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The Standard For Taking A Security Interest In Fixtures

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Introduction

Creditors that have a security interest in the same collateral will often dispute the priority of each other's liens. In general, the security interest that is first perfected will be entitled to priority over subsequent liens.[1] A security interest is generally perfected by filing a financing statement that satisfies the requirements of section 9-502 of the UCC. Section 9-502 provides that a financing statement is sufficient only if it: (1) provides the name of the debtor; (2) provides the name of the secured party or a representative of the secured party; and (3) indicates the collateral covered by the financing statement.[2] Nevertheless, a subsequent lienholder may challenge a filed financing statement because it has errors or omissions rendering it "seriously misleading" under UCC § 9-506 and thus ineffective.[3] U.C.C. § 9-506.

Also, creditors often dispute over whether or not a good has become a fixture in real property. A court's determination that a good has or has not become a fixture can have implications on a creditor's security interest. Part I of this memorandum will explore recent court decisions addressing what renders a financing statement seriously misleading under UCC 9-506.

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[1] U.C.C. § 9-312 (AM. LAW INST. & UNIF. LAW COMM'M 1977).
[2] *Id.*
[3] U.C.C. § 9-506.

It will also discuss safe harbor provisions within the UCC that provide protection for creditors that fail to provide the debtor's name in accordance with UCC § 9-503(a). Part II of this memorandum will explore the methodology used by courts to determine when a good has become a fixture. It will also examine different UCC filings used to perfect a security interest in fixtures and how courts resolve priority disputes based on the type of filing used by a creditor.

I. If a Financing Statement is Seriously Misleading It Will Not Be Sufficient to Perfect A Creditor's Security Interest.

UCC § 9-506(a) provides that if a financing statement has errors or omissions that render it seriously misleading it will be ineffective to perfect a creditor's security interest.[4] However, the UCC only provides a limited definition of when an error or omission renders a financing statement seriously misleading.[5] A financing statement will generally be challenged as being seriously misleading when: (1) the creditor incorrectly provides the name of the debtor; or (2) a creditor uses a super generic collateral description.

A. A Financing Statement is Seriously Misleading if it Fails to Provide the Debtor's Name in Accordance with UCC 9-503(a) Unless it Falls Under the Safe Harbor Provision in UCC 9-506(c).

UCC § 9-506(b) provides that a financing statement will be seriously misleading if it fails to sufficiently provide the debtor's name in accordance with UCC § 9-503(a).[6] UCC § 9-503(a) provides various examples of adequate descriptions of the debtor, depending on the type of entity the debtor is.[7] For example, if the debtor is a registered organization, the financing statement will be sufficient if it provides the name of the debtor in accordance with the Secretary of State's

[4] U.C.C. § 9-506(a).
[5] *Id.*
[6] U.C.C. § 9-506(b).
[7] U.C.C. § 9-503(a).

filing system.[8] If the debtor is an individual to whom the state has issued a non-expired driver's license, the financing statement will be sufficient if it provides the name of the debtor as indicated on the driver's license.[9] If the debtor is an individual to whom the state has not issued a non-expired driver's license, the financing statement will be sufficient if it provides the individual name of the debtor or the surname and first personal name of the debtor.[10] If the debtor is an unregistered organization that has a name, the financing statement will be sufficient if it provides that name.[11] If the debtor is an unregistered organization that does not have a name, the financing statement will be sufficient if provides the names of the partners, members, associates, or other relevant persons.[12]

If a creditor does not comply with the standard outlined in UCC § 9-503(a), their financing statement may still be sufficient if it falls under the safe harbor protection in UCC § 9-506(c).[13] UCC § 9-506(c) provides that if a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement which did not comply with section 9-503(a), failing to provide the correct debtor name does not render the financing statement seriously misleading.[14]

i. Application of UCC § 9-503(a) and UCC § 9-506(c).

