

# Personal Property Secured Transactions

By Steve Weise and Stephen L. Sepinuck\*

## I. THE SCOPE OF ARTICLE 9

### A. IN GENERAL

The first task for a lawyer advising a client about a planned secured transaction is to determine whether Article 9 applies to it (including whether it is a secured transactions at all). Reaching an incorrect conclusion on this issue can lead to a disastrous result. For example, if a person is unaware that Article 9 applies, the person might fail to perfect a security interest under Article 9 and end up losing all interest in the collateral to some other claimant. Alternatively, if Article 9 does not apply, the person might erroneously comply with Article 9 but fail to do whatever applicable law does require to obtain and perfect an interest in the collateral.

The latter problem arose in *In re Montreal, Maine & Atlantic Railway, Ltd.*,<sup>1</sup> in which Wheeling & Lake Erie Railway Company (“Wheeling”) extended the debtor, Montreal, Maine & Atlantic Railway, a \$6 million line of credit. The debtor in return granted Wheeling a security interest in all accounts and payment intangibles. A few years later, a tragic derailment accident occurred in Quebec and the debtor filed a claim with its insurer for business interruption damages. In the debtor’s bankruptcy, Wheeling claimed that the insurance proceeds were part of its collateral. The court concluded that—because Article 9 does not apply to an interest in, or a claim under, an insurance policy, unless the claim is for loss or damage to collateral,<sup>2</sup> and because an insurance claim for lost business is not a claim for loss or damage to collateral—Article 9 did not apply to Wheeling’s security interest.<sup>3</sup> The court then analyzed Wheeling’s security interest under Maine common law. The court was unsure what Maine law would require to perfect a security interest in an insurance policy or claim, but ultimately concluded that some step, beyond the execution of a secur-

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1. *Wheeling & Lake Erie Ry. Co. v. Keach (In re Montreal, Me. & Atl. Ry., Ltd.)*, 799 F.3d 1 (1st Cir. 2015).

2. See U.C.C. §§ 9-102(a)(64)(E), 9-109(d)(8) (2013).

3. *In re Montreal*, 799 F.3d at 5–10. In so ruling, the court noted that, even when the insurance claim is settled, the resulting promise by the insurer to pay is still excluded. *Id.* at 6–8.

ity agreement, designed to furnish fair notice to other creditors is required.<sup>4</sup> The secured party had taken none of the possible steps.<sup>5</sup>

Sometimes, other law takes precedence over Article 9. In *Lili Collections, LLC v. Terrebonne Parish Consolidated Government*,<sup>6</sup> the court ruled that—because Article 9 does not apply to the extent that other state law expressly governs the creation, perfection, priority, or enforcement of a security interest created by the state or a governmental agency thereof,<sup>7</sup> and because provisions of the relevant state law restrict the ability of state agencies to borrow funds and pledge assets—Article 9 did not apply to a contractor's assignment of its right to payment from a state agency.<sup>8</sup> According to the court, Article 9's anti-assignment rules did not render ineffective the clause in the contractor's agreement with the agency prohibiting assignment. This conclusion is suspect because the state did not create the security interest, the contractor did.

A somewhat similar issue arose in *Etzler v. Indiana Department of Revenue*,<sup>9</sup> in which a secured party claimed its security interest in a breeder's award owed to the debtor by a state agency was superior to the rights of a judgment creditor. The judgment creditor claimed that the security interest was excluded from Article 9 by Indiana's non-uniform section 9-104(d)(14), which refers to "the creation, perfection, priority, or enforcement of a security interest created by . . . a governmental unit of the state," and which was modeled on section 9-109(c)(2) of the U.C.C. However, the court properly rejected that argument, noting that the provision deals with government debtors, not government account debtors.<sup>10</sup>

One recurring issue concerning the scope of Article 9 arises when a seller of goods, particularly motor vehicles, includes language in the sales agreement conditioning the entire transaction on the availability of third-party financing, yet allows the buyer to take possession of the goods. Section 2-401(1) provides that the retention of title by the seller of delivered goods is limited in effect to a security interest.<sup>11</sup> If the conditional sale is a "sale," it creates a security interest and the seller must comply with Article 9 when perfecting and enforcing its rights to the goods. If no "sale" has occurred because of the condition, then

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4. *Id.* at 10–11.

5. *Id.* at 11. Although Wheeling had filed a financing statement describing the collateral to include accounts and payment intangibles, the court ruled that "[t]hose forms of collateral, as defined in the UCC, do not include rights under an insurance policy." *Id.* The court seems to have confused definitions with scope. The definition of "payment intangibles" is broad enough to cover the insurance claim, even though such claims are outside the scope of Article 9. *See* U.C.C. § 9-102(a)(42), (61) (2013).

6. 175 So. 3d 434 (La. Ct. App. 2015).

7. U.C.C. § 9-109(c)(2) (2013).

8. *Lili Collections, LLC*, 175 So. 3d at 436 (citing LA. CONST. art. VII, §§ 8, 14; LA. STAT. ANN. § 39:1410.60).

9. 43 N.E.3d 250 (Ind. Ct. App. 2015).

