

# Personal Property Secured Transactions

By Stephen L. Sepinuck\*

## I. THE SCOPE OF ARTICLE 9

Unless an exception applies, Article 9 of the Uniform Commercial Code (“U.C.C.”) applies to any transaction, regardless of the transaction’s form, in which personal property secures an obligation.<sup>1</sup> Article 9 also applies to several other types of transactions. Such transactions include sales of accounts, chattel paper, payment intangibles, or promissory notes.<sup>2</sup> The implications of applying Article 9 to such a transaction can be significant. If the secured party in such a transaction—that is, the buyer of the receivables<sup>3</sup>—fails to recognize that Article 9 applies and, therefore, fails properly to perfect its security interest, the buyer might end up losing all rights in the purchased receivables to someone else.

One case from last year dealt with this issue in the context of a preference action. In *In re Cornerstone Tower Services, Inc.*,<sup>4</sup> a business in need of financing entered into a transaction structured as a sale of all future receivables for \$50,690 “until” \$65,897 was paid. The court concluded that the transaction was a true sale, not a loan, because the transaction documents described it as such, the seller had no obligation to repurchase accounts, and if there were no receipts on a particular day, the buyer was to receive no funds that day.<sup>5</sup> Nevertheless, because the buyer did not file a financing statement to perfect its interest, the accounts became

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1. See U.C.C. § 9-109(a)(1) (2013).

2. See *id.* § 9-109(a)(3).

3. See *id.* § 9-102(a)(73)(D) (defining “secured party” to include a buyer of receivables); see also *id.* § 9-102(a)(28)(B) (defining “debtor” to include a seller of receivables).

4. Official Comm. of Unsecured Creditors v. LG Funding, LLC (*In re Cornerstone Tower Servs., Inc.*), No. BK16-40787, 2018 WL 6199131, at \*2 (Bankr. D. Neb. Nov. 9, 2018); see also Official Comm. of Unsecured Creditors v. EBF Partners, LLC (*In re Cornerstone Tower Servs., Inc.*), No. BK16-40787, 2019 WL 127359, at \*1, \*6 (Bankr. D. Neb. Jan. 3, 2019) (dealing with a similar transaction with a different financier and concluding the transaction was a sale, rather than a loan).

5. *In re Cornerstone Tower Servs., Inc.*, 2018 WL 6199131, at \*7–8. Although several other courts have ruled that similar transactions are true sales, not loans, see, e.g., *Power Up Lending Grp., Ltd. v. Cardinal Energy Grp., Inc.*, No. 2:16-cv-1545 (DRH) (GRB), 2019 WL 1473090 (E.D.N.Y. Apr. 3, 2019); *Ortega’s Mexican Rest., LLC v. Happy Rock Merchant Solutions, LLC* (*In re Ortega’s Mexican Rest., LLC*), No. 18-20306 (JJT), 2019 WL 417852 (Bankr. D. Conn. Feb. 1, 2019), that conclusion is questionable. See John F. Hilson & Stephen L. Sepinuck, A “Sale” of Future Receivables: Disguising a Secured Loan as a Purchase of Hope, *TRANSACTIONAL LAW.*, Apr. 2019, at 14.

property of the seller's bankruptcy estate,<sup>6</sup> and payments that the buyer made pre-petition might be avoidable preferences.<sup>7</sup>

Another type of transaction to which Article 9 sometimes applies is a consignment.<sup>8</sup> When Article 9 does apply to such a transaction, it treats the consignment as a security interest, the consignor as a secured party, the consignee as the debtor, and the consigned goods as the collateral.<sup>9</sup> If the consignor's security interest is unperfected, U.C.C. section 9-319 treats the consignee as having sufficient rights in the consigned goods to grant a security interest in them to someone else.<sup>10</sup> But not all consignment transactions fall under Article 9. If the merchant to which the goods are delivered for sale is "generally known by its creditors to be substantially engaged in selling the goods of others," the transaction will not be a "consignment" within the meaning of Article 9, and Article 9 will not apply.<sup>11</sup> One court misapplied this rule last year, perpetuating a misinterpretation of the law.

In a pair of decisions arising in the bankruptcy of TSAWD Holdings, Inc., the bankruptcy court dealt with priority disputes between the debtor's principal secured party with a perfected security interest in all of the debtor's inventory and two vendors that had delivered goods to the debtor for sale.<sup>12</sup> In one dispute, the court ruled that, because the secured party had actual knowledge that the debtor was selling the vendor's goods on consignment, the vendor's interest was not—vis-à-vis the secured party—subject to Article 9.<sup>13</sup> Therefore, the vendor's interest in the goods was not rendered subordinate to the secured party's interest by the vendor's failure to file a continuation statement and maintain perfection.<sup>14</sup> Resolving a related dispute, the court ruled that the secured party did not have actual knowledge that the debtor was selling a different vendor's goods on consignment until the vendor filed a financing statement and sent notification of the transaction to the secured party.<sup>15</sup> Because of that, the vendor's interest in

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6. *In re Cornerstone Tower Servs., Inc.*, 2018 WL 6199131, at \*8.

7. *Id.* at \*9–11.

8. See U.C.C. § 9-109(a)(4) (2013).

9. See *id.* §§ 1-201(b)(35), 9-102(a)(12), (20), (28)(C), (73)(C).

10. See *id.* § 9-319(a).

11. See *id.* § 9-102(a)(20)(A)(iii).

12. See *TSA Stores, Inc. v. Wilmington Sav. Fund Soc'y, FSB (In re TSAWD Holdings, Inc.)*, 595 B.R. 676 (Bankr. D. Del. 2018); *TSA Stores, Inc. v. Wilmington Sav. Fund Soc'y, FSB (In re TSAWD Holdings, Inc.)*, No. 16-10527 (MFW), 2018 WL 6885922 (Bankr. D. Del. Nov. 26, 2018). In a more recent decision involving a third vendor, the court ruled that although the debtor's secured party had actual knowledge that the debtor was selling the goods on consignment, the secured party did not have actual knowledge of either: (i) that consigned goods comprised 20 percent or more of the value of the debtors' inventory, and thus the debtor was "substantially engaged" in the business of selling the goods of others; or (ii) that the debtor was selling a particular vendor's goods on consignment. Consequently, the debtor's transaction with that vendor was governed by Article 9. *TSA Stores, Inc. v. Wilmington Sav. Fund Soc'y, FSB (In re TSAWD Holdings, Inc.)*, No. 16-50368 (MFW), 2019 WL 1590531 (Bankr. D. Del. Apr. 12, 2019).

13. *In re TSAWD Holdings, Inc.*, 595 B.R. at 683–85.

14. *Id.* at 685.

15. *In re TSAWD Holdings, Inc.*, 2018 WL 6885922, at \*4–7.

goods consigned before that time was subject to Article 9 and subordinate to the lender's security interest.<sup>16</sup>

But the statutory test is not whether the secured party knows the debtor is selling consigned goods, it is whether the debtor is generally known by its creditors to be substantially engaged in selling the goods of others.<sup>17</sup> The drafters of Article 9 were well aware of how to phrase a rule based on a particular person's knowledge, and did so in more than a dozen different provisions.<sup>18</sup> The court in *TSAWD Holdings* cited none of those provisions. Instead, the court relied on two cases in which courts suggested that this would produce an "absurd" result. A secured creditor that had knowledge of the consignment could have priority over the consignor (because of what other creditors did not know), whereas a secured party without such knowledge but perhaps with reason to know (based on what creditors know generally—which the courts referred to as "constructive knowledge" and "imputed knowledge") would take subject to the rights of the consignor.<sup>19</sup>

But, this seemingly anomalous result is not absurd at all. In fact, it is grounded in very sound policy: to prevent intractable priority problems. The reference to the knowledge of creditors is not in a priority rule; it is in a definition relating to the scope of Article 9.<sup>20</sup> That placement is important. If the nature of a consignment transaction between A and B—and the law that governs it—is determined by what a particular creditor of the putative consignee knows, then consider what happens if there are multiple creditors, some that know the nature of the consignee's business and some that do not know. In such a case, the consignment transaction between A and B would apparently be both inside and outside of Article 9. This could lead to circular priorities, with no logical way to break the circle.

