SEARCHERS BEWARE: COURT VALIDATES NOTICE OF TAX LIEN FILED AGAINST TAXPAYER'S FORMER NAME

Five years ago, the Sixth Circuit ruled that a notice of federal tax lien need not be filed under the taxpayer's exact name to be effective. *In re Spearing Tool and Manufacturing Co.*, 412 F.3d 653 (6th Cir. 2005), *cert. denied*, 549 U.S. 810 (2006). The decision signaled that the IRS was not subject to the more exacting standard applicable to filers of UCC financing statements, and it sent commercial lawyers into something of a tizzy. Unfortunately, a recent district court decision from South Carolina has now taken *Spearing Tool* one step further by holding that a notice of federal tax lien listing the taxpayer by its **former name** was sufficient to give an IRS tax lien priority over a subsequent judgment lien. *Trane Company v. CGI Mechanical, Inc.*, 2010 WL 2998516 (D.S.C. 2010). Both decisions allow the IRS to be carefree in its filing and require competing creditors to be brilliant in their searching.

The *Spearing Tool* decision: IRS allowed to file using variations of debtor's name. In *Spearing Tool*, the IRS had filed a notice of federal tax lien with the Michigan Secretary of State using the name for the taxpayer that had appeared in some (but not all) of the taxpayer's tax returns. That name deviated from the taxpayer's actual name in three ways:

Name in Notice	*Actual Name*
Spearing Tool & Mfg. Company Inc.	Spearing Tool and Manufacturing Co., Inc.

(i) it used an ampersand instead of "and"; (ii) it used the abbreviation "Mfg." instead of "Manufacturing"; and (iii) it spelled out "Company" instead of using the abbreviation "Co." A search by one the taxpayer's secured creditors using the debtor's actual name failed to disclose the notice. As a result, that creditor continued to lend to the debtor. When the debtor later went into bankruptcy, the secured creditor challenged the priority of the federal tax lien, claiming the notice was insufficient.

The Sixth Circuit ruled for the IRS. Even though a filed financing statement using an incorrect name for the debtor would not be effective if it would not be disclosed in response to a search request using the debtor's correct name (UCC 9-506), the court ruled that the IRS was not subject to that standard. Instead, a notice of federal tax lien is effective if a "reasonable and diligent search" would have revealed it. The court concluded that a reasonably diligent search would have involved looking under variations that abbreviated "and" and "manufacturing." The bottom line was that the IRS was able to avoid the UCC and play by a different set of rules than other filers.

The one bright spot in the Sixth Circuit case was that the court did distinguish some earlier decisions that also gave the IRS wide latitude in its tax lien notices. Those decisions involved searches using a paper index, on which entries with misspellings could nevertheless readily be discovered. The court seemed to recognize that such decisions are inapposite to electronic searches of a computer database. Indeed, it expressly restricted its holding to the facts of the case and declined to speculate about what a reasonably diligent search would entail if there were many possible abbreviations, instead of only two. This suggests that while the Sixth Circuit was willing to impose on creditors the burden of searching under a finite number of possible abbreviations of the debtor's name, it would not compel them to search against an infinite number of possible misspellings.

The *Trane* decision: IRS allowed to file using debtor's former name. In the South Carolina case, the debtor-taxpayer was incorporated in 1979 under the name Clontz-Garrison Mechanical Contractors, Inc. In 2003, it officially changed its name to CGI Mechanical, Inc. In March and

May of 2006, the IRS filed with the Charleston, SC, Register of Deed two notices of federal tax lien against the debtor for delinquent employment taxes. These notices identified the debtor by its old name. This was apparently because the debtor's employment tax returns for the relevant years had used the debtor's old name even though the debtor's corporate income tax returns for those years had used its new name.

Name in Notice / Former Name	*Actual Name / Current Name*
Clontz-Garrison Mechanical Contractors, Inc.	CGI Mechanical, Inc.

In October 2006, The Trane Company obtained a confession of judgment against the debtor in connection with a breach of contract action. Trane had conducted business with the debtor from 2000 to 2005, and in 2004 had changed most (but not all) of its correspondence with the debtor to reflect the debtor's new name.