10. *Id.* at 256–57 (citing IND. CODE § 26-1-9.1-109(d)(14)). The court also ruled that the judgment creditor did not have priority over the secured party under U.C.C. § 9-317(a), because the judgment creditor was not a lien creditor. *Id.* at 257.

11. U.C.C. § 2-401(1) (2011); *see also id.* § 1-201(b)(35) (making a similar point in the definition of "security interest").

there is no security interest.<sup>12</sup> In *In re Heien*,<sup>13</sup> a vehicle buyer signed a bailment contract in connection with the purchase of a car. The bailment contract provided that the purchase was conditioned on approval of the buyer's financing and, until then, the vehicle remained the seller's property. The court ruled that, even if the bailment contract was contemporaneous with the purchase agreement, because the buyer obtained delivery of the vehicle, a "sale" had occurred. Thus, the seller's interest was limited to a security interest and the vehicle came into the buyer's bankruptcy estate.

## B. LEASING

Distinguishing a lease of goods—which is governed by Article 2A of the U.C.C.—from a sale with a retained security interest—which is governed by Articles 2 and 9—is often difficult. The issue is a heavily factual one, and rests on whether the putative lessor retains, as a practical matter, a meaningful economic interest in the goods.<sup>14</sup> The U.C.C. contains some detailed rules that give a definitive answer in some situations in which the lease is not terminable by the lessee. Among these are when the lease extends beyond the economic life of the goods or the lessee has an option to buy the goods for nominal consideration.<sup>15</sup> When these definitive rules do not apply, the analysis falls back to an all-the-facts-and-circumstances test.<sup>16</sup> The issue can be important because a lessor that overlooks the possibility that its transaction is a sale combined with a security interest might not perfect what turns out to be a "security interest."

*In re Gutierrez*<sup>17</sup> involved an automobile lease that was not subject to termination by the lessee. The lease provided that the lessee would become the owner of the automobile at the end of the lease. Although these facts ordinarily should make the transaction a disguised sale with a retained security interest, the court ruled that the agreement was a lease, not a secured sale, because the agreement expressly stated that it was a lease.<sup>18</sup> As such, the transaction was governed by the Puerto Rico Act to Regulate Personal Property Lease Contracts and the lessee waived the right to have the lease treated under the U.C.C. as a secured sale.<sup>19</sup> Because of this non-U.C.C. statute, the lessee's waiver was effective. Or-

12. The courts are divided on the effect of the condition. Compare *Patterson v. Univ. Ford, Inc.*, 758 S.E.2d 185 (N.C. Ct. App. 2014) (holding that unsatisfied financing condition in the conditional delivery agreement prevented the existence of a contract), with *Hillen v. Dennis Dillon Auto Park & Truck Ctr., Inc.* (*In re Byrd*), 546 B.R. 434 (Bankr. D. Idaho 2016) (holding that contract, which acknowledged that buyer would finance the transaction, but which was not "contingent on [buyer] obtaining financing," did not prevent a sale from occurring), and *In re Jones*, No. 12-14608, 2013 WL 1092099 (Bankr. E.D. Tenn. Jan. 17, 2013) (holding that conditional language in bills of sale created a condition subsequent, not a condition precedent, and thus auto dealer was limited to a security interest).

13. *Autocenters St. Charles, LLC v. Heien* (*In re Heien*), 528 B.R. 901 (E.D. Mo. 2015).

14. See U.C.C. § 1-203(a)–(b) (2011).

15. See *id.* § 1-203(b).

16. See, e.g., *In re Grubbs Constr. Co.*, 319 B.R. 698 (Bankr. M.D. Fla. 2005); *Coleman v. Daimler-Chrysler Servs. of N. Am., LLC*, 623 S.E.2d 189 (Ga. Ct. App. 2005).

17. *Gutierrez v. Popular Auto, Inc.*, (*In re Gutierrez*), 526 B.R. 449 (Bankr. D.P.R. 2015).

18. *Id.* at 454–55, 462–63.

19. *Id.* at 462–63.

dinarily, a person subject to a particular article of the U.C.C. cannot waive its application.

Four other courts held that leasing transactions were true leases after properly analyzing whether the lessor retained a residual interest in goods. In *In re Johnson*,<sup>20</sup> the court held that a four-year lease of a truck with an option to purchase at the end of the term for \$8,500 was a true lease. The court ruled that, because the lessee did not show that the option price was nominal in relation to the anticipated fair market value of the truck at the end of the lease term or the lessee's costs of performing under the agreement, the transaction was a true lease.<sup>21</sup>

The court, in *In re Wells*,<sup>22</sup> ruled that a ninety-one-month lease of a two-year-old vehicle with an option to purchase at the end of the term for \$3,444 was a true lease because the term was not for the remaining economic life of the vehicle and, regardless of whether the option price was equal to 20 percent or 38.8 percent of the vehicle's original value, it was not nominal.<sup>23</sup>

In *GEO Finance, LLC v. University Square 2751, LLC*,<sup>24</sup> a ten-year lease of a geothermal water supply system with an option to purchase at any time for approximately \$300,000 and an option to renew for eight consecutive five-year terms was a true lease because the system had a useful life of fifty years and the option price was not nominal.<sup>25</sup>

