SECURED VERSUS UNSECURED CREDITORS – BASIC TERMS

A. General Concepts and Terms:

1. The status of being secured is a fundamental divide between creditors.

2. A creditor with a lien on specific property of the borrower/debtor is a **secured creditor**. A lien exists only as to identifiable property (although certain liens, such as federal tax liens, may attach to all property of a debtor).

3. A lien is a right of a creditor to repaid from the proceeds of the property subject to or encumbered by the lien.

4. Property subject to the secured creditor's lien is the secured creditor's **collateral.**

5. A voluntary lien in *personal* property is typically known as a **security interest**, which is the term used in Article 9 of the Uniform Commercial Code.

6. A voluntary lien in *real* property is typically known as either a **mortgage** or **deed of trust.**

7. A lien can encumber both tangible and intangible property (such as a copyright, or an account receivable) as well as after-acquired property.

8. A lien creates leverage and reduces risk as to the secured creditor's ability to obtain repayment. Because of the secured creditor's lower risk, it should be able to extend credit at a lower interest rate and to a wider group of borrowers/debtors.

9. A lender without a lien is an **unsecured creditor** or **general creditor**, and the lender's claim is an **unsecured claim**.

10. A secured creditor typically has the right to repossess and sell its collateral following the borrower's default.

11. A secured creditor whose collateral is worth more than the amount of the creditor's claim is **over-secured**. A secured creditor whose collateral is worth less than the amount of the creditor's claim is **under-secured**.

12. As a practical matter, an under-secured creditor holds two types of claim against the borrower. The creditor is a secured creditor up to the value of its collateral, and an unsecured creditor for the remaining balance of its claim (the deficiency amount).

13. An unsecured creditor holds no claim against specific property of a debtor. Upon its debtor's default, it may not seize any the debtor's property, but must instead sue for a judgment on its claim.

B. Types of Secured Claims and Liens:

1. A voluntary lien or **security interest** is created by contract.

2. The contract creating a security interest in personal property is a typically referred to as a **security agreement**. The security agreement identifies which property is subject to the security interest.

3. There are three requirements for a security interest to be effective between the creditor and the debtor: (a) the debtor must have signed a security agreement; (b) the creditor must have provided value/credit to the debtor; and (c) the debtor must have rights in the collateral.

4. When the foregoing three requirements are satisfied, the security interest has **attached** to the collateral.

5. For a security interest to be effective against other creditors of the debtor, it must be **perfected**. A security interest is most often perfected by the filing of a **filing statement** with the appropriate state recording office. When the debtor is an enterprise organized under state law (i.e., a corporation or limited liability company or limited liability partnership), the filing statement is properly filed with the recording office of the state of the debtor's organization, without regard to the location of the collateral.

6. A **judicial lien** is an involuntary lien created as part of the process of collecting a judgment.

7. A **statutory lien** is an involuntary lien created by statute or under the common law to protect a specific type or class of creditor. Examples of statutory liens are landlord liens for unpaid rent; tax liens for unpaid taxes; and mechanics' liens for unpaid goods and services provided to real estate projects.

8. A **purchase money security interest (**"PMSI") is a security interest granted to secure the repayment of the loan used by the debtor to acquire the collateral. A non-PMSI is a security interest granted in property which the debtor already owns.

8. A voluntary lien in collateral has priority over the debtor's right under state law to declare the property as **exempt**. Involuntary liens in collateral are typically subordinate or junior to the debtor's rights to declare the property in question as exempt.

9. State law **exemption** is typically ineffective