Although the debtor ceased operations in 2005, it became entitled to some settlement proceeds in unrelated litigation. Both the debtor's tax liability and Trane's judgment exceeded the amount of these settlement proceeds, and both the IRS and Trane claimed priority to those proceeds. The dispute centered on whether the IRS notices properly identified the debtor.

New decision goes beyond *Spearing Tool* decision. The court began its analysis by quoting the general standard used in *Spearing Tool:* to be effective, a notice of federal tax lien must identify the debtor in such a manner that a reasonably diligent search would reveal the notice. Trane acknowledged that, under *Spearing Tool,* minor variances in the debtor's name do not undermine the effectiveness of a tax lien notice, but it argued that this case was different because the variance was quite significant in that a diligent search under the debtor's current name would not have revealed the notices.

In fact, the Charleston Register of Deeds maintains an index of tax lien notices, with an alphabetical listing of the taxpayers' names. The parties stipulated that a search of this index, either in person or electronically, using the debtor's old name would have revealed both notices but a search under the debtor's new name revealed neither. Nevertheless, the IRS argued that a reasonably diligent search would have included the debtor's former name.

Trane argued that this was an absurd result: it would require someone interested in Exxon to search against Esso and someone interested in 3M Company to search against Minnesota Mining and Materials Company—names that those companies had changed long ago. The court disagreed, taking particular note that Trane had conducted business with the debtor for years prior to the debtor's name change and, after the change, had continued to use the debtor's old name at least 16 times in its correspondence with the debtor. The court interpreted the Sixth Circuit's decision in *Spearing Tool* as requiring inquiry into what was reasonable in that particular circumstance and *as to that particular searcher at issue, in light of the knowledge of that particular searcher.*

In fact, there was little in *Spearing Tool* that unequivocally focused on the secured creditor's knowledge. The court in that case did note that the filing office had recommended to the secured creditor, Crestmark, that it search using abbreviations of the debtor's name, and the court in passing stated the question presented as "whether Crestmark conducted a reasonable and diligent electronic search," but nothing in its analysis suggests that the analysis truly depends on who the competing claimant is and what that claimant knows. Moreover, the acknowledged standard is expressed quite clearly in objective terms: would a reasonably diligent searcher have found the filed notice?

Critique of the recent decision. The decision in *Trane* is reminiscent of the decision last year by the California Court of Appeals in *Fariba v. Dealer Services Corp.*, 100 Cal. Rptr. 3d 219, 70 UCC Rep. 2d 193 (Cal. Ct. App. 2009). As reported in the September 2009 issue of this newsletter, the court in that case analyzed whether a debtor was "generally known by its creditors to be substantially engaged in selling the goods of others" (see UCC 9-102(a)(20)(A)(iii)), by inquiring whether the particular creditor challenging the consignment was aware of the debtor's business practices. That transformed what is supposed to be a purely objective inquiry with only one answer into a subjective inquiry which might yield different answers as to different competing creditors, with the possibility of circular priorities.

The decision in the South Carolina case does the same. By focusing on the fact that Trane had done business with the debtor before the name change and afterwards occasionally used the debtor's former name, and from those facts concluding that a reasonably diligent search *by Trane* would have revealed the tax lien notice, the court turned an objective standard into a subjective one. This approach too can create an unbreakable circle of priorities. For example, consider a situation in which both Creditor A and Creditor B were competing with the IRS, the IRS had filed first, but the notice filed by the IRS used the debtor's former name. Assume further that Creditor A has priority over Creditor B, and Creditor A was aware of the debtor-taxpayer's former name, but Creditor B not. Under the approach used in *Trane,* the IRS would have priority over Creditor A, Creditor A would have priority over Creditor B, and Creditor B would have priority over the IRS. An unwelcome circular priority.

For this reason, the decision in *Trane* is wrong. Yet

unless and until it is reversed, it remains something to which prospective secured lenders and buyers must pay heed. The moral of *Spearing Tool* survives with renewed vigor: searchers must be more careful in looking for federal tax liens than in looking for filed financing statements.

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