Mechanics Liens and UCC’s – Being in the Best Position to Get Paid

Agenda

• An Overview of Mechanic's Liens and UCC Filings
• Who Uses These Tools
• Different Types of UCC Filings
• Security Agreements and Financing Statements
• Collection and Enforcement Upon Debtor Default
• Similarities and Differences between State Mechanic's Lien Laws
• Using Preliminary Notices to Speed Payments
• Questions and Answers
Property pledged as a guarantee of payment for an obligation or loan.

**Collateralize Receivables**

- Personal Property
- Real Property

**Warning!**

Your customers are under an increased risk for bankruptcy

Prevent  Accept
Priority in UCC Filings

Claims are paid based on where they are situated on the claims priority ladder.

1. Secured Creditors
2. Administrative Priority Claims
3. Lower-Level Priority Claims
4. Pre-petition Unsecured Creditors

Security: Consensual or Judicial

• CONSENSUAL SECURITY
  • Provided with the consent of the debtor
  • Available to all types of lenders
    • Letters of credit
    • Security interests (UCCs) in A/R, inventory and/or equipment
• **JUDICIAL SECURITY**
  - Does not require consent of the debtor
  - Applicable under the mechanic’s lien and bond claim statutes

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**The Value of Money**

<table>
<thead>
<tr>
<th>Margin %</th>
<th>Write Off</th>
<th>Sales to Recover</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>$50,000</td>
<td>$166,666</td>
</tr>
<tr>
<td>25</td>
<td>$50,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>15</td>
<td>$50,000</td>
<td>$333,333</td>
</tr>
</tbody>
</table>

*The cost of write-offs*
Proven Strategies

- Reduce DSO
- Improve Cash Flow
- Improve Working Capital

Evolution

1 of the 10 of the 15...
Article 1: General Provisions
Article 2: Sales
Article 2A: Leases
Article 3: Negotiable Instruments
Article 4: Bank Deposits and Collections
Article 4A: Funds Transfers
Article 5: Letters of Credit
Article 6: Bulk Transfers
Article 7: Warehouse Receipts, Bills of Lading
Article 8: Investment Securities
**Article 9: Secured Transactions**

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The Expanding Code

- Canada
- Mexico
- Puerto Rico
- Australia
- New Zealand
Benefits of Secured Transactions

- Secured creditor status in a Chapter 7
- Right of Repossession (PMI)
- Part of the secured creditor team in a Chapter 11
- Generally protected from preferential payment suits
- Public record of debt in case business is sold
- Public record of ownership of assets

Two Types of UCC Filings

1. Blanket, or Basic
2. Purchase Money Security Interest
Blanket, or Basic, UCC Filing

- A security interest covering nearly all types of collateral owned by the debtor

Two Characteristics:

1. The filing covers all assets
2. The priority stacks
Promissory Note

For Value Received, the undersigned ( Borrower ) promises to pay to the order of ABC COMPANY, in full, the principal sum of $20,000, together with interest on the unpaid principal balance from the date hereof, at the rate of 2% per annum. Principal and interest shall be payable at Clinton, OH, or such other place as the Maker may designate, in consecutive monthly installments of $2,000.00 (starting 2/15/2020 until the entire principal balance is paid).

If any monthly installment under this Note is not paid when due, the amount due and owing shall bear interest at the rate of 2% per annum, with interest accruing on the unpaid principal balance from the date hereof, until paid, at the rate of 2% per annum. The Maker shall pay to the Holder all costs and expenses incurred by the Holder in the collection of any overdue payments made hereunder, and the Borrower shall indemnify the Holder for any losses incurred. The Borrower shall pay all costs and expenses of the Holder in connection with the enforcement of this Note, including but not limited to, reasonable attorneys fees.

Secured Creditors

Debtor: $61,000

Unsecured Creditors

split what’s left over

Blanket, or Basic, UCC-1 Filing

Debtor: $61,000

• Secured creditors are paid first, in the order of their filings

• First in time, first in right!
Purchase Money Security Interest

- A priority security interest in specific identifiable goods with a secondary non-priority interest in intangibles.

