

SPOTLIGHT

The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code to be published after the previous edition of the Newsletter. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the opinion.

In re Rowe, **369 B.R. 73 (D. Mass. 2007)**

This case involves a very restrictive application of U.C.C. § 9-203(b)'s requirement of an authenticated security agreement. It is reminiscent of the well known, but widely disfavored, holding in *American Card Co. v. H.M.H. Co.*, [196 A.2d 150](#) (R.I. 1963).

Lake Equipment Leasing, Inc. and Jeffrey M. Rowe executed an “equipment lease” by which Lake leased a plow with a digging attachment to Rowe for five years. The document identified Rowe’s Chevy truck as “collateral” – presumably for Rowe’s payment obligations – and listed the truck by its vehicle identification number. The title certificate for the truck also listed Lake as the “first lienholder.” In addition, Rowe executed a limited power of attorney that would permit a third party, Frank’s Far Rockaway Auto School, Inc., to sign certain documents to secure title to the truck. In spite of all this, the court concluded that there was no valid security agreement.

The court acknowledged, as a preliminary matter, that the parties’ failure to execute a document entitled “security agreement” was not dispositive of whether the parties had in fact created a security agreement. Nevertheless, the court ruled that the lease, title certificate, and limited power of attorney were insufficient to establish the existence of a security agreement because of the absence of “granting language” by which the debtor expressly transferred rights in the truck. The court cited *In re Modafferi*, [45 B.R. 370](#), 372 (S.D.N.Y. 1985), in support of this portion of its holding. The court correctly quoted *Modafferi*, but misapplied it. *Modafferi* involved a financing statement signed by the debtor together with a promissory note that was silent as to the existence of collateral. In essence, the only document in any way indicating the existence of collateral was the financing statement. Because the purpose of a financing statement is to put third parties on notice that the filer *may* have a security interest in the identified property, it has never played well as a security agreement and the *Modafferi* court ruled that it was insufficient. In doing so, it noted that “some language reflecting a desire to grant a security interest must be contained within the documents offered to establish a security agreement under U.C.C. § 9-203.”

But the facts in *Rowe* were substantially different. The transaction document between the parties which created the payment obligation expressly indicated that Rowe’s truck was to serve as “collateral.” Indeed, the references to “collateral” and “first lienholder” are otherwise nonsensical and the limited power of attorney is otherwise unnecessary. Nevertheless, the *Rowe* court seemed to equate “language reflecting a desire to grant a security interest” with “language granting a security

interest.” Because the documents contained no explicit “granting language,” the court held that no security interest was created. The court’s holding is overly restrictive and fails to respect the likely intent of the parties.

RP Machine Enterprises, Inc. v. UPS Capital Business Credit,
2007 WL 2475871 (D. Mass. 2007)

This case totally misconstrues the legal effect of a secured party’s failure to provide notice of a disposition of collateral pursuant to U.C.C. § 9-611.

Gould & Eberhardt Gear Machinery Corp. borrowed approximately \$3 million from UPS Capital Business Credit. The loans were guaranteed by the United States Department of Agriculture and were secured by G&E’s business assets as well as certain real estate owned by G&E’s president and owner. After G&E defaulted on its repayment obligations, UPS and the USDA decided to accelerate the indebtedness and liquidate the collateral. As part of this process, UPS asked G&E to execute a “Waiver of Notice Regarding Disposition of Collateral,” and G&E did so. The court ruled that this waiver was insufficient because it referred only to a non-U.C.C. portion of the Massachusetts General Laws and did not purport to waive the notification requirement of Article 9.

Despite the default, G&E and UPS continued to discuss alternatives to foreclosure on the business assets (the real estate was foreclosed upon separately). As part of these discussions, G&E located a potential purchaser for the company’s business assets – RP Machine Enterprises, Inc. RP offered to purchase G&E’s assets as part of a joint-venture arrangement with G&E. UPS verbally accepted the offer, and the parties entered into a secured party bill of sale whereby UPS purported to transfer its interests in the G&E assets for \$700,000.