It is precisely for this reason that the definition of consignment was phrased somewhat objectively—in reference to the knowledge of creditors generally—rather than subjectively, why the earlier decisions that the *TSAWD Holdings*

16. *Id.* at \*7.

17. See U.C.C. § 9-102(a)(20)(A)(iii) (2013).

18. See *id.* §§ 9-317(b), (c), (d), 9-320(b), 9-321(a), 9-323(b), (d)–(g), 9-330(b), (d), 9-337(1), (2); see also *id.* §§ 9-320(a), 9-321(b), (c), 9-341(2) (each expressly treating a claimant's knowledge as irrelevant).

19. *In re TSAWD Holdings, Inc.*, 595 B.R. at 682 (quoting *Fariba v. Dealer Servs. Corp.*, 100 Cal. Rptr. 3d 219, 229 (Ct. App. 2009); *Eurpac Serv., Inc. v. Republic Acceptance Corp.*, 37 P.3d 447, 451 (Colo. App. 2000)). The court also cited in support several other decisions predating the revisions to Article 9, *In re TSAWD Holdings, Inc.*, 595 B.R. at 681–82 (collecting cases), and it acknowledged two cases ruling to the contrary. *Id.* at 682–83 (citing *Russell v. Mountain Nat'l Bank (In re Russell)*, 254 B.R. 138 (Bankr. W.D. Va. 2000); *Multibank Nat'l of W. Mass. v. State St. Auto Sales, Inc. (In re State St. Auto Sales, Inc.)*, 81 B.R. 215 (Bankr. D. Mass. 1988)). The court failed to cite other contrary authority. See, e.g., *Overton v. Art Fin. Partners LLC*, 166 F. Supp. 3d 388 (S.D.N.Y. 2016); *In re Niblett*, 441 B.R. 490 (Bankr. E.D. Va. 2009); *French Design Jewelry, Inc. v. Downey Creations, LLC (In re Downey Creations, LLC)*, 414 B.R. 463 (Bankr. D. Ind. 2009); *Rayfield Inv. Co. v. Kreps*, 35 So. 3d 63 (Fla. Dist. Ct. App. 2010).

20. See U.C.C. § 9-102(a)(20)(A)(iii) (2013).

court relied on have been criticized,<sup>21</sup> and why the Permanent Editorial Board for the U.C.C. has drafted a commentary rejecting these earlier decisions.<sup>22</sup>

## II. ATTACHMENT OF A SECURITY INTEREST

In general, there are three requirements for a security interest to attach to collateral: (i) the debtor must authenticate a security agreement that describes the collateral; (ii) value must be given; and (iii) the debtor must have rights in the collateral or the power to transfer rights in the collateral.<sup>23</sup> There were interesting cases on the first and third of these requirements last year.

### A. AN AUTHENTICATED SECURITY AGREEMENT THAT DESCRIBES THE COLLATERAL

The requirement of an authenticated security agreement is fairly easy to satisfy. The agreement must create or provide for a security interest, that is, it must include language indicating that the debtor has given a secured party an interest in personal property to secure payment or performance of an obligation (or in connection with a sale covered by Article 9),<sup>24</sup> and it must describe the collateral.<sup>25</sup> Of course, the appropriate party must authenticate the security agreement.<sup>26</sup> In other words, the person authenticating the security agreement must be the one who has ownership rights in the collateral.

This requirement proved to be problematic in *In re Meena, Inc.*<sup>27</sup> The case involved a franchisor that entered into three franchise agreements with two individuals. The individuals authenticated two security agreements covering their existing and after-acquired inventory and equipment.<sup>28</sup> However, the franchisor then proceeded to sell inventory to corporations owned by the individuals. The court ruled that the franchisor did not have a security interest in the corporations' property because the corporations were not signatories to the security agreements.<sup>29</sup>

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21. See Steven O. Weise, *Personal Property Secured Transactions*, 65 BUS. LAW. 1293, 1294 (2010); Stephen L. Sepinuck, *Misguided California Court Changes "Consignment" Standard*, CLARK'S SECURED TRANSACTIONS MONTHLY, Sept. 2009, at 1, 2–3.

22. PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, COMMENTARY NO. 20: CONSIGNMENTS 5–6 (Jan. 24, 2019). It is also worth noting that rules based on a particular person's knowledge test that fact at a specific time, typically when the person acquires an interest in property. Neither the court in the *TSAWD Holdings* cases, nor the cases it relied on, discussed at what point in time it would be appropriate to test the secured party's knowledge: (i) when the secured creditor acquired its security interest; (ii) when the secured party last gave value; or (iii) when the parties entered into the consignment transaction.

23. See U.C.C. § 9-203(b) (2013).

24. See *id.* § 9-102(a)(74).

25. See *id.* § 9-203(b).

26. See *id.* § 9-102(a)(7).

27. No. 8-18-74693-reg, 2018 WL 5880916 (Bankr. E.D.N.Y. Nov. 6, 2018).

28. *Id.* at \*3.

29. *Id.* at \*7.

A single security agreement can secure obligations the debtor owes at the time the agreement is executed and future advances, obligations the debtor incurs later.<sup>30</sup> Moreover, the official comments reject any requirement that the future advances be somehow related to the initial indebtedness.<sup>31</sup> Nevertheless, one court last year refused to regard a future-advances clause in an agreement for a terminated transaction applicable to a subsequent transaction.

In *Jipping v. First National Bank Alaska*,<sup>32</sup> the debtor's first security agreement with a bank, executed in 2009, granted the bank a security interest in the debtor's deposit accounts to secure a \$1.3 million loan and all future obligations to the bank.<sup>33</sup> That agreement also expressly stated that the security interest would "continue in effect even though all or any part of the Indebtedness is paid in full."<sup>34</sup> The debtor paid off the 2009 loan in 2011. In 2013, the debtor borrowed \$2.6 million from the bank and executed a new security agreement that did not include deposit accounts in the description of the collateral or refer to the 2009 agreement.<sup>35</sup> The 2013 agreement did, however, contain a merger clause stating that it "together with any Related Documents, constitutes the entire understanding and agreement of the parties as to the matters set forth in [the] Agreement."<sup>36</sup> The court ruled that the original security agreement was not a Related Document because it was not executed in connection with the subsequent loan, and, therefore, the bank's later loan was not secured by deposit accounts.<sup>37</sup>

In general, the description of collateral in a security agreement does not need to be specific or to list expressly every item; it needs only to "reasonably identif[y]" the collateral.<sup>38</sup> In other words, the security agreement must "make [it] possible" to identify the collateral.<sup>39</sup> For most types of property, a description by a type defined in the U.C.C. is sufficient.<sup>40</sup> Several courts dealt with this requirement last year.

30. See U.C.C. § 9-204(c) (2013).

31. See *id.* § 9-204 cmt. 5.

32. 735 F. App'x 436 (9th Cir. 2018).

33. See *Jipping v. First Nat'l Bank Alaska*, 568 B.R. 321, 323 (D. Alaska 2017), *aff'd*, 735 F. App'x 436 (9th Cir. 2018).

34. *Id.* (quoting the 2009 Security Agreement).