Finally, *CD Construction, LLC v. Hard Hat Industries, Inc.*<sup>26</sup> involved a sale-leaseback transaction for an excavator. The court ruled that the transaction created a true eighteen-month lease even though the lessee had a purchase option any time after the sixth month. The lease term was for less than the economic life of the excavator, there was no obligation or option to renew the lease, and the purchase option price was not nominal. The court properly concluded that the transaction did not satisfy the bright-line test under section 1-203(b) for a sale with a retained security interest.<sup>27</sup>

## II. ATTACHMENT OF A SECURITY INTEREST

In general, there are three requirements for a security interest to attach, that is, effectively to come into existence: (i) the debtor must authenticate a security agreement that describes the collateral; (ii) value must be given; and (iii) the

20. No. 15-00104-NPO, 2015 WL 1508460 (Bankr. S.D. Miss. Mar. 27, 2015).

21. *Id.* at \*4-6.

22. *Wells v. Am. Fin., Inc. (In re Wells)*, No. 15-80056-CR-13, 2015 WL 3862969 (Bankr. N.D. Ala. June 22, 2015).

23. *Id.* at \*2.

24. 105 F. Supp. 3d 753 (E.D. Mich. 2015).

25. *Id.* at 764-65. Consequently, the lessor did not need to file a financing statement and a buyer of the property in which the system was installed took subject to the lease and was liable in unjust enrichment for continuing to use the system without paying the monthly metered usage fee. *Id.* at 766-68.

26. No. 1-1552, 2015 WL 6509507 (Iowa Ct. App. Oct. 28, 2015).

27. *Id.* at \*2-5. Unfortunately, the court then failed to analyze the transaction under the facts-and-circumstances test of section 1-203(a) or discuss the fact that the parties did not discuss the value of the excavator when setting the option price, or that its value apparently exceeded all the consideration due under the lease. *See id.* at \*4.

debtor must have rights in the collateral or the power to transfer rights in the collateral.<sup>28</sup> There were significant cases on each of these requirements last year.

#### A. EXISTENCE OF SECURITY AGREEMENT

The requirement of an authenticated security agreement is fairly easy to satisfy. The agreement must create or provide for a security interest;<sup>29</sup> 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>30</sup> and it must describe the collateral.<sup>31</sup> If no single document satisfies these requirements, multiple writings may do so collectively, under what is known as the “composite document rule.”<sup>32</sup>

In *In re Brown*,<sup>33</sup> the debtor signed a letter granting her former romantic partner the right to drive her vehicle until the debtor paid a \$3,000 debt (unless the former partner earlier allowed any female in the vehicle). The court ruled that the letter did not create a security interest because it provided only the right to drive the vehicle, not to repossess or sell the car in the event of a default.<sup>34</sup>

In *Royal Jewelers Inc. v. Light*,<sup>35</sup> the debtor signed an agreement purporting to grant a security agreement in collateral—a ring—described in a separate exhibit, but did not sign the exhibit. The court properly ruled that there is no requirement that the debtor separately authenticate or sign an exhibit that the security agreement references, even though that exhibit contains the description of the collateral.<sup>36</sup>

Four cases last year dealt with whether the proper person authenticated the security agreement. In *Old Battleground Properties, Inc. v. Central Carolina Surgical Eye Associates, P.A.*,<sup>37</sup> a creditor claimed a security interest in specified works of art. Several pieces of art were expressly excluded from the collateral description in the creditor’s financing statement and the creditor sent a letter to another secured party denying that the creditor had a security interest in those works of art. The remaining art was described in a security agreement purportedly executed by the debtor’s husband on the debtor’s behalf, but the debtor alleged that her husband was not so authorized to sign on her behalf and that his sig-

28. See U.C.C. § 9-203(b) (2013).

29. See *id.* § 9-102(a)(74) (defining “security agreement”).

30. See U.C.C. § 1-201(b)(35) (2011) (defining “security interest”).

31. See U.C.C. § 9-203(b)(3)(A) (2013).

32. See, e.g., *Bank of Am., N.A. v. Outboard Marine Corp.* (*In re Outboard Marine Corp.*), 300 B.R. 308, 323 (Bankr. N.D. Ill. 2003); see generally *In re Weir-Penn, Inc.*, 344 B.R. 791, 793 (Bankr. N.D. W. Va. 2006) (citation omitted) (referencing “a collection of documents . . . [that] in the aggregate disclose an intent to grant a security interest in specific collateral”).

33. *Simmons v. Brown* (*In re Brown*), No. 14-72940-BEM, 2015 WL 2123819 (Bankr. N.D. Ga. Apr. 29, 2015).

34. *Id.* at \*3.

35. 859 N.W.2d 921 (N.D. 2015).

36. *Id.* at 927.

37. No. 15 CVS 1648, 2015 WL 846697 (N.C. Super. Ct. Feb. 25, 2015).

nature was a forgery. Accordingly, the court refused temporarily to restrain the debtor from transferring the artwork because the creditor had not shown a likelihood of success on its claim of a security interest in any of the artwork.

