral free of SI and doesn’t do anything to stop it, this can be implied authorization

Has to be authorization from the SC not **just to sell** the collateral, but to **sell it free of the SI**

Would apply to Bonnie’s Boat World

* + - * 1. **(2)** Buyer in ordinary course

**§ 9-320(a)**: a buyer in ordinary course of business … takes free of a SI created by the buyer’s seller

**AKA** if you are a buyer, you take free of a SI that was granted by the person who is selling you the item even if it is perfected and even if the buyer knows of the SI’s existence

This would also apply to Bonnie’s Boat World

Bonnie is the D who has granted an SI in all inventory to her inventory lender. When she sells a boat to a buyer, the **buyer takes free of the SC’s SI whether the sale is authorized or not** (b/c this is a buyer in ordinary course)

This covers a lot of normal commerce

When do you become a buyer?

Q of whether you can officially attain buyer status and thus protection before you have taken title, possession of the goods or before you have paid for the goods

**EXCEPTION TO THIS EXCEPTION**-- **§ 9-320(e)**: NOT if the creditor has possession of the goods

If the SC has possession of the collateral, then you do not get the buyer in ordinary course protection

This possession should alert the buyer

* + - * 1. **(3)** Consumer to consumer

Narrow exception

**§ 9-320(b)**: a buyer of goods from a person who used or bought the goods for use primarily for personal, family, or household purposes **takes free of a SI**, even if perfected, **if** the buyer buyers:

**(1)** W/o knowledge of the SI;

**(2)** For value;

**(3)** Primarily for the buyer’s personal, family or household purposes; and

**(4)** Before the filing of a fin. statement covering the goods

**NOTE**: if a store sold this consumer good to the garage sale seller, prob. won’t have a fin. statement on file (b/c will take an auto perfected PMSI)

Consumer goods in the hands of the seller AND the buyer

This is the “garage sale” exception

Buyers at garage sales would have no way of knowing about these SIs (b/c don’t have to have fin. statements filed)

You are not a buyer in ordinary course

* + - * 1. **(4)** Unperfected SI

**§ 9-317(b)**: a buyer … takes free of SI .. if the buyer gives value and receives delivery of the collateral w/o knowledge of the SI .. and before it is perfected

Doesn’t have to be a buyer in ordinary course

* + 1. **Prob. 36.1**
       1. We are worried about the buyer (Card)
       2. Facts: Eddy buys RV from All Seasons (All Seasons has SI)
          1. Eddy gives SI to All Seasons, sale prohibited (agrees not to sell)

Eddy sells to Sunrise in violation of his SA with All Seasons. Sunrise takes subject to All Seasons’ lien (recognizes it and says it will pay off All Seasons’ 17k loan). But Sunrise doesn’t do this—sells to Card (buyer) instead

Sunrise sells to Card in ordinary course

* + - 1. Issue: When Sunrise bought the RV, did it take subject to All Season’s SI?
         1. **Yes**; no reason why it wouldn’t

Starting point is that SI continues in the collateral despite its sale. Unless an exception applies, this SI continues

The authorized disposition exception does NOT apply

**Sunrise is NOT a buyer in the ordinary course of business (even though they sell RVs) b/c EDDY is not a seller in the ordinary course of selling RVs (this is the CRITICAL part of the definition—we are talking about the SELLER’s business, not the buyer’s)**

The falls under the general rule—no exceptions apply

* + - 1. (a) Card sues All Seasons to remove the lien
         1. Does Card take the RV from Sunrise subject to All Season’s SI?

Card IS a buyer in the ordinary course of business b/c Sunrise IS in the business of selling RVs

**But Card (buyer) does NOT get the protection of this exception b/c the SI was not created by the buyer’s seller (Sunrise)**

This SI was created by the seller’s seller

\*Only your immediate seller’s SI is covered

Card is buying this RV **subject** to All Season’s perfectly valid SI securing $17k

So her RV is only really worth $6k (b/c she bought it for $23k)

Could she go after Sunrise arguing something like fraud?