35. *Id.*

36. *Jipping*, 735 F. App'x at 436 (quoting the 2013 Security Agreement).

37. *Id.* at 437. For different views about this case, compare E.H. Geiger & Stephen L. Sepinuck, *Zombie Documents*, TRANSACTIONAL LAW., Feb. 2019, at 1 (criticizing the court's disregard of the language of the initial agreement, which expressly provided that the security interest would continue after the loan was repaid, but suggesting that the court's conclusion might nevertheless be correct depending on what other conflicts exist between the two security agreements, and suggesting that if the merger clause in the new security agreement had stated that the new agreement "supersedes" prior agreements, the issue should have been avoided), with Scott Burnham, *Zombie Documents: A Dissenting View*, TRANSACTIONAL LAW., Apr. 2019, at 13 (criticizing the court's understanding of the parole evidence rule, and suggesting that the rule, if properly applied, would not prevent application of the future advances clause in the original security agreement).

38. See U.C.C. § 9-108(a) (2013).

39. *Id.* cmt. 2.

40. *Id.* § 9-108(b)(3).

In *In re Cocoa Services, LLC*,<sup>41</sup> a security agreement described the collateral as “[a]ll of the Debtor’s equipment . . . whether now owned or hereafter acquired and wherever located . . . [i]ncluding but not limited to the equipment listed below.”<sup>42</sup> This was followed by a long list of specified items. The court ruled that this description was sufficient to cover all equipment, not merely the items specifically listed. Moreover, it did not matter that the list of specified items indicated an incorrect address for those items.<sup>43</sup>

In *ARA Inc. v. City of Glendale*,<sup>44</sup> the court dealt with a factoring agreement that lacked an express after-acquired property clause but which granted the factor a security interest in “all accounts” of the debtor and which defined “Accounts Receivable” to include accounts “arising . . . from time to time.”<sup>45</sup> After noting that the law does not “explicitly require” an after-acquired property clause when the collateral is rotating collateral, such as accounts,<sup>46</sup> and that the factor would likely not have agreed to be secured by an asset that would be depleted in a short time in the normal operation of the debtor’s business, the court concluded that the language of the agreement was sufficient to cover after-acquired accounts.<sup>47</sup>

In *In re Somerset Regional Water Resources, LLC*,<sup>48</sup> a debtor-in-possession financing order provided for the sole member of the debtor to “assign to Lender any rights or interest in the 2015 Federal tax refund due to him individually, but attributable to the operating losses of the Debtor.”<sup>49</sup> The court ruled this language was ambiguous as to whether it covered a refund of 2014 taxes attributable to a carryback of 2015 losses.<sup>50</sup> After considering parol evidence, it was apparent that the parties understood that the entirety of any refund generated on account of the 2015 operating losses was to be the collateral.<sup>51</sup>

Occasionally, courts have to deal with a security agreement that has an inadequate description of the collateral at the time the debtor authenticated it but which is later supplemented or completed. In *Gill v. Board of the National Credit Union Administration*,<sup>52</sup> a written security agreement that was to collateralize a limousine lacked a description of the vehicle when the debtor signed the agreement. A description that was consistent with parties’ intent, the loan application, and the notice of lien filed with the state department of motor vehicles—and

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41. *Nisselson v. Bank of the W. (In re Cocoa Servs., LLC)*, No. 17-11936-JLG, 2018 WL 1801240 (Bankr. S.D.N.Y. Apr. 13, 2018).

42. *Id.* at \*10.

43. *Id.* at \*11.

44. No. CV-17-02512-PHX-GMS, 2018 WL 1411787 (D. Ariz. Mar. 21, 2018).

45. *Id.* at \*2 (quoting the factoring agreement).

46. *Id.* (citing *Filtercorp Partners LP v. Gateway Venture Partners III, LP (In re Filtercorp, Inc.)*, 163 F.3d 570, 579 (9th Cir. 1998); *Stoumbos v. Kilimnik*, 988 F.2d 949, 954–55 (9th Cir. 1993)).

47. *Id.*

48. *Somerset Tr. Co. v. Mostoller (In re Somerset Reg’l Water Res., LLC)*, 592 B.R. 38 (Bankr. W.D. Pa. 2018).

49. *Id.* at 44 (quoting court order).

50. *Id.* at 52–53.

51. *Id.* at 56–61.

52. No. CV 93-1597 (MDG), 2018 WL 5045755 (E.D.N.Y. Oct. 16, 2018).

which identified the limousine by year, make, color, and VIN—was later added by the secured party.<sup>53</sup> The court ruled that this was sufficient.<sup>54</sup>

In contrast, in *Mac Naughton v. Harmelech*,<sup>55</sup> a lawyer signed a security agreement that described the collateral as “all real or personal property wherever located,” which was not a sufficient description.<sup>56</sup> Although that agreement contained language granting the lawyer permission “to sign [the clients’ names] to any UCC-1 or other documents reasonably necessary to perfect the security interest in the Property,” the court ruled that the lawyer could not unilaterally amend the security agreement and sign the clients’ names to the amendment because the authorization language dealt with perfecting the security interest, not with altering the terms of the security agreement so as to unilaterally define the property serving as collateral.<sup>57</sup>

## B. RIGHTS IN THE COLLATERAL

When a debtor’s rights to transfer property are restricted by contract or law, the debtor might nevertheless be permitted to grant a security interest in that property. That is because Article 9 contains several rules that override many contractual and legal restrictions on assignment.<sup>58</sup> Unfortunately, these rules are rather complex and that complexity might have contributed to one court’s misapplication of them.

In *re Woodbridge Group of Cos.*,<sup>59</sup> a limited liability company issued three promissory notes that expressly provided that the lenders’ rights were not assignable and that any such attempted assignment would be null and void. After the LLC filed for bankruptcy, the holders of the notes purported to sell the notes to a buyer, which then filed a proof of claim. The debtor objected to the claim.

The court looked to sections 9-406 and 9-408 but misinterpreted both. Because the transaction between the lenders and the buyer was a sale of promissory notes—which is itself a transaction governed by Article 9<sup>60</sup>—section 9-408 is the section that properly applied.<sup>61</sup> Pursuant to that section, the restriction on assignment would be ineffective to prevent the buyer’s interest from attaching, but the LLC would have no duty to render performance to the buyer.<sup>62</sup> Unfortunately, the court erroneously concluded that section 9-406 applied.<sup>63</sup> Although that section, when it applies, actually provides greater protection for the secured party—it makes the restriction on assignment ineffective to prevent the security interest from attaching and requires the account debtor to render

53. *Id.* at \*3, \*9.

54. *Id.* at \*9.

55. No. A-2014-16T1, 2018 WL 3763879 (N.J. Super. Ct. App. Div. Aug. 9, 2018).

56. See U.C.C. § 9-108(c) (2013).

57. *Mac Naughton*, 2018 WL 3763879, at \*4–5.

58. See U.C.C. §§ 9-406(d)–(f), 9-407, 9-408, 9-409 (2013).

59. 590 B.R. 99 (Bankr. D. Del. 2018).

60. See U.C.C. § 9-109(a)(3) (2013).

61. See *id.* §§ 9-406(e), 9-408(a), (b).

62. See *id.* § 9-408(a), (d).

63. In *re Woodbridge Grp. of Cos.*, 590 B.R. at 108–09.

performance to the secured party<sup>64</sup>—the court erroneously concluded that the section “endorses the enforceability of anti-assignment provisions in the sale . . . of promissory notes.”<sup>65</sup> In reality, section 9-406 does no such thing. When it applies, section 9-406 overrides restrictions on transfer. Under no circumstances does it “endorse” restrictions on transfer.<sup>66</sup>

Just in case Article 9’s rules overriding transfer restrictions were not complex enough, several states have enacted non-uniform variations of these provisions. One of those variations was pivotal in a case decided last year.