The remaining three cases all dealt with collateral owned by a limited liability company ("LLC") or by the members of an LLC. In *Hepp v. Ultra Green Energy Services, LLC*,<sup>38</sup> the court held that the managing member of an LLC did not have actual authority to bind the LLC to a note and security agreement and might not have had apparent authority, which requires conduct by the principal—not the agent—that causes a third party to believe that the agent is authorized.<sup>39</sup>

The case of *United Bank v. Expressway Auto Parts, Ltd.*<sup>40</sup> is somewhat similar. An individual signed a security agreement on behalf of the debtor, an LLC of which he identified himself as a member. However, the individual was neither a member nor a manager of the LLC, and thus lacked actual authority to bind the LLC. However, the court held that the individual had apparent authority and that the LLC ratified his action by reporting the secured obligation as a liability on its federal income tax returns and making monthly payments for eight years.<sup>41</sup>

In *In re Floyd*,<sup>42</sup> the sole members of an LLC signed a note and security agreement on behalf of the LLC and had the creditor's security interest noted on the certificate of title for, among other things, a vehicle owned by one of them individually. The court ruled that this was sufficient because the parol evidence—including the application for the certificate of title that the owner must have signed—demonstrated their intent to grant a security interest.<sup>43</sup>

The debtor need not authenticate a written security agreement if the secured party has possession of the collateral pursuant to an unauthenticated security agreement (which can be oral). In *In re Cable's Enterprise, LLC*,<sup>44</sup> the court applied this rule and held that a lender—to whom the debtor had, at the time the loan was made, given possession of an excavator as security for the loan—had a valid security interest despite the absence of an authenticated agreement.

For some transactions or collateral, law outside Article 9 imposes additional requirements for a valid security agreement. Such was the case in *Martino v. American Airlines Federal Credit Union*,<sup>45</sup> which involved a credit union's efforts to set off a customer's deposit account against the customer's obligation on a credit card issued by the credit union. The Truth in Lending Act prohibits a credit card issuer from offsetting a cardholder's indebtedness arising in connection with a consumer credit transaction against funds of the cardholder held on

38. No. 13 C 4692, 2015 WL 1952685 (N.D. Ill. Apr. 28, 2015).

39. *Id.* at \*5–6; see also RESTATEMENT (THIRD) OF AGENCY § 3.03 & cmt. b (AM. LAW INST. 2006) ("[A]n agent's apparent authority originates with express conduct by the principal . . .").

40. No. 15CA51, 2015 WL 6697469 (Ohio Ct. App. Nov. 2, 2015).

41. *Id.* at \*4.

42. *Gugino v. Rowley (In re Floyd)*, 540 B.R. 747 (Bankr. D. Idaho 2015).

43. *Id.* at 756–57.

44. *Cable's Enter., LLC v. Dunn (In re Cable's Enter., LLC)*, No. 14-10782, 2015 WL 9412805 (Bankr. M.D.N.C. Dec. 21, 2015).

45. 121 F. Supp. 3d 277 (D. Mass. 2015).

deposit with the issuer.<sup>46</sup> The regulations promulgated thereunder clarify that this prohibition does not alter or affect the right of the card issuer to “[o]btain or enforce a consensual security interest in the funds.”<sup>47</sup> However, the Official Staff Interpretation of the regulation places a hurdle on the card issuer’s path toward obtaining such a security interest by requiring that the consumer “specifically intend to grant a security interest in the deposit account.”<sup>48</sup> The *Martino* court ruled that a credit union did not satisfy this heightened standard because the language in the credit card agreement purporting to grant the credit union a security interest was not separately signed and did not reference a specific amount of deposited funds or a specific deposit account number, even though it did appear in a box with bolded text.<sup>49</sup>

To be effective, an authenticated security agreement must provide a description of the collateral.<sup>50</sup> In most cases, a description of collateral by type of property defined in Article 9 is sufficient.<sup>51</sup> However, in a consumer transaction, a description of consumer goods only by type is insufficient.<sup>52</sup>

In *Morris v. Ark Valley Credit Union*,<sup>53</sup> the debtor executed mortgages on his real property. A clause in the mortgages purported to grant a security interest in “fixtures” on the real property. In reversing a bankruptcy court decision to the contrary, the district court held that, because the mortgage described the collateral not just as fixtures, but as fixtures attached to specified real property, the description was not just by type of collateral, and hence a security interest could attach to the debtor’s mobile home if it was a fixture.<sup>54</sup>

## B. VALUE GIVEN

The requirement for attachment that “value has been given”<sup>55</sup> is written in the passive voice quite intentionally. The value need not come from the secured party and need not go to the debtor, a term defined to mean the owner of the collateral.<sup>56</sup> In fact, Article 9 contemplates that the debtor need not be the prin-

46. 15 U.S.C. § 1666h (2012).

47. 12 C.F.R. § 226.12(d)(2) (2016); see also *id.* § 1026.12(d)(2).

48. *Id.* pt. 226, supp. I, para. 12(d)(2), cmt. (1)(i).

49. *Martino*, 121 F. Supp. 3d at 284–90; see also Allen Benson, *An Avoidable Trap for Credit Card Issuers*, THE TRANSACTIONAL LAW., Oct. 2015, at 6, 6–9 (analyzing the *Martino* case).

50. U.C.C. § 9-203(b)(3)(A) (2013).

51. See *id.* § 9-108(b).

52. *Id.* § 9-108(e)(2).

