Commercial Law I—Law 101A

Fall 2003
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http://uccstuff.com

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Why Allow Secured Credit?

- Reasons for secured credit
  - Better allocation of scarce assets for the creditor with a *perfected* security interest
  - Better ability to collect a debt, particularly if the creditor takes possession of the collateral
- Side benefits
  - Lower interest rates, better terms
  - More credit for marginal debtors

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Why Allow Secured Credit?

- Consider the potential for other forms of cost savings
  - Lower monitoring costs for creditors
  - Asset based lenders need only value the collateral, potentially easier than monitoring an entire business
  - Protection against involuntary creditors as well as unsecured creditors
- But there are arguments against the institution of secured lending

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Why Allow Secured Credit?

- Consider whether secured lending is simply a zero sum game
  - Secured lenders may charge lower interest but then unsecured lenders must charge higher interest
  - Fairness of giving secured creditors with bargaining power priority over those with little power (e.g. employees with wage claims) or involuntary creditors such as tort claimants

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Why Allow Secured Credit?

- You should be generally aware of these big picture arguments
  - Not a main focus of the class
  - But may influence court decisions like Knox
- A system of secured credit must have certainty to promote the benefits claimed for the system
- Equitable exceptions destroy systemic certainty

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Why Allow Secured Credit?

- The main challenge (unsuccessful) to the regime of secured credit was suggested by Prof. Warren at Harvard
  - She suggested that a carve-out (e.g. 20% of all debtor assets) be set aside for the benefit of unsecured and involuntary creditors
  - The proposal generated lots of smoke but went nowhere
- Lucian Bebchuk tried to show why secured credit was not efficient

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Why Allow Secured Credit?

- I do not find these arguments particularly interesting
  - –Secured lending as an institution is here to stay
  - –Evidence for secured lending at least as far back as the Old Testament
- My focus is on making secured lending procedures as efficient as possible
  - –Why not more efficient? Lawyer monopoly? Lobbying?

Social Construction

- We start with the idea that the secured credit relationship is a socially constructed relationship
  - –Think of a ritual or a recipe
  - –If you follow the steps, the social relationship is created
- We are interested to identify the steps in the ritual
  - –How much variance between the recipe and the actual steps taken is allowed?

Social Construction

- As a first approximation, the UCC (particularly Article 9) serves as our recipe book
  - –This recipe book was created because, prior to the uniform code, case law and a myriad of statutory schemes that varied from state to state made construction of the social relationship both complicated and uncertain

Social Construction

- The social relationship may not be given effect
  - –Because of inequitable conduct on the part of the secured party OR
  - –Because the secured party did not follow the proper recipe OR
  - –Changed circumstances require the performance of another ritual
- Let us focus on the performance of the ritual

Social Construction

- The actors: identify a debtor and a creditor
  - –In this regard, think about legal persons, not natural persons
- The props: identify the collateral
  - –In this regard, think about property objects
  - –Property objects are not things you can kick but are legal constructs
- The Hegel reading develops this

Social Construction

- Property objects may be tangible or intangible
  - –Make sure you also think about property objects on a time line
  - –Are the property objects that form the collateral all in existence today? Owned by the debtor?
  - –What about property objects that the debtor acquires in the future?
- *"After acquired property"* clause

Social Construction

- C loans D $100 at T1
  - D owns 2 machines
  - D grants C a SI in "all its machines" in a signed security agreement
- At T2, D buys 3 new machines
- At T3, D fails to repay C
  - Payment failure may be at scheduled maturity or as a result of acceleration
- C claims a security interest in all 5 machines—What result?

Social Construction

- The description of the secured obligation is critical
  - Does it cover principal? Interest? Fees and costs?
  - Also think about the secured obligation on a time line
- What about loans made after the creation of the security interest?
- What about loans made prior to the creation of the security interest?

Social Construction

- C loans D $100 at T1
  - D owns 5 machines
  - D grants C a SI in "all its machines" in a signed security agreement
- At T2, C loans D an additional $200
- At T3, D fails to repay C
- C claims its security interest secures repayment of both advances. Result?
- *"Future advance"* clause

Social Construction

- At T1, C loans D $200
- At T2, C loans D an extra $100
  - D owns 5 machines
  - D grants C a SI in "all its machines" in a signed security agreement
- At T3, D fails to repay C
- C claims its security interest secures repayment of both advances. Result?
- Think about *"preferences"* under BC

Social Construction

- At T1, C loans D $100 to buy X
  - D grants C a SI in X in a signed SA
- At T2, C loans D $200 to buy Y
  - D grants C a SI in Y in a signed SA
- At T3 D repays the $100 loan
- At T4, D defaults and C accelerates
- C claims that X serves as collateral for the unpaid $200 advance. Result?
- *"Cross-collateralization"* clause

Social Construction

- First, decide whether the relationship you want to create is permitted
  - Find specific authority in the statute
- Second, figure out what the default rule specifies
  - Is the relationship created automatically by law OR
  - Is the relationship created only if it is specified in the K?

Social Construction

- Third, determine the extent to which the ritual is open ended or "loose"
  - –Some rituals require strict compliance
  - –Think about the composite document rule—Bollinger & Ortiz
  - –We will contrast the composite document rule used to find security agreements with the rules for presentation under L/Cs

Social Construction

- Creation of the security interest:

"In this security agreement D and C agree that: the collateral is D's printing press and the obligation secured is the $100 loan made by C to D on October 1, 200X

/s/ D /s/ C"

- Does this work as a security agreement? Need for C's signature?
- *"Granting"* clause

Social Construction

- Creation of the security interest:

"In this conditional sale agreement, dated May 1, 200X, B and S agree that: S hereby sells a printing press, delivered to B today, subject to payment of $100 in 90 days by B to S

/s/ B /s/ S"

- Does this work as a security agreement? Need for S's signature?