In *Consumer Financial Protection Bureau v. RD Legal Funding, LLC*,<sup>67</sup> the Consumer Financial Protection Bureau and the New York Attorney General brought an action against RD Legal Funding and related individuals and entities that, in return for an up-front payment, purported to buy from several former NFL players their rights to payment under a settlement agreement with the NFL. The settlement agreements expressly prohibited assignment and stated that any attempted assignment was void.<sup>68</sup> Although section 9-408(d) overrides many restrictions on the assignment of general intangibles,<sup>69</sup> the New York version expressly excludes the “right to receive compensation for injuries or sickness as described in 26 U.S.C. § 104(a)(1) and (2).”<sup>70</sup> Because the settlement agreement related to claims for physical injuries resulting from repeated brain trauma that retired NFL players experienced while active in professional football, the court ruled that the settlement agreement fell within this exclusion, New York’s version of section 9-408 did not apply, and therefore the contractual restriction on assignment was effective.<sup>71</sup>

### III. PERFECTION OF A SECURITY INTEREST

#### A. METHOD OF PERFECTION

In general, perfection of a security interest is necessary, but not always sufficient, for the secured party to have priority over the rights of lien creditors, other secured parties, and buyers, lessees, and licensees of the collateral.<sup>72</sup> The method or methods by which a secured party can perfect a security interest depend on the type of collateral and the nature of the transaction. The dominant method of

64. See U.C.C. § 9-406(a), (d) (2013).

65. *In re Woodbridge Grp. of Cos.*, 590 B.R. at 109.

66. For a more detailed discussion and criticism of the court’s decision, see Carl S. Bjerre & Stephen L. Sepinuck, *Spotlight*, *TRANSACTIONAL LAW.*, Feb. 2019, at 8, 8–9.

67. 332 F. Supp. 3d 729 (S.D.N.Y. 2018), *appeal filed*, No. 18-3156 (2d Cir. Oct. 23, 2018).

68. *Id.* at 753.

69. A right to payment under a settlement agreement is normally a “general intangible” under Article 9. See U.C.C. § 9-102(a)(42) (2013).

70. N.Y. U.C.C. LAW § 9-408(d)(1) (Consol. 2016); see 26 U.S.C. § 104(a)(1)–(2) (2018) (addressing “amounts received under workmen’s compensation acts as compensation for personal injuries or sickness [and] the amount of any damages . . . received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness”).

71. *Consumer Fin. Prot. Bureau*, 332 F. Supp. 3d at 756.

72. See U.C.C. §§ 9-317, 9-322(a) (2013).

perfection is by filing a financing statement, but other methods include taking possession or control of the collateral, complying with a certificate-of-title statute, and complying with any preemptive federal law.<sup>73</sup> Among the first steps in determining how to perfect are: (i) to identify and classify the collateral; (ii) to ascertain whether Article 9 applies to a security interest in that collateral; and (iii) to determine which state's law governs.

In *In re Jaghab*,<sup>74</sup> the debtor owned 50 percent of the shares of stock in a corporation. In return for a nonrecourse loan, the debtor granted Flores a security interest in his shares. The shares were uncertificated and Flores never filed a financing statement.<sup>75</sup> The court correctly ruled that the uncertificated shares were "investment property" in which a security interest could be perfected by filing a financing statement or by control,<sup>76</sup> and that control could be achieved either by delivery of the uncertificated security to the secured party or by the issuer agreeing to comply with the instructions of the secured party.<sup>77</sup> Because none of that had occurred, the security interest was unperfected and the debtor's bankruptcy trustee could avoid the security interest.<sup>78</sup>

A security interest in fixtures can be perfected either by filing a financing statement in the U.C.C. records of the jurisdiction in which the debtor is located<sup>79</sup> or by recording a fixture filing in the office where interests in the associated real property are recorded.<sup>80</sup> In *In re Cocoa Services, LLC*,<sup>81</sup> the court ruled that, even if a secured party's fixture filing was ineffective to perfect a security interest in fixtures because it did not correctly identify the record owner of the real property and gave an incorrect address for the real property, the secured party's security interest was perfected by the financing statement filed in the jurisdiction in which the debtor is located.<sup>82</sup>

## B. ADEQUACY OF FINANCING STATEMENT

To be sufficient to perfect a security interest, a filed financing statement must provide the name of the debtor, provide the name of the secured party or a representative of the secured party, and indicate the collateral.<sup>83</sup> The indication of collateral need not be specific; it merely must reasonably identify the collateral or, put another way, provide enough information so that the identity of the col-

73. See *id.* §§ 9-310 to -314.

74. Thaler v. GJ & JF Realty Holdings, Inc. (*In re Jaghab*), 584 B.R. 472 (Bankr. E.D.N.Y. 2018).

75. *Id.* at 476.

76. *Id.* at 481 (citing U.C.C. §§ 9-102(a)(49), 9-312(a), (b)).

77. *Id.* (citing U.C.C. §§ 8-106(c), 9-106(a)). Delivery of an uncertificated security occurs when the issuer registers the purchaser as the owner or when another person, other than a securities intermediary, becomes the registered owner on behalf of the purchaser. See U.C.C. § 8-301(b) (2013).

78. *In re Jaghab*, 584 B.R. at 481.

79. See U.C.C. §§ 9-301(1), 9-501(a) (2013); see also *id.* § 9-301 cmt. 5b.

80. See *id.* §§ 9-301(4), 9-501(a)(1).

81. Nisselson v. Bank of the W. (*In re Cocoa Servs., LLC*), No. 17-11936-JLG, 2018 WL 1801240 (Bankr. S.D.N.Y. Apr. 13, 2018).

82. *Id.* at \*9, \*14.

83. See U.C.C. § 9-502(a) (2013).

lateral is objectively determinable.<sup>84</sup> For this purpose, an indication of the collateral by a type defined in Article 9 or a statement that the financing statement covers “all assets” or “all personal property” is normally sufficient.<sup>85</sup> There were two notable decisions last year dealing with this requirement.

In *In re I80 Equipment, LLC*,<sup>86</sup> a filed financing statement described the collateral as “[a]ll Collateral described in First Amended and Restated Security Agreement dated March 9, 2015 between Debtor and Secured Party.” However, the referenced security agreement was not attached. The court ruled that the financing statement was ineffective to perfect. As the court put it, the collateral description “provides no information whatsoever” about the collateral, and that is not objectively determinable, even though the financing statement might have put searchers on notice that the secured party claimed a security interest in some assets of the debtor.<sup>87</sup>

In *In re 8760 Service Group, LLC*,<sup>88</sup> an amended financing statement described the collateral as “[a]ll Accounts Receivable, Inventory, equipment and all business assets, located at 1803 W. Main Street.” The court ruled that this was effective to perfect, even though the debtor’s goods were located at a different address, and even though the description was ambiguous—the listed address could restrict all the described collateral or merely the phrase “all business assets”—because a reasonably prudent searcher should inquire further.<sup>89</sup>

A security interest in goods, instruments, money, tangible chattel paper, and tangible negotiable documents can be perfected by taking possession of the collateral.<sup>90</sup> For this purpose, a secured party takes possession of collateral if an agent of the secured party has possession<sup>91</sup> or if a bailee—a person other than the debtor, the secured party, an agent of the secured party, or a lessee of the collateral—has or takes possession and authenticates a record acknowledging that it holds possession of the collateral for the secured party’s benefit.<sup>92</sup>

84. *See id.* § 9-108(a), (b)(6).

