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DISPATCHES FROM THE TRENCHES

A Little Something About Fixtures

By Kenneth P. Weinberg

Many people in the leasing industry are aware that large items of equipment that are integrated into a building, attached to real property with concrete or otherwise very difficult to remove may constitute "fixtures" under the various legal rules applicable to leasing and other sorts of financings. In addition to the practical difficulties of foreclosing on this sort of equipment in the event the lessee defaults under its lease obligations, this type of equipment raises special legal issues as well.

Unfortunately, it is very difficult to provide an accurate definition of what a "fixture" really is. Under Article 9 of the Uniform Commercial Code, a fixture is defined to be "goods that have become so related to particular real property that an interest arises under real property law." U.C.C. §9-102(a)(41). Of course, this definition is merely a legal conclusion and isn't of much use in day to day practice. The definition under the older version of Article 9 was similarly unhelpful. As a result, state case law generally provides the detail necessary to make a determination and the definition can vary in state by state. This is a very uncertain area of the law and rests primarily on facts and circumstances test. Nonetheless, many courts look at the following: (1) the degree of the equipment's physical affixation to the real property; (2) the ease of removing the equipment; (3) the intention of the parties; (4) the reasonable expectations of a

third party landlord or mortgagee of the real estate; and (5) the extent to which the presence of the fixtures is critical to the functioning of the real estate.

The following examples may be helpful. Equipment that is bolted onto a concrete foundation is more likely to be a fixture than equipment that is not. Equipment which has a structure built around it so that it cannot be removed without tearing down part of the building is even more likely to be a fixture than something which is merely bolted onto real property. The ability to take equipment apart fairly easily and remove it may help prevent the equipment from being classified as a fixture but the more costly or difficult the disassembly, the less likely this avenue is to help. Considering the manner in which the equipment interacts with the building also helps. For example, a computer system that is integrated throughout the building by way of multiple pieces and invasive wiring is more likely to be fixture than a large server that can be picked up and moved to, and used at, another location fairly easily. Similarly, an air conditioning unit is likely to be a fixture because of expectations that it is part of the building.

Lessors of more expensive equipment that may be likely to be classified as a fixture sometime make fixture filings in the place where a mortgage would be recorded in order to help assure that they have rights in the leased equipment in the event a court later determines that the leased equipment constitutes fixtures under state law. This precaution is taken because owners of, or parties holding a real estate mortgages on, the land and buildings in which the equipment is placed may obtain rights with respect to the equipment that would conflict with the lessors' rights.

Prudent lessors should proceed carefully if there is a strong chance that the equipment will be characterized as a fixture and if the value of leased equipment is an important part of the credit decision. Fixture filing rules and procedures vary significantly from the general filing, priority and other provisions generally used for regular equipment. Although some variations are simple, others are more complicated and require more detailed guidance. Some differences relating to fixture filings rules and procedures include the fact that a financing statement filed as a fixture filing must: (a) indicate that it covers fixtures; (b) indicate that it is to be filed for record in the real property records; (c) provide a description of the real property to which the collateral is related which is sufficient for the financing statement to fit into the real-property search system;

and (d) provide the name of the record owner of the property if the lessee/debtor is not the record owner. U.C.C. §9-502(b) and Official Comment No. 5.

As noted earlier, fixture filings must be made in different offices than filings regularly made for leased equipment. For those that are interested, the rules outlining where to make fixture filings are found in: (i) U.C.C. §9-301(3)(A)-- which requires fixture filings to be made in the state where the fixtures are located instead the state where the debtor/lessee is located; and (ii) U.C.C. §9-501(a)(1)(B)-- which requires that fixture filings be made in the office designated by that state for the filing or recording of a mortgage on the related real property instead of with the secretary of state. Other differences include special purchase money security interest and priority rules that are located in U.C.C. §9-334. The key lesson is for lessors to be alert to certain types of equipment which is likely to be classified as fixtures and, in the event such equipment is involved and the lessor wants additional protection, to proceed carefully and make sure fixture rules are followed.

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