The aforementioned UCC provisions can lead to a creditor's lien being unperfected because, depending on their jurisdictions standard search logic, a slight error in the debtor description may render a creditor's financing statement seriously misleading. For example, in *In*

[8] U.C.C. § 9-503(a)(1).
[9] U.C.C. § 9-503(a)(4).
[10] U.C.C. § 9-503(a)(5).
[11] U.C.C. § 9-503(a)(6)(a).
[12] U.C.C. § 9-503(a)(6)(b).
[13] *Id.*
[14] *Id.*

re Fuell, a bankruptcy court in Idaho held that a creditor's misspelling of the debtor's name on the financing statement made it seriously misleading and thus it did not perfect the creditor's security interest.[15] There, the debtor, Andrew Fuell, acquired credit to purchase tools and equipment, secured by an interest in those same tools.[16] The creditor subsequently filed a UCC-1 financing statement with the Idaho Secretary of State which indicated that the debtor's name was "Andrew Fuel" (as opposed to Andrew Fue*ll*).[17] Shortly thereafter, the debtor filed for chapter 7 bankruptcy.[18] The bankruptcy trustee then filed an adversary proceeding alleging that the defendant creditor failed to properly perfect its security interest because it misspelled the debtor's name on its financing statement.[19]

The court agreed with the trustee and held that the creditor failed to perfect its security interest by misspelling the debtor's name on its financing statement.[20] The court held that misspelling the debtor's name made the creditor's financing statement seriously misleading because it did not comply with the state's standard search logic.[21] The state of Idaho requires creditors to use the "debtor's full exact legal name" on financing statements, which the creditor here did not do.[22] Accordingly, because the plaintiff here could not find the creditor's security interest by using the state's standard search procedures, the slight error in the debtor's name made the financing statement seriously misleading and thus, the creditor did not perfect its lien.[23] This case is hardly unique and often misspelling the debtor's name or non-compliance with state

[15] *In re* Fuell, No. 06-40550, 2007 WL 4404643, at *1 (Bankr. D. Idaho Dec. 13, 2007).
[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] *Id.* at *2.
[20] *Id.* at *4.
[21] *Id.*
[22] *Id.* at *3.
[23] *Id.* at *4.

requirements will make a financing statement seriously misleading and unsalvageable by the safe harbor provision in UCC § 9-506(c).[24]

These cases suggest that creditors must be meticulous in describing the debtor correctly.[25] A slight error, by a letter or two, will likely render the financing statement seriously misleading and consequently, the creditor's lien unperfected.[26] Moreover, courts will not be persuaded to avoid these harsh results by equitable considerations because state databases must be organized by the debtor's name and so for the notification system to properly function, it is critical that the debtor's name is listed correctly on the financing statement.[27]

B. *A Super Generic Collateral Description Will Likely Not Be Deemed Seriously Misleading.*

As previously stated, for a financing statement to be sufficient it must adequately indicate the collateral covered.[28] A revised version of Article 9, which was adopted by all 50 states in 2001, allows for a significantly more lenient collateral description.[29] Specifically 9-504 now provides that a financing statement's collateral description will be sufficient if it covers "all assets or personal property" of the debtor."[30] Such financing statements that indicate the

[24] *See* Pankratz Impl. Co. v. Citizens Nat'l Bank, 130 P.3d 57, 59 (Kan. 2006) ("Roger House" instead of "Rodger House"); *see also In re* Borden 353 B.R. 886, 887 (Bankr. D. Neb. 2006) ("Mike Borden" instead of "Michael R. Borden"); *see also* Clark v. Deer & Co. (*In re* Kinderknecht), 308 B.R. 71, 72 (10th Cir. BAP 2004) ("Terry J. Kinderknecht" instead of "Terrance J. Kinderknecht"); *see also* Hastings State Bank v. Stalnaker (*In re* EDM Corp.), 431 B.R. 459, 461 (8th Cir. BAP 2010) ("EDM Corporation d/b/a EDM Equipment" instead "EDM Corporation").
[25] *In re* Laursen, 391 B.R. 47, 50 (Bankr. D. Idaho 2008).
[26] *Id.*
[27] *Id.*
[28] U.C.C. § 9-502.
[29] Cynthia Grant, *Description of the Collateral Under Revised Article 9*, 4 DEPAUL BUS. & COM. L.J. 235, 237 (2006).
[30] *Id.*

collateral as "all assets" have colloquially become known as super generic collateral descriptions.[31]

These super generic collateral descriptions are often challenged by subsequent creditors as seriously misleading under UCC § 9-506(a). Case law on the subject has established that subsequent creditors are unlikely to succeed in this argument.[32] Even if a super generic collateral description can be interpreted in multiple ways, so long as one possible interpretation covers the collateral at issue, the burden shifts to the subsequent creditor to further inquire as to the extent of the earlier security interest and the collateral description will not be deemed seriously misleading.[33] *ProGrowth v. Wells Fargo Bank* establishes this proposition of law.[34]

i. ProGrowth Bank, Inc. v. Wells Fargo Bank.

