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Figuring Out Fixtures

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Fixtures occupy a unique position in commercial law—namely the intersection between real and personal property. As such, the issues relating to these assets are sometimes not fully appreciated by both real estate lenders, who often assume that their lien on financed real property will cover everything attached to that property, and personal property financiers, who often assume that their collateral is free of competing liens, although they may have only searched the UCC central filing office.

When assets are or become fixtures, how to perfect a lien against those fixtures and how to determine the priority of that lien has challenged the judiciary and confounded lenders for years, as evidenced by the continuing court battles between personal property and real estate secured lenders. Today's column examines those questions, as well as the treatment generally of these assets under Article 9 of the Uniform Commercial Code.

What Exactly Is a Fixture?

The UCC defines fixtures under §9-102(a)(41) as “goods that have become so related to particular real property that an interest in them arises under real property law.” Unfortunately, the line between real property and personal property, as important as it is, is not clearly drawn by the Code.

Two observations should be made here. First, fixtures must be goods. Goods are defined as “all things movable when a security interest attaches.”¹ The UCC does not, however, define “movable.” Black's Law Dictionary defines “movable,” in the context of property, as “that which can be changed in place.” But most items (even houses) are “movable” in some respect or other.

The other important observation is that the UCC passes the question of determining what constitutes a fixture to state real property law and, unfortunately, state law is a hodgepodge of vague criteria. Of course, commentators over

the years have offered up various formulations to assist judges and practitioners in identifying fixtures, some a bit more entertaining than others. One example is: “Anything which could be moved more than a half inch by one blow with a hammer weighing not more than five pounds and swung by a man not more than 250 pounds would not be a fixture.” Then there is: “Anything would be deemed a fixture unless one could loosen the item from the floor or wall with a screwdriver and a crescent wrench within one hour.” And my personal favorite: “You take the world, you shake it, and everything that doesn't fall off is [a fixture].”²

The leading case on what constitutes a fixture dates back to 1853. In *Teaff v. Hewitt*,³ the Supreme Court of Ohio articulated three criteria in analyzing whether goods are fixtures. These are: (1) whether the goods are actually attached to the real estate, (2) whether the goods have been fitted and adapted to be used with the real estate, and (3) whether the party *intended* the goods to be a permanent accession to the real estate.

If the above factors still seem particularly unhelpful in providing guidance, that is a view shared by many. It is beyond the available space and scope of this article to conduct a full discussion of court decisions in the wake of *Teaff*, but suffice it to say that this subject has generated an extremely fact-based history of decisions and the only certainty in regard to court decisions in this area is the uncertainty.⁴

Perfecting a Lien Against Fixtures

Given the difficulty in predicting whether goods are fixtures, counsel is well advised to perfect a client's lien on assets affixed to real estate, as well as against those not affixed to real estate but which become so, in a manner that preserves its priority against both real and personal property creditors.⁵ Under UCC §9-334(a), a security interest under Article 9 may be created in goods that “are fixtures or may continue in goods that become fixtures.” Thus, in general, a lien perfected against an asset that is not attached to real estate will remain perfected even if the asset subsequently becomes a fixture.⁶

A lien on fixtures can be perfected by filing. The UCC permits three types of filings against fixtures: one is a standard state-level financing statement filing as contemplated under §9-502(a), the second is a “fixture filing,” and the third is a real estate “record of mortgage.”

A lien on goods that are fixtures can be perfected under Article 9 in the same manner as applies to goods that do not constitute fixtures, that is, by filing a financing statement satisfying the requirements of §9-502(a). Under §9-502(a), a financing statement is generally sufficient if it provides the name of the debtor, the secured party (or its representatives) and indicates the collateral covered. The UCC provides that law of the state of the debtor's location governs perfection of such lien, and that the office of the secretary of state of such state is the appropriate place to file a financing statement against goods that “are or are to become fixtures” where the financing statement is not filed as a fixture filing.⁷

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The UCC also provides two alternative means of perfection by filing for fixtures. The first of these is the “fixture filing.” A fixture filing is defined in UCC §9-102(a)(40) as a financing statement that satisfies the requirements of both UCC §9-502(a) and §9-502(b). UCC §9-502(b) states that, in order to qualify as a fixture filing, a financing statement must also (i) indicate that it covers fixtures, (ii) state that it is to be filed in the real property records, (iii) provide a description of the real property to which the collateral is related,⁸ and (iv) if the debtor does not have an interest of record in the real property, provide the name of a record owner. UCC

commentary cautions that the description of the real property must be sufficient to be found by a real-property searcher.⁹