85. *See id.* §§ 9-108 cmt. 2, 9-504. In contrast, a description of collateral as “all . . . assets” or “all . . . personal property” is insufficient in a security agreement. *See id.* § 9-108(c) & cmt. 2. A description of a commercial tort claim merely by that classification is insufficient in both a security agreement and a financing statement. *See id.* § 9-108(e)(1).

86. *First Midwest Bank v. Reinhold (In re I80 Equip., LLC)*, 591 B.R. 353, 355 (Bankr. C.D. Ill. 2018).

87. *Id.* at 360, 363. A similar result was reached in *In re Financial Oversight & Management Board for Puerto Rico*, 590 B.R. 577, 585, 589 (D.P.R. 2018) (holding as ineffective to perfect filed financing statements that described the collateral as “[t]he pledged property described in the Security Agreement attached as Exhibit A hereto,” and which attached the security agreement, because the attached security agreement did not define the pledged property and instead referenced a bond resolution that defined the term but which was not attached), *aff’d in relevant part*, 914 F.3d 694, 710 (1st Cir. 2019), *petition for cert. filed*, No. 18-1389 (U.S. May 3, 2019). This decision will be discussed in next year’s survey.

88. 586 B.R. 44, 48 (Bankr. W.D. Mo. 2018).

89. *Id.* at 51–52.

90. *See* U.C.C. § 9-313(a) (2013).

91. *See id.* cmt. 3; *see also id.* § 1-103(b) (indicating that, unless displaced by particular provisions of the U.C.C., the law of principal and agent supplements its provisions).

92. *See id.* § 9-313(c).

None of these methods worked for the secured party in *In re Community Home Financial Services, Inc.*<sup>93</sup> In that case, a secured party obtained an assignment of mortgage loans represented by instruments that were in the possession of a law firm acting as custodian for the assignor. The court ruled that the security interest had not been perfected by possession through an agent because the Custodial Agreement identified the law firm as the agent of only the assignor, not the assignee/secured party.<sup>94</sup> The secured party also had not perfected through possession of a bailee because the law firm never acknowledged that it held the instruments for the secured party.<sup>95</sup>

### C. PROCEEDS

A security interest automatically attaches to identifiable proceeds of the collateral.<sup>96</sup> If the security interest in the original collateral is perfected, the security interest in the proceeds will be automatically perfected.<sup>97</sup> However, the security interest in the proceeds becomes unperfected twenty-one days after it attaches unless one of the following exceptions applies: (i) a filed financing statement covers the original collateral, the proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed, and the proceeds are not acquired with cash proceeds; (ii) the proceeds are identifiable cash proceeds; or (iii) before or within the twenty days after the security interest attached, the secured party has done whatever is necessary to perfect the security interest in the property irrespective of the fact that the property is proceeds.<sup>98</sup>

The court in *In re National Truck Funding LLC*<sup>99</sup> made a slight error in applying this rule last year.

The debtor in the case owned a fleet of commercial trucks that it leased on a weekly renewable basis to independent truck drivers. Several lenders had security interests in the trucks (presumably, each lender had a security interest in different trucks, but that is not important to the analysis). None of the lenders had

93. *Johnson v. Edwards Family P'ship LP (In re Cmty. Home Fin. Servs., Inc.)*, 583 B.R. 1 (Bankr. S.D. Miss. 2018).

94. *Id.* at 81.

95. *Id.* at 81–82. Although a perfected security interest that is assigned normally remains perfected, see U.C.C. § 9-310(c) (2013), the court concluded that this rule can be and was varied by agreement because the secured party's principal stated the name on the lockbox, custodial agreement, and all other documents should be amended, but he did not follow through with the necessary amendments. *In re Cmty. Home Fin. Servs., Inc.*, 583 B.R. at 82–83.

96. See U.C.C. §§ 9-203(f), 9-315(a)(2) (2013). This rule does not apply if Article 9 does not apply to a security interest in the type of property constituting the proceeds.

97. See *id.* § 9-315(c). This rule does not apply if some other law governs perfection of a security interest in the type of property constituting the proceeds.

98. See *id.* § 9-315(d).

99. *Nat'l Truck Funding LLC v. Yolo Capital Inc. (In re Nat'l Truck Funding LLC)*, 589 B.R. 294 (Bankr. S.D. Miss. 2018).

filed a financing statement, but the court assumed, given the posture of the case, that they had perfected their security interests through compliance with the applicable certificate-of-title statute.<sup>100</sup> The issue was whether the lenders had perfected security interests in the payments that the debtor received pursuant to the leases. The court concluded that such payments were cash proceeds of the trucks, and hence the lenders' security interests were perfected.<sup>101</sup>

Unfortunately, the court's analysis skipped a step. Each time the debtor leased a truck, the lease itself was proceeds of the truck (in the form of chattel paper).<sup>102</sup> The security interest automatically attached to these leases and was automatically perfected. The payments that the debtor received were, in turn, proceeds of the leases. Whether the security interests in the payments were perfected depends on how long after the creation of the leases the payments were made. If payment under a lease was made while the security interest in the lease was still perfected, then the security interest in the payment would be perfected initially and would remain perfected beyond twenty days because the payment was itself cash proceeds of the lease.<sup>103</sup> If, however, payment was made more than twenty days after the lease was created, then the security interest in the lease would have become unperfected before the payment was made,<sup>104</sup> and the security interest in the payment would never have been perfected.<sup>105</sup> In short, the court compressed the analysis by treating the payments as proceeds of the trucks rather than as proceeds of the leases. Because of this, the court overlooked the significance of the time period between entry into a lease and payment, such that the court might have reached an incorrect result.<sup>106</sup>

## IV. PRIORITY OF A SECURITY INTEREST

### A. BUYERS OF GOODS

A buyer of goods takes free of an *unperfected* security interest in the goods if the buyer gives value and receives delivery without knowledge of the security interest.<sup>107</sup> A buyer of goods encumbered by a *perfected* security interest normally takes subject to that security interest.<sup>108</sup> But if the buyer and the original debtor are located in different jurisdictions, an interesting rule can apply. The security interest will remain perfected for one year following the sale.<sup>109</sup> If the

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100. *Id.* at 297–99.

101. *Id.* at 302.

102. See U.C.C. § 9-102(a)(64)(A) (2013) (defining “proceeds” to include whatever is received upon the lease of collateral); see also *id.* § 9-102(a)(11) (defining “chattel paper” to include a lease of specific goods).

103. See *id.* § 9-315(c), (d)(2).

104. See *id.* § 9-315(d).

105. See *id.* § 9-315(c).

106. For an expanded discussion of the case, see Carl S. Bjerre & Stephen L. Sepinuck, *UCC Spotlight*, COM. L. NEWSL. (Am. Bar Ass'n, Chicago, IL), Mar. 26, 2018, at 9, 11–12.

107. See U.C.C. § 9-317(b) (2013).

108. See *id.* § 9-201(a).

109. See *id.* § 9-316(a)(3).

secured party fails to re-perfect under the law of the buyer's jurisdiction within that one-year period, the security interest becomes unperfected and is deemed never to have been perfected against the buyer.<sup>110</sup> This allows the buyer to retroactively take free of the security interest if the buyer received delivery and gave value without knowledge of the security interest.<sup>111</sup> There was an interesting case last year involving these rules.