After the agreement was executed, and while G&E’s president was out of the country, RP’s personnel entered G&E’s premises and began removing property from the premises. In response, G&E sought protection through a Chapter 11 bankruptcy proceeding, claiming that the notification of the sale was insufficient. The bankruptcy court agreed, ruled that the defective notice rendered the sale ineffective to transfer title, and ordered turnover of the property. This was patently in error. While it would have been appropriate for the court to have considered the defective nature of the notification in determining G&E’s liability, if any, for a deficiency, Article 9 provides no support for using it to invalidate the sale. Indeed, just the opposite; both the Code and the comments expressly provide that a good faith transferee in a disposition gets to keep the property even if the secured party failed to comply with Article 9. *See* § 9-617 & comment 2.

Nevertheless, the ruling was apparently never appealed and RP ultimately purchased the assets through the bankruptcy process, albeit for a much higher price. It then sued UPS for breach of contract to recover the difference. In ruling on RP’s motion for summary judgment, the district court then compounded the bankruptcy court’s mistake. It not only accepted without question the bankruptcy court’s conclusion that the sale was invalid (although in fairness the issue was not before it), but somehow also concluded that RP had no cause of action for breach against UPS. In doing so, the court never cited § 9-610(d), which provides that a secured party makes a warranty of title

in a disposition contract unless it follows the normal to disclaim that warranty. The court's holding may be explained at least in part by the fact that none of the cases in this portion of the court's opinion arose under the U.C.C. One case involved the sale of electricity, one involved a pre-U.C.C. conditional sale of an automobile, and the others all involved real estate. Nevertheless, the court seems to have assumed – without any reasoned analysis – that because the bankruptcy court had invalidated the sale, no valid contract ever existed.

Attorney's Title Insurance Fund, Inc. v. Regions Bank,
491 F. Supp. 2d 1087 (S.D. Fla. 2007)

This last case illustrates a common misconception: that any payment transaction can be reversed if the underlying transaction to which it is connected is fraudulent. The decision reflects no error of analysis by the court, but instead a rather pointless litigation tactic.

In the case, two unnamed imposters purported to sell certain real property that belonged to Mr. and Mrs. Chuvén to an individual named Jacobs, who apparently had no knowledge of the fraudulent scheme. Home Equity Mortgage Company financed Jacobs' purchase, and Attorney's Title Insurance Fund, Inc. provided the title insurance for the transaction. At the closing, the closing agent delivered to the imposters a check for the purchase price, made payable to Mr. and Mrs. Chuvén. The check was drawn upon Regions Bank. The imposters forged the Chuvéns' endorsement, and Regions Bank paid the check.

After the Chuvéns learned of the fraudulent transaction, they got the deed to Jacob cancelled. Attorney's Title paid the unpaid balance of Home Equity Mortgage's loan to Jacob and thereby acquired any cause of action the Chuvéns (or, for that matter, Home Equity Mortgage) might have based upon the fraud. Attorney's Title then sued Regions Bank to recover based upon the bank's payment of the check. Although, as the court noted, Attorney's Title failed to identify any particular legal theory under which it was entitled to recovery, the suit was apparently based upon a theory of conversion; specifically, that Regions Bank had converted the Chuvéns' funds by paying the check to the fraudfeors. (As is ordinarily the case in Article 3 litigation, the fraudfeors were apparently judgment-proof or unavailable for suit and were therefore not part of the litigation.)

Because the check was never delivered to the Chuvéns, however, the Chuvéns had no rights in the check and therefore no cause of action in conversion. Instead, the only rights they had in this transaction stemmed from the underlying transaction – that is, the fraudulent scheme to sell their property. Attorney's Title argued that the Chuvéns had received constructive delivery of the check when it was given to the fraudfeors. For this argument to succeed, the fraudfeors must have been acting as agents for the Chuvéns. Since the Chuvéns were not involved in the scheme, the fraudfeors could not have been acting as their agents, and the constructive delivery argument therefore fails.

To recap, the Chuvéns– and by assignment, Attorney's Title – had no cause of action based upon the payment transaction because the check was never delivered to them or to their agent. *See* § 3-420(a)(ii). Indeed, the imposters' indorsement of the check was valid. *See* § 3-404(a). The

Chuvens' only cause of action related to the unauthorized and fraudulent land sale, and that action was satisfied by cancellation of the deed. Thus, subrogation to the Chuvens' rights provided no cause of action to Attorney's Title. It is, however, possible that Attorney's Title has its own cause of action against the closing agent if she knew or should have known of the fraudulent scheme. The specific contours of any such cause of action would depend upon the relationship, if any, between the closing agent and Attorney's Title, which is not revealed in the facts of the case.

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