53. 536 B.R. 887 (D. Kan. 2015).

54. *Id.* at 892–93. But cf. *Angell v. Accugenomics, Inc. (In re Gene Express, Inc.)*, No. 10-08432-8-JRL, 2013 WL 1787971, at \*5–7 (Bankr. E.D.N.C. Apr. 26, 2013) (holding that commercial real estate lease that purported to grant the landlord a security interest in “any personal property belonging to Tenant and left on the Premises” did not adequately describe the collateral because “personal property” is not a permissible description, but failing to address why the phrase “left on the premises” did not suffice to render the description something other than supergeneric). On remand, the bankruptcy court found that the mobile home was a fixture. *Morris v. Ark. Valley Credit Union (In re Gracy)*, No. 13-11917, 2015 WL 5552651, at \*4 (Bankr. D. Kan. Sept. 17, 2015).

55. U.C.C. § 9-203(b)(1) (2013).

56. See *id.* § 9-102(a)(28)(A). But cf. *In re Adirondack Timber Enter., Inc.*, No. 08-12553, 2010 WL 1741378, at \*3 (Bankr. N.D.N.Y. Apr. 28, 2010) (holding that debtor that authenticated an

principal obligor or even owe the secured obligation at all, but might instead be someone other than the person to whom the secured party extended credit.<sup>57</sup> Two cases explored this rule last year.

In *Citigroup Global Markets, Inc. v. KLCC Investments, LLC*,<sup>58</sup> the debtor received a \$14 million loan and later that day executed a security agreement purporting to grant a security interest in a securities account to an LLC to secure the resulting indebtedness. The court ruled that the security interest attached even though the loaned funds came from the personal account of the LLC's owner.<sup>59</sup> Similarly, in *In re DigitalBridge Holdings, Inc.*,<sup>60</sup> the funds loaned to the debtor came from an affiliate of the secured party, rather than the secured party itself. The court ruled that the security interest attached, after noting that the debtor authenticated a promissory note payable to the secured party and no other party claimed a right to collect the debt.<sup>61</sup>

### C. RIGHTS IN THE COLLATERAL

A few secured parties ran into trouble last year with the requirement that the debtor have rights in the collateral or the power to convey rights in it. For example, in *In re 11 East 36th, LLC*,<sup>62</sup> an LLC authenticated a pledge agreement by which it purported to grant a security interest in its membership interest in a subsidiary LLC that owned several condominium units. When both entities filed for bankruptcy protection, the lender claimed a security interest in the subsidiary's condominium units. The court ruled that the parent did not own the subsidiary's units, so the security interest could not attach to those units, even though the lender filed a financing statement identifying some of those units as the collateral.<sup>63</sup> The lender had only a security interest in the parent's interest in its subsidiary.<sup>64</sup>

In *ACF 2006 Corp. v. William F. Conour Clerk's Entry of Default Entered 11/18/2013*,<sup>65</sup> a lender had a perfected security interest in a law firm's accounts, which

agreement granting a security interest to a manufacturer to secure all obligations owed to the manufacturer and its affiliates did not grant a security interest to the bank subsidiary of the manufacturer, and thus the bank was not entitled to adequate protection).

57. See, e.g., U.C.C. § 9-102(a)(59) (2013) (defining "obligor"); *id.* § 9-102(a)(72) (defining "secondary obligor"); *id.* § 9-611(c)(1), (2) (specifying that notification of a disposition must be sent to the debtor and any secondary obligor, among others); *id.* § 9-621(b) (indicating when a secondary obligor is entitled to be sent a proposal to accept collateral); *id.* § 9-623(a) (indicating that collateral may be redeemed by the debtor and any secondary obligor, among others); *id.* § 9-625 (indicating the debtor, the obligor, and the secondary obligor, among others, may be entitled to damages if a secured party fails to comply with Part 6 of Article 9).

58. No. 06 Civ. 5466 (LAP), 2015 WL 5853916 (S.D.N.Y. Sept. 28, 2015).

59. *Id.* at \*8. The court also noted that contract law requires that consideration exist, not that it flow from the promisee to the promisor. *Id.*

60. *Bird v. SKR Credit, Ltd. (In re DigitalBridge Holdings, Inc.)*, No. 10-34499, 2015 WL 5766761 (Bankr. D. Utah Sept. 30, 2015).

61. *Id.* at \*9.

62. No. 13-11506 (RG), 2015 WL 397799 (Bankr. S.D.N.Y. Jan. 29, 2015).

63. *Id.* at \*2.

