

Louisiana Security Devices

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A Précis

SECOND EDITION

Jason J. Kilborn

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To Randy Trahan, Alain Levasseur, and Mike Rubin, who inspired me to learn about the Civil Law and who taught me everything I know about how it intersects with modern commercial law

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Preface

This book is designed to demystify the complex and multifaceted law of secured transactions in Louisiana. One can easily get lost in the myriad of details of any one aspect of this law. This book is intended to serve as a map. The historically complex law of security devices has been further complicated by Louisiana's adoption of Article 9 of the Uniform Commercial Code (including the most recent revision in 2001), replete with non-uniform modifications to fit Louisiana's unique legal and commercial environment. Especially when one attempts to chart the boundaries and overlap among security interests, mortgages, and statutory privileges in provisions in the Civil Code, Code Ancillaries, and Chapter 9 of Title 10 of the Revised Statutes (the Louisiana Commercial Laws), clear guidance is virtually nonexistent. This book attempts to fill that void and offer an overview of the new world of Louisiana security devices in the 21st century.

The title of this book reflects its carefully confined goal, however. This is not a "treatise," so the reader will not find every answer to every question, nor even an analysis of each provision of this area of the law and illustrative jurisprudence. Instead, in this "précis," one will find a basic exposition of the main ideas and most commonly encountered provisions in modern secured transactions law. To be sure, this book is designed to answer many—perhaps most—questions that will occur to the average student, practitioner, or researcher in this area. Even for those questions left unanswered, this book should set even the most unseasoned novice on the right track to finding the answer elsewhere, if need be.

The intended audience for this book thus ranges from the student wading through the material in a Security Devices or Secured Credit or Secured Transactions course, to the new lawyer setting out on a confusing research assignment in a case involving a secured transaction, to the experienced lawyer returning to this area of the law after an extended absence to find that the law has changed dramatically in the past 15, 10, and even 5 years. In writing this book, I hope to ease the lives of many such people by reducing their research time for a complex secured transaction project from days to hours (or from hours to minutes) and increasing their confidence in the solution to sometimes very difficult problems.

Jason Kilborn
Baton Rouge, LA

Introduction

What Is a Security Device and Why Do They Exist?

A “security device” is a statutory or contractual mechanism that enhances the likelihood that the person to whom an obligation is owed (the “obligee” or “creditor”) will have a reliable and certain source of recovery of value if the person who owes the obligation (the “obligor” or “debtor”) fails to live up to her end of the bargain (in other words, if she “defaults” on the obligation). A security device allows the creditor to feel more “secure” that an obligation will be met, particularly if the obligor has less-than-perfect creditworthiness. If the obligor fails to perform, a security device allows the creditor either to have identified items of the debtor’s property seized and sold and the proceeds applied to the debt (in preference to the rights of other unpaid creditors), or to seek payment from some third party. Security devices are thus “accessory” to “principal obligations” that they support. One cannot have an effective security device without a principal obligation. In most secured transactions (that is, deals involving a security device), the principal obligation is to repay a sum of money previously lent by the creditor (often a bank), but security devices support many sorts of obligations to transfer value.

The availability of security devices encourages those with money to lend it to others to whom they might not lend without greater security of repayment. This increases economic activity (and, we hope, general welfare) by putting money to productive use in the flow of commerce. Encouraging people to enter into transactions and create societally beneficial principal obligations is perhaps the main reason

for the existence (and expansion) of security device law (though one might reasonably criticize modern security device law for the method or extent to which it seeks to accomplish this goal).

To understand fully why security devices exist and the function they serve, we have to understand the limited remedies available to an “unsecured” creditor; that is, a creditor who does not have a “security device” backing up its debtor’s principal obligation. Suppose Bank agrees to lend \$10,000 to Borrower for the purchase of a used car. When the time comes to repay this loan, Borrower fails to do so; that is, she “defaults.” What are Bank’s options at this point? Obviously, Bank should try to seek some informal compromise arrangement with Borrower to avoid the expense of a legal battle. Failing that, though, in Louisiana as in most other places, enforcing an obligation through “normal” channels is a long and expensive process that often fails to produce a recovery of value for the creditor. Unsecured creditors like Bank face at least three main impediments to recovering value from a defaulting obligor.

First, an unsecured creditor can take little or no direct action against a recalcitrant debtor; rather, the creditor must engage the judicial system to enforce a defaulted obligation against the debtor’s property. Since the mid-1800s, debtor’s prison is no longer an option to coerce payment from defaulting debtors (though child support debtors sometimes are jailed for contempt of court for failure to pay their court-ordered support obligations). Creditors are limited to seeking recovery from the debtor’s property, and only after obtaining a judgment and enforcing it through official channels. Creditors cannot engage in “self help” to take matters into their own hands. In our example, Bank cannot have Borrower jailed for refusal to fulfill her repayment obligation, and it cannot legally seize the car, even though Bank lent Borrower the very money used to purchase the car. Bank must file a lawsuit on the unpaid obligation, obtain a judgment, and send out the sheriff to find and seize Borrower’s property (including, perhaps, the car).