In *H&S Contracting, Inc. v. Kinetic Leasing, Inc.*,<sup>112</sup> First Bank and Trust ("First Bank") had a security interest in the debtor's equipment that it perfected by filing a financing statement in South Dakota, which is where the debtor was located. On October 1, 2015, the debtor sold several items of equipment to a buyer located in Minnesota.<sup>113</sup> In September 2016, the buyer sold some of that equipment through an auctioneer. On the day of the sale, First Bank, the auctioneer, and the buyer's own secured lender worked out a deal to allow the item to be sold free and clear of all liens. Specifically, they agreed that the security interests would attach to the sale proceeds in whatever priority First Bank and the secured lender had in the equipment and that the proceeds would be held until that priority could be ascertained.<sup>114</sup> Apparently, no one informed the buyer of this arrangement.<sup>115</sup> When the buyer did not receive any portion of the proceeds, the buyer brought an action seeking a determination that First Bank had no claim to the funds.<sup>116</sup>

First Bank argued that, because the sale occurred less than a year after the buyer purchased the equipment, First Bank's security interest in the equipment was still perfected at that time. That security interest then attached to the sale proceeds and was automatically perfected pursuant to section 9-315(c) and remained indefinitely perfected thereafter pursuant to section 9-315(d)(2) because the sale proceeds were cash proceeds.<sup>117</sup> The buyer and its lender argued that, because First Bank never re-perfected as to the equipment, First Bank's security interest became unperfected and was deemed never to have been perfected.<sup>118</sup>

The court agreed with First Bank.<sup>119</sup> It concluded that First Bank had no duty to re-perfect in Minnesota after the auction sale to remain perfected in the cash

110. See *id.* § 9-316(b).

111. See *id.* § 9-316 cmt. 3.

112. No. 17-cv-355 (JRT/LIB), 2018 WL 3340372 (D. Minn. June 8, 2018).

113. The court first stated that the equipment "was physically transferred from [the debtor] to [the buyer] in Minnesota." *Id.* at \*1. But it is the location of the buyer, not the location of the collateral that matters. See U.C.C. § 9-301(1) (2013). The court later stated that "a security interest perfected in one jurisdiction (South Dakota) remains perfected for one year after a transfer of collateral to a person that becomes a debtor ([the buyer]) and is located in another jurisdiction (Minnesota)." *H&S Contracting, Inc.*, 2018 WL 3340372, at \*5 (implying that the buyer was indeed located in Minnesota). Unfortunately, the court never expressly indicated in what state the buyer was incorporated. Cf. U.C.C. § 9-307(e) (2013) (providing that a corporate debtor is located in the jurisdiction in which it is incorporated).

114. *H&S Contracting, Inc.*, 2018 WL 3340372, at \*2.

115. *Id.* at \*3.

116. *Id.*

117. *Id.* at \*6.

118. *Id.* at \*7.

119. *Id.* at \*8.

proceeds.<sup>120</sup> In so doing, it noted that, because the parties had agreed to allow the equipment to be sold at auction free of any liens, there was, after that sale, no equipment against which First Bank could have re-filed in Minnesota.<sup>121</sup> Instead, the rules regarding perfection in proceeds controlled the outcome.<sup>122</sup> The decision is correct.<sup>123</sup>

Although a buyer of goods normally takes subject to a perfected security interest in the goods, there are several exceptions to this general rule. Among them are: (i) if the secured party authorizes the sale free and clear;<sup>124</sup> and (ii) if the debtor is in the business of selling goods of that kind and the buyer qualifies as a buyer in ordinary course of business.<sup>125</sup> There were noteworthy cases last year dealing with each of these rules.

In *Security National Bank of Sioux City v. Welte*,<sup>126</sup> a bank with a perfected security interest in a farmer's equipment had an implied course of dealing that permitted the farmer to sell equipment free of the bank's security interest. However, the court ruled that the farmer's sale of two tractors to his son for less than a quarter of their value would not fall within that course of dealing, and therefore the security interests in the tractors survived.<sup>127</sup>

In *Inland Bank & Trust v. ARG International AG*,<sup>128</sup> Inland Bank & Trust ("Inland Bank") had a perfected security interest in the existing and after-acquired inventory of Metallic Conversion Corp. ("Metallic"). In June 2016, Metallic purchased on credit from ARG International AG ("ARG") three hundred metric tons of aluminum bars, which remained in the possession of a third-party warehouse.<sup>129</sup> The following month, Metallic determined that it could not use the bars and sold them back to ARG. The parties agreed that the purchase price for the July transaction would be netted against the amount due under the June contract.<sup>130</sup> One month later, Metallic defaulted on its loan from Inland Bank and the bank demanded that ARG turn over the aluminum bars.<sup>131</sup>

The court ruled that, even though the bars remained with the warehouse, Metallic had acquired ownership of the aluminum bars when ARG instructed

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120. *Id.* at \*7–8.

121. *Id.* at \*8.

122. *Id.* (quoting U.C.C. § 9-315 cmt. 7 (“[I]f the security interest in the original collateral was perfected, a security interest in identifiable cash proceeds will remain perfected indefinitely, regardless of whether the security interest in the original collateral remains perfected.”)).

123. The court also dealt with First Bank's conversion claim against the buyer with respect to another item of collateral that the buyer had resold in May 2016. The court ruled—again correctly—that, because the secured party's security interest in that item became unperfected one year after the sale, the buyer had retroactively taken free of First Bank's security interest. Consequently, First Bank had no claim for conversion. *Id.* at \*9–13.

124. See U.C.C. § 9-315(a)(1) (2013).

125. See *id.* §§ 1-201(b)(9), 9-320(b).

126. No. 17-0907, 2018 WL 6120206 (Iowa Ct. App. Nov. 21, 2018).

127. *Id.* at \*3–4.

128. No. 16-CV-9964 (LAK)(SN), 2018 WL 3543905 (S.D.N.Y. May 3, 2018).

129. *Id.* at \*1.

130. *Id.*

131. *Id.* at \*2.

the warehouser to release the bars to Metallic.<sup>132</sup> Consequently, Inland Bank's security interest attached to the bars.<sup>133</sup> When Metallic resold the bars back to ARG, ARG did not qualify as a buyer in ordinary course of business because it acquired the bars in partial satisfaction of a money debt.<sup>134</sup> However, a factual issue remained about whether Inland Bank authorized the resale free and clear of its security interest because it never objected to Metallic's sales of its inventory and parties in the metal trading industry frequently buy and sell raw materials from the same counterparties and "net out" the purchase prices of the open contracts.<sup>135</sup>

## B. OTHER PRIORITY ISSUES

Article 9 provides that a security agreement is effective according to its terms against purchasers of the collateral and against creditors (presumably of the debtor).<sup>136</sup> But this statement has little or no relevance when a competing claimant has an interest in the collateral that arises under federal law. In such a case, one must look to the applicable federal law to determine the relative priorities. There were two noteworthy cases last year dealing with the priority of a security interest under federal law.

In *S & H Packing & Sales Co. v. Tanimura Distributing, Inc.*,<sup>137</sup> the U.S. Court of Appeals for the Ninth Circuit addressed a recurring issue that had split the circuits: under what circumstances does a secured party with a perfected security interest in accounts defeat the rights of produce growers who sold produce on credit to the debtor, and thus are the beneficiaries of a statutory trust on all of the debtor's assets under the Perishable Agricultural Commodities Act ("PACA").<sup>138</sup>

The case involved Tanimura Distributing, Inc. ("Tanimura"), which purchased perishable produce from numerous growers. This arrangement made Tanimura a trustee over a PACA trust, with trust res consisting of the produce and its proceeds, and the growers as the beneficiaries. Tanimura sold the produce on credit to third parties, generating accounts, and then factored the accounts to AgriCap Financial ("AgriCap") in a transaction structured as a sale of accounts.<sup>139</sup> When Tanimura ceased operations, the growers and AgriCap disputed who had priority in the accounts.

Because a PACA trustee is allowed to remove assets from the trust in any commercially reasonable way without breaching the trust, the Ninth Circuit had previously ruled that the factor has priority as long as the factoring transaction is

132. *Id.* at \*3.