The second alternative means is through a record of mortgage. Under UCC §9-502(c), a record of mortgage¹⁰ is effective as a financing statement filed as a fixture filing if (i) the record indicates the goods it covers, (ii) those goods are or are to become fixtures related to the real property described in the record, (iii) the record satisfies the requirements for a fixture filing (but the record need not indicate that it is to be filed in the real property records¹¹), and (iv) the record is duly recorded. Interestingly, the 2010 amendments to Article 9 also include language indicating that, for Alternative A States (the “only if” states¹²), an individual or surname and first personal name of a debtor (i.e., a lower threshold than might otherwise apply) will be sufficient for a record of mortgage filed as a financing statement against an individual debtor.

A fixture filing and, not surprisingly, a mortgage record effective as a fixture filing, must be filed in the office designated under state law for the recording of a mortgage on the related real property.¹³ The law of the jurisdiction where the fixtures are located will govern perfection and effect of perfection or non-perfection and priority of a security interest perfected by this type of filing.¹⁴

Priority of Creditor's Lien

The choice among the methods of perfection becomes significant when determining the priority of competing liens.

As between competing Article 9 secured creditors without claims to the related real estate, the standard rules of priority apply. The first to perfect will have priority. However, the results can be different when real estate secured lenders are involved.

UCC §9-334 establishes the general rule for priority of liens as between real estate and personal property creditors. Subsection (c) states what it describes as the “residual priority” rule,¹⁵ which applies only if one of the other rules does not. Under the residual priority rule, a security interest in a fixture will be subordinate to a conflicting security interest of an “encumbrancer or owner of the real property.”¹⁶ However, subsection (e)(1) then provides that a perfected security interest in fixtures *will* prevail over a real property-secured lender if (x) the debtor has an interest in or is in possession of the real estate *and* (y) the personal property lien is perfected by a prior recorded fixture filing. So, the first-to-file rule applies as between real estate lenders and personal property financiers, but *only* if the personal property creditor has perfected its lien through a fixture filing or mortgage record. A lien perfected through a standard state-level financing statement, on the other hand, will be subordinate to a real estate mortgage covering the fixtures, as well as to a fixture filing, even if such state-level filing was

recorded prior to the mortgage or fixture filing. If filed to perfect a purchase-money security interest, the fixture filing generally will also prevail against a prior mortgage (other than a construction mortgage) if such filing is within 20 days of when the goods become fixtures.

The rules of priority described above are illustrated in the recent case of *Sturtz Machinery v. Dove's Industries*.¹⁷ In that case, Sturtz Machinery sold a number of vinyl window manufacturing machines located in Virginia to Dove's Industries, a Pennsylvania corporation, in early 2011. M&T Bank subsequently provided financing to Dove's and perfected a security interest in such machinery, among other collateral, by filing a financing statement against Dove's with the Secretary of State of Pennsylvania. In August 2012, several months after M&T filed its financing statement, Dove's defaulted on its obligations to M&T and, shortly thereafter, Sturtz filed a financing statement with the State Corporation Commission of Virginia, as well as a fixture filing in Pulaski County, Virginia, against Dove's.

Counsel needs to be mindful of the risks presented to personal property secured creditors by real estate lenders who may have a mortgage on real estate where such collateral is located.

The court held that M&T's security interest prevailed over Sturtz's lien. The court reasoned that both M&T and Sturtz had properly filed their financing statements. Since neither, however, held a lien on the related real property, the special priority rules of §9-334 were inapplicable and, as between the two personal property secured creditors, the rule of first-to-file applied. The result would clearly have been different if Sturtz had possessed a lien on the related real property (and was accordingly an “encumbrancer” of such real property).

Conclusion

The above rules illustrate the need for caution on the part of practitioners, particularly those who represent financiers of assets, such as equipment, that present a higher probability of being affixed to realty. Given the difficulty in ascertaining under local law exactly when movable assets may constitute fixtures, counsel needs to be mindful of the risks presented to personal property secured creditors by real estate mortgages. Practitioners are advised to record fixture filings, wherever possible, against equipment and other assets that may be or become attached to real estate. They should also consider routinely performing lien searches in county real estate records as well as state-level UCC filing offices in respect of such assets.