In *ProGrowth*, there was a priority contest between two lenders, ProGrowth Bank and Wells Fargo Bank.[35] The debtor granted a security interest in two annuity contracts to Wells Fargo as the collateral agent for Global One.[36] According to Wells Fargo's initial financing statements, the collateral was:

> All of Debtor's right, title, and interest in and to, assets and rights of Debtor, wherever located and whether now owned or hereafter acquired or arising, and all proceeds and products in that certain Annuity Contract No.: LE900015 issued by Lincoln Benefit Life in the name of Debtor . . . .[37]

This financing statement had two important errors: (1) it indicated that the collateral was contract number "L*E9*00015" instead of "L*9E*00015" and (2) it stated that the annuity contract

[31] *See id.* at 236.
[32] ProGrowth Bank, Inc. v. Wells Fargo Bank, 558 F.3d 809, 814 (8th Cir. 2009).
[33] *Id.*
[34] *Id.*
[35] *Id.* at 811.
[36] *Id.*
[37] *Id.*

was issued by Lincoln Benefit Life instead of Fidelity& Guaranty.[38] Wells Fargo's subsequent financing statement described the collateral as:

> All of Debtor's right, title, and interest in and to, assets and rights of Debtor, wherever located and whether now owned or hereafter acquired or arising, and all proceeds and products in that certain Annuity Contract No.: L9E00016 issued by Lincoln Benefit Life in the name of Debtor . . . .[39]

This financing statement did not contain an error in the collateral description but also stated that the annuity contract was issued by Lincoln Benefit Life instead of Fidelity & Guaranty.[40] Shortly thereafter, ProGrowth Bank took a security interest in the same two annuity contracts and a priority dispute between the two creditors arose.[41]

ProGrowth Bank argued that Wells Fargo's financing statements were seriously misleading because the first contained letters in the wrong order and both misidentified who issued the contracts.[42] The court rejected ProGrowth Bank's argument because of the first part of Wells Fargo's financing statements, whereby its security interests covered "*All* of Debtor's right, title, and interest in and to, assets and rights of Debtor . . ." could have been interpreted in one of two ways: (1) where the "all assets" language only applied to the annuity contracts or; (2) where the "all assets" language was a separate indication of collateral.[43] The court held that because the second interpretation could have covered the collateral at issue, the financing statement was not seriously misleading as it put subsequent creditors on notice that the collateral may already be encumbered.[44] At that point, the burden shifted to the subsequent creditor to determine the extent of the prior security interest.[45]

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[38] *Id.*
[39] *Id.*
[40] *Id.*
[41] *Id.*
[42] *Id.* at 813.
[43] *Id.* at 813-14.
[44] *Id.*
[45] *Id.*

ProGrowth's holding—that super generic indications of collateral are not seriously misleading—has been adopted throughout the Eight Circuit.[46] Furthermore, the Bankruptcy Court for the Western District of New York has also adopted the holding of *ProGrowth*.[47]

The adoption of UCC § 9-504 and *ProGrowth* are favorable developments for creditors who are the first to perfect a security interest in a debtor's collateral.[48] So long as creditors use a super generic collateral description their financing statement will not be deemed seriously misleading and they will prevail in a priority contest.[49] Section 9-504 and *ProGrowth* require junior lienholders to make further inquiry into the extent of prior security interests and effectively remove the seriously misleading argument from their arsenal.[50]