133. *Id.*

134. *Id.* at \*3–4 (citing U.C.C. § 1-201(b)(9) (A "[b]uyer in ordinary course of business" does not include a person that acquires goods . . . in total or partial satisfaction of a money debt.)).

135. *Id.* at \*5–6.

136. See U.C.C. § 9-201(a) (2013).

137. 883 F.3d 797 (9th Cir. 2018) (en banc).

138. 7 U.S.C. §§ 499a–499s (2018).

139. *S & H Packing & Sales Co.*, 883 F.3d at 799.

commercially reasonable.<sup>140</sup> In contrast, the Second, Fourth, and Fifth Circuits have ruled that the factor wins only if its transaction with the debtor is a commercially reasonable sale of accounts; if the transaction is instead a loan with the accounts as collateral, the rights of the PACA beneficiaries take priority.<sup>141</sup> In earlier decisions in this case, both the district court and a panel of the circuit court concluded they were bound by the Ninth Circuit's earlier decision.<sup>142</sup> Rehearing the case en banc, the Ninth Circuit overruled its prior decision and agreed to follow its sister circuits.<sup>143</sup> Accordingly, the court remanded the case for a determination of whether Tanimura's transaction with AgriCap was a true sale or a loan. In making this determination, the principal question is whether Tanimura retained the risk of nonpayment on the accounts: if it did, the transaction is probably not a sale.<sup>144</sup>

The relative priority of an Article 9 security interest and a federal tax lien is governed by the Federal Tax Lien Act.<sup>145</sup> Under that Act, a "first-in-time" rule applies: the tax lien has priority if notice of the tax lien is properly filed before the security interest is perfected.<sup>146</sup> For this purpose, "perfected" apparently means something different than what it means under Article 9. To be perfected—or "choate," as courts sometimes call it—the identity of the secured party, the property subject to the security interest, and the amount of the secured obligation must all be established.<sup>147</sup>

In *SE Property Holdings, LLC v. Unified Recovery Group, LLC*,<sup>148</sup> a lender had a security interest in the debtor's existing and after-acquired accounts and had perfected that security interest years before the IRS filed a notice of tax lien. As to one particular and sizeable account, the debtor had, before the tax lien notice was filed, fully performed the services giving rise to the account at issue. However, the court concluded that the debtor's obligations also included providing the account debtor with the documentation needed to substantiate the work performed and, until the account debtor gave its approval of that documentation, the account was inchoate.<sup>149</sup> Because it was unclear whether that had occurred

140. See *Boulder Fruit Express & Heger Organic Farm Sales v. Transp. Factoring, Inc.*, 251 F.3d 1268 (9th Cir. 2001), *overruled by S & H Packing & Sales Co.*, 883 F.3d at 813.

141. See *Nickey Gregory Co. v. AgriCap, LLC*, 597 F.3d 591, 598 (4th Cir. 2010); *Reaves Brokerage Co. v. Sunbelt Fruit & Vegetable Co.*, 336 F.3d 410, 414 (5th Cir. 2003); *Endico Potatoes, Inc. v. CIT Grp./Factoring, Inc.*, 67 F.3d 1063, 1067–69 (2d Cir. 1995).

142. See *Pac. Tomato Growers, Ltd. v. Tanimura Distrib., Inc.*, No. CV 08-5100-GW (FFMx), 2012 WL 5899417, at \*9 (C.D. Cal. Nov. 13, 2012), *aff'd*, *S & H Packing & Sales Co. v. Tanimura Distrib., Inc.*, 850 F.3d 446, 450 (9th Cir. 2017), *vacated*, 883 F.3d 797, 813 (9th Cir. 2018) (en banc).

143. *S & H Packing & Sales Co.*, 883 F.3d at 813.

144. *Id.* at 801–02, 813.

145. 26 U.S.C. §§ 6321–6323 (2018).

146. See *United States v. McDermott*, 507 U.S. 447, 449 (1993); see also 26 U.S.C. § 6323(a) (2018).

147. *McDermott*, 507 U.S. at 449; *id.* at 456 (Thomas, J., dissenting) (discussing whether the lien was perfected or whether something else had "to be done to have a choate lien").

148. 357 F. Supp. 3d 537 (E.D. La. 2018).

149. *Id.* at 550–52.

before notice of the tax lien was filed,<sup>150</sup> the court declined to issue a summary judgment as to the priority of the competing interests in that account.<sup>151</sup>

## V. ENFORCEMENT OF A SECURITY INTEREST

### A. REPOSSESSION

Article 9 permits a secured party to repossess collateral without judicial process provided it can do so without causing a breach of the peace.<sup>152</sup> This duty not to breach the peace is non-delegable; a secured party violates the rule even if an independent contractor causes a breach of the peace.<sup>153</sup> In *Hyman v. Capital One Auto Finance*,<sup>154</sup> the court ruled that the debtor stated causes of action against the secured party and its repossession agent for conversion, trespass to chattels, and trespass based on the repossession of her automobile despite her objection and passive resistance.<sup>155</sup> The debtor also stated a cause of action under § 1983 against the police officers who arrived at the scene of the automobile repossession and threatened to arrest the debtor if she did not exit the car.<sup>156</sup>

A secured party must always be on the lookout for law outside of Article 9 that limits a secured party's right to repossess collateral. In *Moorer v. Always Towing & Recovery, Inc.*,<sup>157</sup> the court ruled that the debtor stated a claim against the secured party for illegal repossession of her car.<sup>158</sup> Pursuant to the Wisconsin Consumer Act, a secured party has no right to repossess collateral until fifteen days after it sends notification of the default and right to cure, and such notification cannot be sent earlier than ten days after the debtor is one full payment behind,<sup>159</sup> yet the secured party sent the notification before that time.<sup>160</sup>

When repossessing collateral, a secured party and its agents must be careful not to take property other than the collateral, or at least must endeavor to return such property promptly to its owner. In *Magley v. M & W Inc.*,<sup>161</sup> the court held

150. A security interest that attaches to an account after notice of a federal tax lien is filed can have priority over the tax lien if the security agreement is a "commercial transactions financing agreement" and attachment occurs within forty-five days after the tax lien notice is filed. See 26 U.S.C. § 6323(c) (2018). The court was apparently willing to assume that the security agreement in this case qualified as a commercial transactions financing agreement, and thus the issue was whether the lien had become choate before that forty-five-day period expired, not before the notice was filed. See *SE Prop. Holdings, LLC*, 357 F. Supp. 3d at 551 & n.55.

151. *SE Prop. Holdings, LLC*, 357 F. Supp. 3d at 553–54.

152. See U.C.C. § 9-609(a)(1), (b)(1) (2013).

153. *Id.* § 9-609 cmt. 3. Some states have rules outside of Article 9 to the contrary. See, e.g., CAL. BUS. & PROF. CODE § 7507.13(b) (Deering 2007).

154. 306 F. Supp. 3d 756 (W.D. Pa. 2018) (denying most motions to dismiss); see *Hyman v. Morris*, 320 F. Supp. 3d 707 (W.D. Pa. 2018) (denying summary judgment).

155. *Hyman*, 306 F. Supp. 3d at 761–67.

156. *Id.* at 769–73 (analyzing 42 U.S.C. § 1983).

157. No. 16-cv-1504-pp, 2018 WL 4233005 (E.D. Wis. Sept. 5, 2018).

158. *Id.* at \*12.

159. WIS. STAT. § 425.105(1) (2015); see *id.* § 425.103(2) (defining "default"); *id.* § 425.104 (addressing notification of default).

160. *Moorer*, 2018 WL 4233005, at \*8.