64. *Id.* at \*3. Moreover, this security interest was unperfected because the filed financing statement described the condominium units, rather than the membership interest in the subsidiary. *Id.*

65. No. 1:13-cv-01286-TWP-DML, 2015 WL 417553 (S.D. Ind. Jan. 30, 2015).



included the firm's rights under contingent fee agreements with clients. However, the court ruled the security interest did not encumber all the fees recovered upon resolution of the cases after the representation was switched to another firm because the debtor law firm was entitled only to the *quantum meruit* portion of the fees for the services that the debtor law firm had performed.<sup>66</sup>

Even 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. Article 9 contains several rules that override some contractual and legal restrictions on assignment.<sup>67</sup> In *Clark v. Missouri Lottery Commission*,<sup>68</sup> a lottery winner purported to grant a bank a security interest in the winner's right to future lottery distributions to secure a series of loans. Later, relying on a state statute that prohibits the assignment of lottery proceeds,<sup>69</sup> the winner sought a declaratory judgment that the assignment was void. The court ruled that, because section 9-406 overrides restrictions on assignment and expressly prevails in the event of conflict with other law, the security interest attached.<sup>70</sup>

### III. PERFECTION OF A SECURITY INTEREST

#### A. GOVERNING LAW AND METHOD OF PERFECTION

In general, perfection of a security interest is necessary 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>71</sup> The method or methods by which a secured party can perfect depend on the type of collateral and the nature of the transaction. The dominant method of 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>72</sup> Some security interests are perfected automatically upon attachment.<sup>73</sup> The first issue to resolve in determining how to perfect is to ascertain which state's law governs.

In general, the law of the jurisdiction in which the debtor is located governs perfection and the effect of perfection.<sup>74</sup> This rule played a critical role in an im-

66. *Id.* at \*6–7.

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

68. 463 S.W.3d 843 (Mo. Ct. App. 2015).

69. MO. REV. STAT. § 313.285.1 (2000).

70. *Clark*, 463 S.W.3d at 846–48. Courts in Texas and California have reached conflicting decisions on this issue. Compare *Tex. Lottery Comm'n v. First State Bank of DeQueen*, 325 S.W.3d 628, 635–39 (Tex. 2010) (holding that section 9-406 trumps the lottery statute's restriction on assignment even though the lottery statute was more recent and more specific because section 9-406(f) makes clear that it takes precedence over other law), with *Stone St. Capital, LLC v. Cal. State Lottery Comm'n*, 80 Cal. Rptr. 3d 326, 330–40 (Ct. App. 2008) (holding that the California Lottery Act's restriction on assignment of lottery winnings trumped section 9-406(f) because the specific rules in the Lottery Act controlled over the more general rules in Article 9, even though Article 9 was enacted more recently).

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

72. See *id.* §§ 9-310 to -314.

73. *Id.* § 9-309.

74. See *id.* § 9-301(1).

portant case from last year: *In re SemCrude, L.P.*<sup>75</sup> The debtors in the case purchased oil from producers in several states and resold the oil to downstream purchasers. The debtors also traded financial oil derivatives on the New York Mercantile Exchange and on over-the-counter markets, and these trades eventually led to a liquidity crisis that caused the debtors to file bankruptcy. On the date of the petition, the debtors had not yet paid numerous producers. The producers brought adversary proceedings against the downstream purchasers, alleging that the purchasers violated the producers' security interests in the oil. The producers, which had not filed financing statements against the debtors, relied on non-uniform statutes in several states that purport to grant producers, such as themselves, an automatically perfected purchase-money security interest in the oil or gas they produce and then sell on credit.<sup>76</sup> In decisions several years ago, the bankruptcy court ruled that the law of the jurisdictions in which the debtors were located for Article 9 purposes—Delaware and Oklahoma—governed perfection of the producers' security interests and thus the automatic perfection rules of other states did not apply.<sup>77</sup> Because the producers had not filed in Delaware or Oklahoma or otherwise complied with those states' law on perfection, the producers' security interests were unperfected and the downstream buyers took free of those security interests under U.C.C. section 9-317(b). Last year, the district court affirmed, following the reasoning of the bankruptcy court.<sup>78</sup>

Article 9 does not apply to a landlord's lien, which is a product of the common law or non-U.C.C. statutory law, not of a contract.<sup>79</sup> However, Article 9 does apply if a lease of real property grants the landlord a security interest in the tenant's personal property. Such was the case in *In re University General Hospital System, Inc.*<sup>80</sup> Because the landlord had not done anything to perfect its security interest, the landlord was not entitled, in the tenant's bankruptcy proceeding, to relief from the stay to use the collateral.<sup>81</sup>

## B. ADEQUACY OF A FINANCING STATEMENT

To be sufficient to perfect a security interest, a filed financing statement must be authorized by the debtor in an authenticated record.<sup>82</sup> By authenticating a se-

75. *J. Aron & Co. v. SemCrude, L.P.* (*In re SemCrude, L.P.*), No. 08-11525 (BLS), 2015 WL 4594516 (D. Del. July 30, 2015), *appeal docketed*, No. 15-3097 (3d Cir. Sept. 17, 2015).

76. *See* KAN. STAT. ANN. § 84-9-339a (Supp. 2014); TEX. BUS. & COM. CODE ANN. § 9.343 (West 2001).

77. *Arrow Oil & Gas, Inc. v. SemCrude, L.P.* (*In re SemCrude, L.P.*), 407 B.R. 112, 137 (Bankr. D. Del. 2009) ("Texas § 9.343 does not apply in deciding whether the Texas Producers' claimed security interests were perfected. Rather, Delaware law or Oklahoma law governs perfection."); *Mull Drilling Co. v. SemCrude, L.P.* (*In re SemCrude, L.P.*), 407 B.R. 82, 109 (Bankr. D. Del. 2009) ("Kansas § 9-339a does not govern in deciding whether the Kansas Producers' claimed security interests were perfected. Rather, Delaware law or Oklahoma law governs perfection."). This conclusion might have been different if laws in these states had purported to create a statutory lien rather than a security interest.