That Sunrise knew that this RV was only worth $6k

* + - 1. In dealing with Sunrise, could Card have done anything else that could have helped her?
         1. (1) Look at certificate of title before buying

She would have seen All Season’s name/interest on this if she had done this

Probably a title made out to Eddy, bank spot for lienholder (would have asked Sunrise if the obligation to All Seasons had been paid off)

If Sunrise had said that the lien has been cleared, Card could have asked to see the release document

This expects a lot out of the buyer

* + 1. **Prob. 36.2**
       1. Facts: Card saying that she is about to buy a used piano from the mall
       2. Issue: what should you do?
       3. Analysis:
          1. Legally the same as **Prob. 36.1**

If the used piano vendor at the mall purchased a piano from someone else who had granted a SI in it, it is entirely possible that that piano is still encumbered and when Card buys it, she will take it subject to that encumbrance

* + - * 1. As a consumer, you don’t want to pay for a lawyer to represent you when you buy used furniture

BUT puts you alert to the problems for consumers here

* + 1. **Prob. 36.5**
       1. Facts: Davis (dept store) sells a TV to Beavis on credit (signs a SA and promissory note) and Davis files a fin. statement. SA says that Beavis won’t sell it, but 6 months later Beavis has a garage sale where Butthead buys the TV. Davis now wants to repossess the TV from Butthead. Can Davis do this?
       2. Analysis:
          1. Nothing to indicate that this is **not** for household purposes
          2. Butthead should have run a UCC search (b/c Davis filed a fin. statement)

**§ 9-320(b)(4)**

Consumer to consumer exception says that a buyer of goods from a person who bought the goods for household use (applies here) takes free of even a **perfected SI** if (1) takes w/o knowledge of the SI (is the case here); (2) for value (yes); (3) primarily for household use (yes); (4) **before the filing of fin. statement** (this is the problem here)

The previous fin. statement makes this exception inapplicable here

PROF: but it is not reflective of reality that we would expect Butthead to run a UCC search

* + - * 1. Davis is protected b/c filed this fin. statement (SI persists in the TV)
        2. PROF: it is NOT normal for Davis (and dept stores like it) to file a fin. statement in this circumstance (when selling a TV) b/c it is a PMSI (which would be auto perfected);

And b/c the value of the loan is low and value of the collateral is even lower b/c the value of the TV plummets once it is “used”

The SI is valuable to get the D to pay you on time

So ordinary buyers like Butthead would normally be ok here

But maybe Davis would file a fin. statement as an extra step if it is skeptical about the buyer’s reliability (so they can track the collateral later—but the odds that having a fin. statement would help Davis and dept stores at all are pretty low)

This garage sale transaction was unique b/c Butthead bought the TV with a CHECK (this is how Butthead got tracked down by Davis)

In normal life, this transaction will happen clear of any SI

* + - * 1. **If Davis repossesses, does it have to give Butthead back the money he paid Beavis?** NO

Butthead is out the money paid for the TV AND the TV

Davis now has a SI in the TV AND the money in Beavis’s hands (b/c the money is proceeds)

Butthead should now go after Beavis for the money b/c Beavis impliedly warranted that the TV was not encumbered

Now Butthead is the debtor (but not the obligor)

Debtor = owns the collateral that secures the obligation

* + - 1. **§ 9-615(d)**- tells what to do with surplus/deficiency after collateral is sold
         1. If there is a **deficiency**, it is the OBLIGOR who is responsible

Ie. if Davis repo’d the TV and sold for $400 (but Davis was owed $900), go after Beavis for this

* + - * 1. **§ 9-615(d)(1)**- if there is a **surplus**, the DEBTOR gets paid

Ie. Butthead gets the surplus

* + 1. **Prob. 36.6**
       1. **Buyer in ordinary course exception**
       2. (a) F: Sound City grants SI in inventory. “Cash sales in ordinary course only; all proceeds will be paid to lender.” Buyer buys w/o knowing of these restrictions. Buyer paid $2k in cash, signed promissory note for the rest. Can the inventory lender repossess the sound system from the buyer?
          1. Buyer in ordinary course of business exception applies; inventory lender **cannot** repossess the equipment from the buyer

**§ 9-320(a)**

If buyer had known that Sound City was not supposed to do this, this exception would not apply

If she only knew of the SI itself, wouldn’t be a problem and exception would still apply (only is a problem if she knows that the sale to her clear of the SI has not been authorized)

* + - 1. Sound City files Ch. 7; trustee abandons the collateral
      2. (b) If George, a lawyer for Sound City, is given a sound system in satisfaction of $14k account due in legal fees. Can inventory lender repossess from George?
         1. Exception wouldn’t work here b/c George is **not** a buyer in the ordinary course of business
         2. **§ 1-201(b)(9)**: buyer in the ordinary course may buy for cash, exchange of other property, or on secured or unsecured credit (doesn’t have to be cash) … buyer in ordinary course does **not** include a person who acquires goods in total or partial satisfaction of a money debt

**This is the problem with George**

* + - 1. (c) Could George have structured the transaction differently?
         1. Would have been a buyer in ordinary course if Sound City had paid him $14k and George then used the $14k to buy a sound system