161. 926 N.W.2d 1 (Mich. Ct. App. 2018) (per curiam).

that a debtor stated a claim against a repossession agent for taking a tank and sprayer attached to the collateralized vehicle and for initially refusing to return the property despite a demand therefor.<sup>162</sup> Although the debtor granted a security interest in accessions to the vehicle, which the security agreement defined to be “things which are attached to or installed in” the vehicle,<sup>163</sup> the security agreement also included a disclaimer of the secured party’s responsibility for other property “attached to” the collateral, suggesting that not every item attached to the vehicle became an accession.<sup>164</sup> Accordingly, only property attached permanently became an accession.<sup>165</sup> The tank and sprayer were not accessions and thus no security interest was granted.<sup>166</sup> Moreover, even if the repossession agent was permitted to initially take the tank and sprayer, the debtor stated a claim for the agent’s refusal to return them.<sup>167</sup>

## B. NOTIFICATION OF DISPOSITION

After default, a secured party may dispose of the collateral.<sup>168</sup> Before most dispositions, the secured party must send notification of the disposition to the debtor and any secondary obligor.<sup>169</sup> Such a notification must, among other things, indicate the method of the intended disposition and state the time and place of a public disposition or the time after which any other disposition is to be made.<sup>170</sup> In a consumer-goods transaction, the notification must include some additional information, including a description of any liability for a deficiency of the person to whom the notification is sent.<sup>171</sup> That requirement proved to be problematic in one case last year.

In *Williams v. American Honda Finance Corp.*,<sup>172</sup> the Massachusetts Supreme Judicial Court, answering questions certified to it by the U.S. Court of Appeals for the First Circuit, considered how the notification requirement is affected by a Massachusetts law that mandates that a deficiency on a car loan be calculated based on the car’s fair market value, rather than the foreclosure sale price.<sup>173</sup> The state court concluded that the pre-sale notification must expressly describe

162. *Id.* at 10–11.

163. *Id.* at 8 (quoting the Loan and Security Agreement).

164. *Id.* at 8–9 (quoting the Loan and Security Agreement).

165. *Id.*

166. *Id.* at 9–10.

167. *Id.* at 10–11.

168. See U.C.C. § 9-610 (2013).

169. See *id.* § 9-611(b)–(d). In a transaction other than a consumer-goods transaction, a notification that does not include this information might nevertheless be sufficient. Compare *id.* § 9-613(1)–(2) (stating that a notification of disposition in a transaction other than a consumer-goods transaction will be sufficient if it contains specified content but indicating that a notification lacking some of that content might nevertheless be sufficient), with *id.* § 9-614(1) (specifying the content that must be included in a notification of disposition in a consumer-goods transaction notification).

170. See *id.* § 9-613(1).

171. See *id.* § 9-614(1)(B).

172. 98 N.E.3d 169 (Mass. 2018) (answering certified questions); see *Williams v. Am. Honda Fin. Corp.*, 907 F.3d 83 (1st Cir. 2018) (reversing the district court’s conclusion that Honda’s notices were compliant with law and vacating dismissal of debtor’s U.C.C. claim).

173. MASS. GEN. LAWS ch. 255B, § 20B (2012).

the deficiency as the difference between the amount owed on the loan and the fair market value of the vehicle, not the difference between the amount owed and the sale proceeds or the amount owed and the fair market *retail* value of the vehicle.<sup>174</sup> Because the secured party's notifications described the deficiency for which the debtor would be liable based on the amount of the disposition proceeds, the notifications were inadequate.<sup>175</sup>

## VI. LIABILITY ISSUES

A buyer of collateral at an Article 9 disposition acquires the debtor's rights in the collateral,<sup>176</sup> but does not normally assume responsibility for the debtor's obligations. However, the fact that the collateral is sold through an Article 9 disposition does not insulate the buyer from the principles of successor liability.<sup>177</sup> There were three notable cases last year on a buyer's successor liability following a foreclosure sale.

In *Ronnoco Coffee, LLC v. Westfeldt Bros., Inc.*,<sup>178</sup> a newly formed entity purchased substantially all of the debtor's assets at a private disposition conducted by the secured party and, for a few months thereafter, employed the debtor's principals. The court ruled that the buyer did not have successor liability as a mere continuation of debtor because there was no continuity of ownership.<sup>179</sup> It did not matter that, immediately before the sale, the buyer exercised substantial control over the debtor.<sup>180</sup>

A similar conclusion was reached in *Odjaghian v. EngagePoint, Inc.*,<sup>181</sup> in which an entity, controlled by the secured party, bought all the assets of the debtor at a foreclosure sale. The court ruled that the buyer did not have successor liability; it was not a mere continuation of the debtor because it gave fair consideration for the assets, there was no common ownership, and the debtor continued to operate.<sup>182</sup>

174. *Williams*, 98 N.E.3d at 178–80.

175. *Williams*, 907 F.3d at 87–88.

176. See U.C.C. § 9-617(a)(1) (2013).

177. See, e.g., *Call Center Techs., Inc. v. Grand Adventures Tour & Travel Publ'g Corp.*, 635 F.3d 48 (2d Cir. 2011); *Elvis Presley Enters., Inc. v. Passport Video*, 334 F. App'x 810 (9th Cir. 2009); *Murphy & King v. BlackJet, Inc.*, No. 13-80280-CIV-HURLEY, 2016 WL 3017224 (S.D. Fla. May 26, 2016); *Sourcing Mgmt., Inc. v. Simclar, Inc.*, 118 F. Supp. 3d 899 (N.D. Tex. 2015); *Opportunity Fund, LLC v. Savana, Inc.*, No. 2:11-CV-528, 2014 WL 4079974 (S.D. Ohio Aug. 19, 2014); *Ortiz v. Green Bull, Inc.*, No. 10-CV-3747 (ADS) (ETB), 2011 WL 5554522 (E.D.N.Y. Nov. 14, 2011); *Perceptron, Inc. v. Silicon Video, Inc.*, No. 5:06-CV-0412 (GTS/DEP), 2010 WL 3463098 (N.D.N.Y. Aug. 27, 2010); *Miller v. Forge Mench P'ship Ltd.*, No. 00 Civ. 4314 (MBM), 2005 WL 267551 (S.D.N.Y. Feb. 2, 2005); *Milliken & Co. v. Duro Textiles, LLC*, 887 N.E.2d 244 (Mass. 2008); *Cont'l Ins. Co. v. Schneider, Inc.*, 873 A.2d 1286 (Pa. 2005).

178. No. 4:16CV1336 JCH, 2018 WL 902202 (E.D. Mo. Feb. 15, 2018), *appeal filed*, No. 18-1498 (8th Cir. Mar. 7, 2018).

179. *Id.* at \*5.

180. *Id.* at \*7–8.

181. No. JKB-18-0151, 2018 WL 3329617 (D. Md. July 6, 2018), *appeal filed*, No. 19-1491 (4th Cir. May 6, 2019).

182. *Id.* at \*5–6.

Finally, in *Veritas Steel, LLC v. Lunda Construction Co.*,<sup>183</sup> the court ruled that an entity formed by a secured party to conduct a partial strict foreclosure after receiving an assignment of the secured loans did not have successor liability under either the “de facto merger” or “mere continuation” doctrines because there was no continuity of ownership.<sup>184</sup> Although the new entity operated the same business, employed the same workforce, pursued many of the same projects, and had two of the same officers, the key element of a de facto merger is the transfer of ownership for stock, not cash, and the key element of mere continuation is a common identity of stockholders.<sup>185</sup>

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183. No. 2017AP822, 2018 WL 6132330 (Wis. Ct. App. Nov. 21, 2018) (per curiam), cert. granted, 382 Wis. 2d 522 (2019).

184. *Id.* at \*4, \*7–8.

185. *Id.* at \*3, \*6.