II. Fixture Analysis

A. Determining If a Good Has Become a Fixture Is a Fact Sensitive Inquiry.

The UCC defines fixtures as "goods that have become so related to particular real property that an interest in them arises under real property law."[51] This definition provides little guidance to practitioners and judges in determining when a good has actually become a fixture. Thus, courts have come up with their own methodology to determine when a good has become a fixture.[52] The principle elements in determining when a good has become a fixture are: (1) annexation; (2) adaptation; and (3) intent of the annexor.[53] Annexation refers to the physical

[46] *See In re* 8760 Serv. Grp., LLC, 586 B.R. 44, 55 (Bankr. W.D. Mo. 2018); Payne Family Homes, LLC v. Survant Air Sys., Inc., 2018 WL 6592099, at *3 (E.D. Mo. Dec. 14, 2018).
[47] *See In re* Sterling United, Inc., 519 B.R. 586, 592 (Bankr. W.D.N.Y. 2014) ("[W]here a description can reasonably be interpreted in one of two ways—one of which may cover the collateral at issue and one of which does not—notice filing has served its purpose.").
[48] *See ProGrowth*, 558 F.3d at 814.
[49] *Id.*
[50] *Id.*
[51] U.C.C. § 9-102(40).
[52] *See* Teaff v. Hewitt 1 Ohio St. 511, 529-30 (1853).
[53] *Id.*

attachment of the good onto the real property.[54] Adaptation means the real property was designed specifically to include the particular good as an integral part of the property.[55] Intent is the most important element.[56] It examines the intent of the annexor to make the good a permanent part of the real property.[57]

A fixture analysis is hardly a bright line test and is an extremely fact sensitive inquiry.[58] A brief sampling of case law shows just how fact sensitive a fixture analysis can be. For example, in *In re Park Corrugated Box Corp*., a 45,000 pound machine was not considered a fixture because it could easily be moved without damaging the structure.[59] However, in *In re 8760*, a Blast Booth was held to be fixture because it was bolted into the floors and the structure was designed around it.[60] Additionally, in *Marsh v. Sprading,* cabinets were held to be fixtures because they were nailed into the walls and removing them would have severely damaged the property.[61] Accordingly, there is no one determinative factor in a fixture analysis.[62] It depends on the court's analysis of the facts at hand and, specifically, whether the court determines that the annexor intended to incorporate the good into the property.[63]

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[54] Herron v. Barnard, 390 S.W.3d 901, 912 (Mo. Ct. App. 2013).
[55] *See In re* 8760, 586 B.R. at 54.
[56] *Marsh v. Spradling,* 537 S.W.2d 402, 404 (Mo. 1976).
[57] *See In re* 8760 586 B.R. at 54.
[58] Alphonse M. Squillante, *The Law of Fixtures: Common Law and the Uniform Commercial Code - Part i: Common Law of Fixtures*, 15 HOFSTRA L. REV. 191, 199 (1987) ("Every lawyer knows that cases can be found in this field that will support any position that the facts of his particular case require him to take.").
[59] *In re* Park Corrugated Box Corp., 249 F. Supp. 56, 58-59 (D.N.J. 1966).
[60] *See In re* 8760 586 B.R. at 54.
[61] *Marsh,* 537 S.W.2d at 404.
[62] *See Teaff*, 1 Ohio St. at 529-30.
[63] *See id.*

B. *There Are Three Principle Methods for a Creditor to Perfect A Security Interest in A Fixture.*

There are three principle ways for a creditor to perfect a security interest in a fixture.[64] First, a creditor can file a financing statement with the jurisdiction's Secretary of State, which must comply with the requirements of UCC § 9-502(a).[65]

Second, a creditor can file a fixture filing statement.[66] A fixture filing statement is defined in UCC § 9-102(40) as a financing statement covering goods that are or are to become fixtures.[67] A fixture filing must also comply with the general financing statement requirements of UCC § 9-502(a) but additional requirements in UCC § 9-502(b) are imposed upon the creditor.[68] Under UCC § 9-502(b), a fixture filing must also: (1) indicate that the collateral includes a fixture, (2) indicate that it is to be filed in real property records, (3) provide a description of the real property to which the fixture is related, and (4) provide the name of the record owner if the debtor does not have an interest in the real property.[69]