78. *In re SemCrude, L.P.*, 2015 WL 4594516, at \*9-10.

79. *See* U.C.C. § 9-109(d)(1) & cmt. 10 (2013).

80. No. 15-31086-H3-11, 2015 WL 3879484 (Bankr. S.D. Tex. June 22, 2015).

81. *Id.* at \*1-2.

82. *See* U.C.C. § 9-509(a)(1) (2013).

curity agreement, a debtor automatically authorizes the secured party to file a financing statement covering the collateral described in the financing statement.<sup>83</sup> A financing statement filed before a security agreement is made, and without the debtor's authorization in some other authenticated record, is ineffective when filed. However, the debtor's subsequent authentication of a security agreement or other authorization provides the needed authorization, which then in turn makes a previously filed financing statement retroactively effective.<sup>84</sup>

In *In re Adoni Group, Inc.*,<sup>85</sup> a lender filed a financing statement one day before the debtor authenticated the security agreement. The court ruled quite properly that the financing statement was sufficient to perfect the security interest.<sup>86</sup>

To be sufficient, a filed financing statement must also indicate the collateral covered.<sup>87</sup> That indication need not be specific, it need only reasonably describe the collateral.<sup>88</sup> Moreover, a filed financing statement with a minor error is effective provided the error does not render the statement seriously misleading.<sup>89</sup> In *In re Sterling United, Inc.*,<sup>90</sup> a filed financing statement described the collateral as:

[a]ll assets of the Debtor including, but not limited to, any and all equipment, fixtures, inventory, accounts, chattel paper, documents, instruments, investment property, general intangibles, letter-of-credit rights and deposit accounts . . . and located at or relating to the operation of the premises at 100 River Rock Drive, Suite 304, Buffalo, New York.

The debtor's bankruptcy trustee argued that the security interest was unperfected and avoidable because the debtor no longer owned or operated from the River Rock Drive location. The court rejected this argument. In doing so, the court first observed that the language specifying the incorrect location modified the clause beginning "including, but not limited to," not the opening phrase "[a]ll assets of the Debtor."<sup>91</sup> Hence, the collateral description was not incorrect. The court then observed that, even if the description was ambiguous, and if the description could be read to limit all the collateral to the incorrect location—because the purpose of filing is to provide inquiry notice and a reasonable searcher confronting an ambiguous description should investigate further—the financing statement was not seriously misleading.<sup>92</sup>

83. *Id.* § 9-509(b).

84. *See id.* §§ 9-322 cmt. 4, 9-509 cmt. 3.

85. Official Comm. of Unsecured Creditors of Adoni Grp., Inc. v. Capital Bus. Credit, LLC (*In re Adoni Grp., Inc.*), 530 B.R. 592 (Bankr. S.D.N.Y. 2015).

86. *Id.* at 596–99.

87. *See* U.C.C. § 9-502(a)(3) (2013).

88. *See id.* § 9-108(a).

89. *See id.* § 9-506(a).

90. *Ring v. First Niagara Bank, N.A. (In re Sterling United, Inc.)*, No. 1-13-11351-MJK, 2015 WL 7573240, at \*1 (W.D.N.Y. Nov. 25, 2015).

91. *Id.* at \*2.

92. *Id.*

### C. TERMINATION STATEMENTS

Another decision was made last year in the widely publicized case of *In re Motors Liquidation Co.* In 2014, in response to a certified question from the U.S. Court of Appeals for the Second Circuit, the Delaware Supreme Court ruled that a termination statement is authorized by the secured party if the secured party of record reviewed and knowingly approved the termination statement for filing, regardless of whether the secured party subjectively intended or understood the effect of the filing.<sup>93</sup> Early last year, the Second Circuit applied that ruling and held that termination statements prepared by debtor's counsel in connection with the payoff of a separate \$300 million lease transaction, and which, the court concluded, were reviewed and approved by the secured party and its counsel, were effective. As a result, the financing statement referenced in one of the terminations statements, and which related to a \$1.5 billion term loan, was terminated.<sup>94</sup>

### D. PERFECTION BY CONTROL

A security interest in a deposit account as original collateral can be perfected only by control.<sup>95</sup> If the secured party is not the depository bank, then the secured party can obtain control either by becoming the depository bank's customer with respect to the deposit account or, more commonly, entering into an agreement with the bank pursuant to which the bank agrees to comply with the secured party's instructions with respect to the deposit account.<sup>96</sup>

In *In re Southeastern Stud & Components, Inc.*,<sup>97</sup> there were discrepancies between the correct numbers for the debtor's deposit accounts and the account numbers referenced in a deposit account control agreement among the debtor, the depository bank, and the secured party. The court ruled that the discrepancies did not undermine control given that the debtor and the bank were aware of the accounts to which the control agreement applied and, because a financing statement filed by the secured party identified deposit accounts as the collateral, a third party would have inquiry notice regarding the secured party's security interest.<sup>98</sup> Although the court's conclusion is correct, given that nothing about control requires or imparts notice to third parties,<sup>99</sup> the court's comments about the financing statement seem irrelevant to the issue.