Of course, the process of suing on a defaulted obligation is not free, even if the debtor fails to contest liability. Retaining an attorney to file the proper paperwork and have it served on the debtor by the

sheriff often entails significant time and expense. Even after the creditor reduces the obligation to a judgment, that judgment must be enforced through a writ of garnishment (directing the debtor's bank or employer to turn over money in the debtor's bank account or unpaid wages) or a writ of "fieri facias" (often called a "fifa" writ, directing the sheriff to find, seize, and sell property belonging to the debtor and turn over the proceeds to the creditor). By the time the court process concludes and the sheriff arrives with a writ, the debtor may have no property of any value, or other creditors might have already taken what little valuable property the debtor had. So even if Bank goes through the process of obtaining a judgment (even a default judgment) against Borrower, by the time the sheriff arrives to seize, for example, the car that Borrower bought with Bank's money, the car might be damaged, destroyed, or missing, entailing at least further expense if not a total loss for Bank. And note that Bank's losses now include the wasted expense of its lawyer's fees, court costs, and the sheriff's fees.

Second, even if the debtor has valuable property, Louisiana law shields certain property from seizure in enforcement of a judgment. Such "exemption" statutes are part of the law of most states, and Louisiana's list of exempt property is moderately generous to debtors. Some of the most valuable property that an individual might own is protected from seizure in Louisiana, such as one car per household (up to \$7,500 in value), household furniture, tools of the debtor's trade or profession, and up to \$25,000 in equity value in residential property. La. Rev. Stat. 13:3881, 20:1. Corporations and other non-natural business entities do not enjoy these exemptions, but a sole proprietor, for example, might shield much of her valuable property even from business creditors. Back to our example, even if Bank obtains a judgment, and even though Bank lent Borrower the very money used to purchase the car, if it is Borrower's only car, the first \$7,500 of value in that car is protected and reserved for Borrower (and if the car is worth \$7,500 or less, the entire car is protected). The rest of Borrower's property may well also be shielded from Bank's legal advances, leaving Bank with no ready source of recovery.

Third, if the debtor commences a bankruptcy case before the sheriff seizes the debtor's property, all of the creditor's enforcement efforts might have been for naught. The creditor will stand in line with all of the other "general unsecured creditors," generally to receive perhaps 0%-10% of the creditor's claim. For individuals in Louisiana, the same exemptions laws apply both in and outside of bankruptcy, so Bank might recover no value from the car or any other property of Borrower, but at the very least, it will have to share whatever value is available with Borrower's other creditors. Avoiding the ill effects of the debtor's potential bankruptcy filing is perhaps the primary motivation for creditors' seeking one or more security devices.

Having a security device can allow the creditor to avoid all three of these impediments. As we shall see, some contractual security devices in identified items of property allow the creditor to avoid most or all of the judicial process and proceed directly to seizure of the property covered by the security device. In many cases, no ordinary judgment is necessary, and sometimes the intervention of the sheriff is not even required. Under limited circumstances, the creditor can engage in "self help," seizing the debtor's property immediately after default for a quick and reliable source of value. If Bank has a security interest in Borrower's car, Bank might well be able simply to send out its own "repo agent," grab Borrower's car, and sell the car at a private or public sale on Bank's own terms. Even if self help is not allowed, the process of enforcing many security devices is much quicker and easier than the ordinary judicial process. Given the decisive action authorized by some security device laws, the debtor has less time to damage, destroy, or spirit away the property. Moreover, if the creditor follows the rules discussed below, it can achieve first priority to take the debtor's property even after other creditors have already intervened.

Moreover, both exemptions law and bankruptcy law explicitly bow to the rights of creditors with properly arranged security devices. By their very terms, the exemptions laws do not shield property in which the debtor has voluntarily granted a security device by contract, La. Rev. Stat. 13:3881(B)(2), 20:1(C)(7), and secured creditors' rights are largely unaffected by the debtor's bankruptcy filing, particularly after

a series of recent revisions to the federal Bankruptcy Code greatly enhanced the rights of secured creditors.

The law of security devices is thus largely about savvy contract creditors enhancing their rights in advance, before trouble arises, but this is not the whole story. Some security devices arise as a matter of law, and the intersection between consensual and nonconsensual interests is one of the most confusing elements of this area of the law. This book will discuss the four types of security devices available under the law of Louisiana and most other states, as well as where and how these security devices overlap and which takes precedence in the event of a conflict in the same property. The four types of security devices are as follows:

- (1) consensual (contractual) security devices in the debtor's movable property ("security interests," governed by Article 9 of the Uniform Commercial Code, as adopted as Chapter 9 of Title 10 of the Louisiana Revised Statutes);
- (2) consensual (contractual) and non-consensual security devices in the debtor's immovable property and immovable-property-related rights ("mortgages," governed by the Civil Code and several Code Ancillaries in Title 9 of the Louisiana Revised Statutes);
- (3) nonconsensual interests arising as a matter of law in the debtor's movable and immovable property (technically called in Louisiana "privileges," but quite commonly referred to by the generic term "liens" —pronounced "leenz"—governed by the Civil Code and Revised Statutes); and
- (4) agreements by third parties (called "sureties" or "guarantors") to pay the debtor's obligation(s) if the debtor does not ("suretyship," a nominate contract governed by the Civil Code).

Because lenders want maximum security, many of these devices occur together in common transactions. In part for this reason, this book brings all of the security devices together and analyzes their intersection and overlap, as well.