**Fixtures**

Welcome to this podcast on Fixtures brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is how a secured creditor can perfect a security interest in goods that are or might become fixtures in order to prevail against UCC or real estate claimants of the same collateral. This topic primarily requires a careful reading of UCC § 9-334 and an understanding of what is a fixture.

In order to have *priority* with respect to a security interest, it is not enough to simply be a secured creditor; a creditor will want to be a *perfected* secured creditor. While creditors will often file a *financing statement* to perfect their security interest, issues can arise with respect to claimants of the collateral that arise outside of the UCC filing system. Such is the case if goods subject to a security interest are or might become fixtures, which would be governed by the real estate property system. Of course, in the real property system, we record mortgages and other claims to provide notice to others. So, how does a secured creditor perfect its security interest where there is overlap?

There are more than 3000 counties in the United States each having their own real estate recording system. Mortgage lenders typically file a mortgage document signed by the debtor and containing a description of the collateral. A mortgage filing would cover not only the land, but any permanent buildings located on the land. These types of interests are only perfected by filing in the real estate system, not the UCC filing system. This would include a filing with respect to fixtures on the real estate. However, § 9-109 provides that Article 9 applies to security interests in personal property or *fixtures*. So, we have an overlap.

So, with the potential need to satisfy Article 9 and real estate law, a creditor must know if it has a fixture in the first place. Section 9-102(41) defines fixtures as “goods that have become so related to particular real property that an interest in them arises under real property law.” Of course, this necessitates an understanding of real property law, which is state law. While state laws differ, a fixture is generally understood to be goods that become sufficiently related to real estate due to a number of factors, including a degree of physical affixing to the real estate and easy removal, intention of the parties, reasonable expectation of third parties, and the extent to which the fixtures are critical to the functioning of the real estate.

Let’s look at a simple example. I own a vacation home that I agree to sell to my friend Scott. There might be a question as to what types of things on the property would be part of the real estate, what would be fixtures and what would be my personal property. The vacation home and the land are part of the real property, for sure. My handmade sassafras furniture seems to be personal property and Scott would not, without special agreement, receive an interest in the furniture. But what about a custom Aspen wood staircase that I just had installed? And, what about the custom granite countertop that I just put in the kitchen during construction? What about a cast iron stove in the great room that is attached through the roof by a chimney piping system? The aspen wood staircase and granite countertop in light of the firm affixing to the real estate will seem to be fixtures. Yet, what about the cast iron stove? Would there be an assumption that the cast iron stove is personal property or part of the real estate? We might need more information for sure to decide, which might be a problem for a creditor wanting to take a security interest that included the cast iron stove.

When it comes to fixtures, you can already see that a mortgage (with or without a special designation of fixtures) may create a security interest in a fixture. A secured party might also file a financing statement covering fixtures in the state UCC records. But, § 9-502 also provides that a secured party can file what is called a *fixture filing* under Article 9 in the real estate records. A fixture filing is simply the filing of a financing statement in the real estate records that indicates the type of collateral, that it is to be filed in the real property records and provides a description of the real property to which the collateral is related. Additionally, if the debtor does not have an interest of record in the real property, the financing statement filed as a fixture filing must also provide the name of the record owner.

While Article 9 does not require the filing of a fixture filing in the real estate records, the priority rules operate in such a way that a secured creditor with a security interest in fixtures will likely want a fixture filing. Section 9-334 provides a number of rules of the road. First, a security interest can be created in goods that are fixtures or in goods that become fixtures so long as they are not ordinary building materials incorporated into an improvement on the land. Second, real property law also may provide for creation of an encumbrance upon fixtures. Third, and this is important, unless an exception applies, a security interest of an earlier filed real estate encumbrancer (other than the debtor) has priority over a later filed security interest in fixtures. Fourth, an earlier filed construction mortgage will have priority over claims of others with security interests in fixtures recorded before the completion of construction.

Let’s look at a construction example. Presume that the real estate and the construction of my vacation home is financed by First Bank, which has a construction mortgage on the real estate. During construction, I contracted with Tri-State Granite to provide the custom countertop on credit and granted a security interest to Tri-State Granite in the countertop that will become a fixture in the home. Tri-State Granite perfects its interest by a fixture filing in the real estate records. If I fail to pay for the granite countertop, which creditor will have priority? Tri-State Granite’s security interest encumbers only the countertop and it will want to foreclose. Under the rule of § 9-334, however, First Bank as a holder of a prior construction mortgage will be able to prevent the removal of the countertop because it has priority. The same would be true of a mortgage refinancing a construction mortgage. Of course, if Tri-State Granite filed its fixture filing prior to the construction mortgage, then it would have priority, but this is not a likely situation. This might seem unfair to Tri-State Granite, which has a purchase-money security interest, but if it wants to be first during construction it will need to get an agreement from First Bank to subordinate.

Well, what about fixtures that come after construction? For instance, what about that cast iron stove? Remember that there are some exceptions that permit priority over a real estate encumbrancer. There are two important exceptions. First, a *fixture filing* made before the goods become fixtures or within twenty days thereafter will have priority over a conflicting interest of an encumbrancer or owner of the real property if it is a purchase-money security interest and the debtor has an interest of record or is in possession of the real estate. Second, where the debtor has the right under a mortgage to remove fixtures, a *fixture filing* will have priority over an earlier mortgage.

Presume that First Bank has a mortgage in the real estate records on my vacation home. Now, remember we are past construction. I agree to purchase a cast iron stove from Vermont Castings, which takes a security interest in the stove and files a *fixture filing* at the time of installation. Vermont Castings has a purchase-money security interest in the stove and will have priority over the mortgage of First Bank with respect to the cast iron stove, in the event that it turns out to be a fixture.

One last common exception to the rule giving priority to earlier filed real estate encumbrancers is worth mentioning. In the event that we have an earlier filed real estate encumbrancer but we have a creditor perfecting a security interest under Article 9 before the goods become fixtures, the Article 9 claimant will have priority if the fixtures are readily removable factory or office machines, equipment that is not primarily used or leased for use in the operation of the real property, or replacement of domestic appliances that are consumer goods. For example, presume that First Bank has a mortgage in the real estate records on my vacation home. I need a new built in microwave oven. I purchase the microwave oven from Sears on credit with Sears taking a security interest in the microwave oven, which is automatically perfected as consumer goods. The microwave oven is installed and bolted to the wall, but is readily removable. The security interest of Sears would have priority because it is a replacement of a domestic appliance that is consumer goods, a microwave oven.

At this point, you should be able to describe what a fixture is and how a secured creditor might go about perfecting a security interest in a fixture, as well as some of the priority rules related to fixtures.

I hope you’ve enjoyed this podcast on Fixtures.

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