Last, a creditor can file a record of mortgage under UCC § 9-502(c).[70] A record of mortgage is effective as a financing statement or fixture filing so long as it: (1) indicates the goods it covers, (2) the goods are or will become fixtures related to the real property described in the record, (3) the record satisfies the requirements of a fixture filing, and (4) the record is duly recorded.[71]

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[64] Brennan Posner, *Fixated on Fixtures: An Overview of Perfecting and Ensuring Priority of Security Interests in Fixtures,* ABA BUS. LAW 1 (July 26, 2013).
[65] *Id.*
[66] *Id.*
[67] U.C.C. § 9-102(40).
[68] *Id.*
[69] U.C.C. § 9-502(b).
[70] U.C.C. § 9-502(c).
[71] *Id.*

C. *A Secured Creditor Has The Best Chance of Succeeding In A Priority Contest If It Files A Fixture Filing.*

The type of financing statement filed by a secured creditor to perfect its security interest in a fixture can lead to a creditor losing in a priority contest. As between secured creditors without an interest in the underlying real property, the typical UCC rules of priority apply, whereby the first to file will prevail.[72] However, the rules governing priority are more complicated when creditors with interests in the real property are involved.

The general rule governing priority disputes between secured creditors and creditors with interests in real property is provided in UCC § 9-334.[73] Subsection (c) provides, unless an exception applies, the general rule is that a security interest in fixtures is subordinate to the interests of an encumbrancer or owner of the real property.[74] There are seven exceptions listed in UCC § 9-334 to the general rule provided in subsection (c).[75]

Subsection (e)(1) provides the first exception.[76] It states that a security interest in fixtures will prevail over an interest in the real property if the debtor (1) has an interest of record in the real property or is in possession of the real property which is perfected by a fixture filing, and (2) filed first.[77] Thus, if a secured creditor only filed a financing statement (as opposed to a fixture filing) to perfect its interest in a fixture, it would not prevail over a real estate mortgage holder, even if it filed first.[78] Accordingly, a secured creditor would be better off in a priority contest

[72] U.C.C. § 9-322(a).
[73] U.C.C. § 9-334.
[74] U.C.C. § 9-334(c).
[75] U.C.C. § 9-334.
[76] U.C.C. § 9-334(e)(1).
[77] *Id.*
[78] *Id.*

against a creditor with an interest in the real property if it filed a fixture filing as opposed to the general financing statement.[79]

Subsection (e)(2) of UCC § 9-334 provides the second exception for removable fixtures.[80] It provides that so long as the security interest is perfected before the goods become fixtures, a security interest perfected by any method will prevail over an encumbrancer or owner of the real property if the fixtures are readily removable (1) factory or office machines or (2) equipment not primarily used or leased for use in the operation of the real property or (3) replacements of a domestic appliance that are consumer goods.[81] Accordingly, if the creditor is taking a security interest in a readily removable fixture and perfects it before the goods become a fixture, it does not matter which method the creditor chooses to perfect.[82]

Subsection (e)(3) of UCC § 9-334 provides the third exception to subsection (c) for judicial liens.[83] It provides that a security interest in fixtures has priority over an encumbrancer or owner of real property if the conflicting interest in real property is a lien obtained by legal or equitable proceedings after the security interest was perfected by any method.[84] Thus, a security interest in fixtures perfected by any method will prevail over a real property lien so long as the security interest was perfected first.[85]

Subsection (e)(4) of UCC § 9-334 provides the fourth exception to the general rule for manufactured homes and goods covered by certificates of title.[86] It states that a security interest

[79] *Id.*
[80] U.C.C. § 9-334(e)(2).
[81] *Id.*
[82] *Id.*
[83] U.C.C. § 9-334(e)(3).
[84] *Id.*
[85] *Id.*
[86] U.C.C. § 9-334(e)(4).

in fixtures will prevail over an encumbrancer or owner of real property if the security interest is (1) created in a manufactured home in a manufactured-home transaction and (2) perfected in compliance with certificate of title law proscribed in UCC § 9-311(a)(2).[87]