Finally, language in financing agreements stating the intent of the parties that financed assets not constituting fixtures may help protect such collateral from the claims of real estate mortgagees.

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1. See UCC §9-102(a)(44).

2. The first two examples are from White & Summers. See James J. White & Robert S. Summers, Uniform Commercial Code 1056 n. 66 (2d. Ed 1980). The last quotation is attributed to Professor Knippenberg by Lynn LoPucki & Elizabeth Warren, Secured Credit: A Systems Approach 348 (6th ed. 2009) (alteration in original). All three quotations are cited in “Groping Along Between Things Real and Things Personal: Defining Fixtures in Law and Policy in the UCC,” Marc L. Roark, 78 U. Cin. L. Rev. 1437 at 1439 (2010) (the Roark article).

3. 1 Ohio St. 511, 529-30 (1853).

4. See the Roark article at 1466. See also James D. Prendergast, “What are Real Property Fixtures (And How do you Insure against Senior Liens)?” First American Title UCC Division Newsletter, Issue 1, Volume 8 (2012), stating that “...fog, not clarity, is the order of the day.”

5. In fact, Comment 3 to UCC §9-334 and Comment 6 to UCC §9-502, both recognize the need for this conservative approach. Comment 3 states: “Because the question whether goods have become fixtures often is a difficult one under applicable real-property law, a secured party may make a fixture filing as a precaution. Courts should not infer from a fixture filing that the secured party concedes that the goods are or will become fixtures.” Comment 6 states: “In some cases it may be difficult to determine whether goods are or will become fixtures. Nothing in this Part prohibits the filing of a “precautionary” fixture filing which would provide protection in the event goods are determined to be fixtures.”

6. See Cmt. 3 to UCC §9-334. An exception to this rule applies to ordinary building materials that become an integral part of real property. See UCC §9-334(a).

7. See UCC §§9-301(a) and 9-501(a)(2). Note that certain exceptions to these filing rules apply to fixtures of a transmitting utility. See UCC§9-501(b). Those rules are beyond the scope of this article.

8. Note that under current New York UCC §9-502(b), the description must include the book and page number in a deed or mortgage index or identify the property by street, number and town or city. Note also a variation adopted in certain other jurisdictions requires a description sufficient to give “constructive notice of a mortgage under state law if the description were contained in a record of the mortgage of the real property.”

9. See Cmt. 5 to UCC §9-502.

10. “Mortgage” is defined by UCC §9-102(a)(55) as a “consensual interest in real property, including fixtures, which secures payment or performance of an obligation.” “Record of a mortgage” is not defined, but Comment 6 to §9-502 carefully distinguishes between a mortgage and a record of a mortgage in noting that use of the latter term recognizes that in some systems the record actually filed is not the record pursuant to which a mortgage is created.

11. The language in parentheses in subsection (iii) is the result of a slight modification effected pursuant to the 2010 amendments to Article 9 (the 2010 Amendments). In New York, the current provision states “other than an indication that it is to be filed in the real property records” in lieu of the parenthetical language. The 2010 Amendments (including “Alternative A” provisions) are proposed to be adopted in New York pursuant to a UCC modernization act approved by the New York State Legislature on June 19, 2014 and, as of the date of submission of the article for publication, awaiting signature by the governor (see N.Y. State Assembly Bill 9933 (2013-2014 General Assembly (the same legislation as N.Y. State Senate Bill 7816)).

12. See A. Christenfeld and B. Goodstein, “State Legislatures Consider UCC Article 9 Amendments,” 245 NYLJ, No. 105 (June 2, 2011).

13. See UCC §9-501(a)(1).

14. UCC §9-301(c)(1).

15. See Cmt. 5 to UCC §9-334.

16. See UCC §9-334(c). “Encumbrance” is defined in UCC §9-102(a)(32) as a right, other than an ownership right, in real property and includes mortgages and other liens on real property. Although encumbrance could arguably be interpreted to cover state-level financing statement filings on fixtures, the better interpretation is that this reference is intended to be limited to the county-level mortgage and fixture filings.

17. 2014 WL 1383403 (N.D. Ohio April 8, 2014).