Purchase Money UCC Filings Chapter 7

- PMI filers take first position on specific assets or equipment
- Paid on the difference before unsecured creditors receive any distribution
- For those selling equipment or into a stocking environment
Inventory vs. Equipment

It depends on what your customer does with the goods you sell to them.

Is your customer reselling or using your products in their business?

<table>
<thead>
<tr>
<th>INVENTORY (GOODS)</th>
<th>EQUIPMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer resells the goods to another entity</td>
<td>Customer uses the goods in the course of their business</td>
</tr>
<tr>
<td>Search</td>
<td>Contract</td>
</tr>
<tr>
<td>Notify</td>
<td>20-day Rule</td>
</tr>
</tbody>
</table>

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PMSI: The Value of Repossession

- Resale
- Differentiating your receivables

The Value of Repossession

Services

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1. Security Agreement

**UCC Filing - Two Required Elements**

**1. Security Agreement**

A Security Agreement is a legal document that provides security for the performance of a contract. It grants a creditor a security interest in the debtor's assets as collateral for the performance of a contract. The Security Agreement is a contract between the creditor and the debtor, and it is used to secure the debt. It is a legal document that is required to perfect security interest in personal property.

**Two Required Elements**

- **Loan Agreement**
- **Sales Agreement**
- **Consignment Agreement**
- **Promissory Note**
- **Conditional Sales Contract**
- **Dealer Agreement**

**Or….**

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**2. Financing Statement or UCC-1**

A Financing Statement is a legal document that perfects a security interest in personal property. It is filed with the appropriate state agency and provides notice to other creditors of the existing security interest. It is a legal document that is required to perfect security interest in personal property.

**Can be a stand-alone document or exist in other forms**

- **Loan Agreement**
- **Sales Agreement**
- **Consignment Agreement**
- **Promissory Note**
- **Conditional Sales Contract**
- **Dealer Agreement**
- **Or….**
Credit Application Security Agreement

Financing Statement

• Records the secured interest and makes it a public record
• In effect for five years, at which time can be continued for another five-year period
• Filed in locations based on your customer's form of business
Articles of Incorporation

Should be performed with each filing.

Confirms:

1. State of incorporation
2. Corporate legal name of customer
3. State organizational ID number
Financing Statement Miscues

Hastings State Bank v Thomas D. Stalnaker

Debtor: EDM Corporation

- Hastings State Bank filed a financing statement listing the debtor name as “EDM Corporation d/b/a EDM Equipment”

Financing Statement Miscues

Host America v Coastline Financial (UT)

Debtor: K.W.M. Electronics Corporation

- The secured party listed the debtor name on the financing statement without periods.
- Court ruled seriously misleading
Change to Debtor’s Name and Location

- All changes must be filed within four months.
- If late… the security interest will become unperfected in assets the debtor acquired after that four-month period.
- The only exception to the four-month rule is for changes to state of incorporation.
- The Secured Party has one year to correct the filing.

Recognizing Opportunities To Take Security
Opportunities to Take Security

Two areas

- New customers
- Existing customers

New Customers and Security

- Thresholds of credit lines
  - Unsecured vs. Secured lines
- Credit scoring models
- Speed of credit approval
- Discounts
Customer requests extended terms

Customer is past terms or asks for more time to pay

Customer is over the credit line and orders frequently go “on hold”

Anytime you restructure debt

Customer’s financials are declining

You get a particularly large order from an existing customer

Anytime someone asks for a favor!
Creating A Reason

• Declare the debtor in default of the terms of their security agreement
• Advise them they must cease and desist selling the inventory or using the equipment
• Set a cure period
• Inform debtor if payment isn’t made by the cure period secured party will begin repossession proceedings
• Set a date and time for repossession
• Depending on what the security agreement calls out, advise the debtor they must assemble the inventory and have it conveniently available for pickup
• Inform debtor the next step is to send a notice of disposition of collateral to all other secured parties, which may include the bank


Secured party has the right to take possession of collateral upon default.