Subsection (f) of UCC § 9-334 provide the fifth and sixth exceptions.[88] Subsection (f)(1) provides that a security interest in fixtures, even if not perfected, will prevail over an encumbrancer or owner of real property if the encumbrancer or owner of real property consented to the security interest in an authenticated record or disclaimed an interest in the goods as fixtures.[89] Subsection (f)(2) states that a security interest in fixtures, even if not perfected, will prevail over an encumbrancer or owner of real property if the debtor has a right to remove the goods as against the encumbrancer or owner.[90]

Subsection (d) of UCC § 9-334 provides the seventh and last exception to the general rule.[91] It applies specifically to purchase money security interests in fixtures.[92] Purchase money security interests are defined in U.C.C. § 9-103 as a security interest that secures the repayment of a debt in connection with the purchase price of goods.[93] UCC § 9-334(d) provides that a purchase money security interest perfected by a fixture filing before or within 20 days after goods have become fixtures will have priority over a creditor with a real estate interest so long as the real estate creditor's interest arose before the goods became fixtures.[94] In order for a secured creditor to prevail under UCC § 9-334(d), it must also have an interest of record in or be in

[87] *Id.*
[88] U.C.C. § 9-334(f).
[89] U.C.C. § 9-334(f)(1).
[90] U.C.C. § 9-334(f)(2).
[91] U.C.C. § 9-334(d).
[92] *Id.*
[93] U.C.C. § 9-103.
[94] U.C.C. § 9-334(d).

possession of the real property where the fixture is located.[95] Subsection (h) provides an exception to subsection (d) for construction mortgages.[96] Under subsection (h) a construction mortgage will take priority over a purchase money security interest if the mortgage is recorded before the goods become fixtures and the goods become fixtures before the completion of construction.[97] A construction mortgage is a mortgage borrowed to finance the construction of real property.[98]

i. Application of UCC § 9-334.

An illustrative case of a bankruptcy court grappling with perfection issues in a fixture is Matter of *Cliff's Ridge Skiing Corp.*[99] In *Cliff's Ridge,* there was a priority contest between three creditors over a debtor's ski chairlift.[100] The court first had to determine whether the ski chairlift was a fixture.[101] The court ultimately determined that the chairlift was a fixture because it was attached to the realty and the debtor intended to permanently affix it so.[102] Next, the court had to determine which creditors perfected a security interest in the chairlift, which it concluded all three had done.[103] The court rejected an argument by the third creditor that it held a purchase money security interest in the chairlift because the money it loaned the debtor did not enable the debtor to acquire the chairlift.[104] The court ultimately applied the "first in time, first in right" rule under UCC § 9-313 because no exceptions under UCC § 9-334 applied.[105] It held that the first creditor, who received its interest in the chairlift through a real estate encumbrance, was first to

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[95] *Id.*
[96] U.C.C. § 9-334(h).
[97] *Id.*
[98] U.C.C. § 9-334(d).
[99] Matter of Cliff's Ridge Skiing Corp., 123 B.R. 753, 755 (Bankr. W.D. Mich. 1991).
[100] *Id.* at 753.
[101] *Id.*
[102] *Id.* at 759.
[103] *Id.*
[104] *Id.* at 764.
[105] *Id*. at 766.

collect.[106] However, because of a valid subordination agreement between the first creditor and the third creditor, the third creditor took the first's spot and thus would be the first to collect.[107]

The UCC and relevant case law suggest that it is a risk for a creditor to take a security interest in a good that may become a fixture.[108] A secured creditor's interest in the collateral will likely be subordinate to a creditor who has an interest in the underlying real property.[109] A creditor may be able to successfully argue that one of the exceptions under UCC § 9-334 apply which grants them priority over an encumbrancer, but that determination will ultimately be up to a court. Thus, a creditor should also consider gaining an interest in the underlying real property if it takes an interest in a good that may become a fixture.

Conclusion

Courts acceptance of super generic collateral descriptions as sufficient indications of collateral has lessened the burden on secured creditors who are the first to perfect their security interest. However, there is much uncertainty in the area of fixtures. Courts undertake an extremely fact sensitive analysis when they determine whether a good has become a fixture. The determination of whether a good has become a fixture is important to a secured creditor because they can lose priority to an encumbrancer unless a listed exception applies.

[106] *Id.*
[107] *Id.* at 767.
[108] *See id.*
[109] U.C.C. § 9-334(c).