• Voluntary or legal
• May proceed without judicial process
• May not breach the peace
• Recovery through stealth or deception is permitted!
Disposition of Tangible Collateral

The proceeds of disposition shall be applied in the following order:

- Repossession and storage costs
- Attorney fees
- Satisfaction of the indebtedness
- Other secured parties with an interest in the collateral

Disposition of Intangible Collateral

- Upon default a secured party “may notify an account debtor to pay the account directly to the secured party and not the debtor.” UCC 9-607(a)(1)

- In addition, the secured party may collect proceeds to which it is entitled under 9-315 and may commence legal action against third parties to collect accounts and other obligations. UCC 9-607(a)(2)
Mechanic’s Lien Filing Process: Three Steps

- 20 days from *first* furnishing
- 90 days from *last* furnishing
- One year from lien filing

Above deadlines are examples
Reasons to Serve Notices

- Notices initiate compliance with state lien laws and preserve your right to lien if needed.
- Notices identify you to the owner of the property, who wants to ensure you receive payment.
- Notices make you a priority for payment from your customers.

Justifying the Credit

Claims filed below this line may be questionable.

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Who Gets Paid?

Tier 1
- General Contractor

Tier 2
- Sub Contractor

Tier 3
- Supplier
- Service Provider
- Distributor

Who Gets Paid?

Tier 1
- Hi, I'm Paul!
- General Contractor

Tier 2
- Sub Contractor

Tier 3
- Supplier
- Service Provider
- Material Distributor

Claims filed below this line may be questionable.
Notice-Lien-Suit

- 97.3% of the time serving a notice will get you paid
- 99% of the time a notice/mechanic’s lien will get you paid
- Only 1% of the time will it go to suit

Factors in Serving Notices

- Prepared in the Correct Format
- Served in a Timely Manner
- Contains Accurate Information
- Served on all Required Parties
- Served Using the Correct Method of Service
Niewind v. Carlson

- Chuck Niewind dba C&N Construction filed lien for work which he was unpaid.
- “must be in at least 10-point bold type”
- Niewind’s prelien notice was in 11-point font, complying with the first requirement, but it was not in bold or capital letters.

IGA Aluminum Products v. Manufacturer’s Bank

- IGA sent Welch a Preliminary Notice via first class mail
- California Statute says notice must be delivered by personal service, certified, or registered mail.
- Court found that the statute was unambiguously clear, and that IGA’s notice was fatally defective.
Mechanic's Lien Filing Process: Three Steps

- 20 days from first furnishing
- Lien
- 90 days from last furnishing
- 1 year from lien filing
- Foreclosure

Above deadlines are examples

Full/Unpaid Balance

Claims filed below this line may be questionable.
Unpaid Balance Lien States

- The lien is limited to the unpaid portion of the contract
- File the lien/Serve the notice as early as possible to “trap” the unpaid funds
Full/Unpaid Balance

Bank

Owner

Tier 1

General Contractor

Tier 2

Sub Contractor

Sub Contractor

Sub Contractor

Tier 3

Material Supplier

Service Provider

Material Distributor

Claims filed below this line may be questionable.

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Full Balance Lien States

• The lien is enforceable for the full amount regardless of payment made by the owner

Full balance lien states

Unpaid balance lien states

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Lien Deadlines

Mechanic's Lien Filing Process: Three Steps

- 20 days from first furnishing
- 90 days from last furnishing
- One year from lien filing

Above deadlines are examples
Foreclosure: A legal action to enforce a Mechanic's Lien against real property. This usually involves a forced sale of the property at public auction with the proceeds of the sale being applied to satisfy lien.

All attorneys are not created equal...

ATTORNEY: Now doctor, isn't it true that when a person dies in his sleep, he doesn't know about it until the next morning?

WITNESS: Did you actually pass the bar exam?

ATTORNEY: The youngest son, the 20-year-old, how old is he?

WITNESS: He's 20, very close to your IQ.

ATTORNEY: Were you present when your picture was taken?

WITNESS: Are you sh#%ling me?

Charles M. Sevilla, Disorder in the Court: Great Fractured Moments in Courtroom History, W.W. Norton and Company, 1999
All attorneys are not created equal…

• How many times have you committed suicide?

• Was it you or your brother who was killed?

• Do you have any children or anything of that kind?

• Without saying anything, tell the jury what you did next.

• Were you alone or by yourself?


Questions and Some Answers

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