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93. Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, 103 A.3d 1010, 1017–18 (Del. 2014).

94. Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank (*In re Motors Liquidation Co.*), 777 F.3d 100, 105 (2d Cir. 2015) (per curiam). Each of the authors provided advice to the secured party during the litigation.

95. See U.C.C. § 9-312(b) (2013).

96. See *id.* § 9-104(a)(1)–(3).

97. *Alexander v. Mill Steel Co. (In re Se. Stud & Components, Inc.)*, No. 14-32906-DHW, 2015 WL 7750209 (Bankr. M.D. Ala. Dec. 1, 2015).

98. *Id.* at \*3.

99. See U.C.C. § 9-342 (2013) (indicating that a bank need not disclose the existence of a control agreement to anyone unless requested to do so by the depositor).

## IV. PRIORITY

### A. BUYERS

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>100</sup> Two noteworthy cases dealt with this rule last year.

In *In re SemCrude, L.P.*, after concluding that oil producers' security interests were unperfected because the producers had not filed financing statements in the states where the debtors were located,<sup>101</sup> the court addressed the priority between the producers of the oil and the downstream buyers. The court held that there was insufficient evidence to raise a factual dispute about whether the buyers knew of the security interests even though the buyers allegedly knew: (i) that the debtors had purchased oil in states with laws that created the security interests in the oil, (ii) the identities of some of the producers, and (iii) that the producers were unpaid.<sup>102</sup> While the buyers might have known that the debtors had purchased the oil on credit, they might not have known that the producers were still unpaid at the time the oil was resold to the buyers or that the oil was encumbered, especially because the debtors had warranted good title.<sup>103</sup>

In *Four County Bank v. Tidewater Equipment Co.*,<sup>104</sup> a secured party filed financing statements to perfect its security interest in two items of equipment before the debtor sold the equipment. However, the secured party failed to file continuation statements until after the financing statements had lapsed, and thus its interest became unperfected and was deemed never to have been perfected against a purchaser for value.<sup>105</sup> As a result, a buyer that had no knowledge of the security interest when it received delivery of the equipment took free of the secured party's retroactively unperfected security interest.<sup>106</sup> The court refused to impose, under the guise of the duty of good faith, a requirement that buyers search for filed financing statements.<sup>107</sup>

100. *Id.* § 9-317(b).

101. *J. Aron & Co. v. SemCrude, L.P.* (*In re SemCrude, L.P.*), No. 08-11525 (BLS), 2015 WL 4594516, at \*9 (D. Del. July 30, 2015), *appeal docketed*, No. 15-3097 (3d Cir. Sept. 17, 2015); see *supra* notes 75–78 and accompanying text (discussing the case).

102. *In re SemCrude, L.P.*, 2015 WL 4594516, at \*10.

103. *Id.* The court also ruled that the buyers qualified as buyers in ordinary course of business who took free of the producers' security interests under U.C.C. section 9-320(a), even if the security interests were perfected. *Id.* at \*11–14. Although the buyers partially purchased on credit and partially paid in kind through cross-product netting arrangements prevalent in the oil and gas markets, these facts did not cause the transactions to fall outside the ordinary course of business or mean that the buyers acquired the goods in partial satisfaction of a money debt. *Id.*; see also U.C.C. § 1-201(b)(9) (2011) (defining “buyer in ordinary course of business”).

104. 771 S.E.2d 437 (Ga. Ct. App. 2015).

105. *Id.* at 438–39; see U.C.C. § 9-515(c) (2013).

106. *Four Cty. Bank*, 771 S.E.2d at 439–40.

107. *Id.* at 440; cf. U.C.C. § 9-331 cmt. 5 (2013) (“[G]ood faith’ does not impose a general duty of inquiry . . .”).

## B. COMPETING SECURED PARTIES

In general, when there are two perfected security interests in the same collateral, priority is determined under the first-to-file-or-perfect rule. The first security interest perfected or subject to an effective financing statement has priority, provided there was no period thereafter when there was neither filing nor perfection.<sup>108</sup>

In *HSBC Bank USA v. Perez*,<sup>109</sup> each of two banks purchased a duplicate original promissory note for the same mortgage loan. When the mortgagor defaulted, each bank sought to foreclose. Because the sale of a promissory note is an Article 9 transaction,<sup>110</sup> the court looked to Article 9's priority rules to determine which bank had priority.<sup>111</sup> The court then correctly ruled that priority was based not on the order in which the banks filed an assignment of the mortgage, but on the first-to-file-or-perfect rule of section 9-322.<sup>112</sup> Accordingly, the first bank to take possession of its note had priority with respect to the mortgage.<sup>113</sup>

Cases involving duplicate original promissory notes—each assigned to a different party—are not that unusual.<sup>114</sup> Unfortunately, the court in *Perez*, like the courts in many of the other cases, got tripped up in the analysis. First, the court offered no explanation as to why the first-to-file-or-perfect rule of section 9-322 was the appropriate priority rule to resolve the dispute, rather than either section 9-330 or 9-331,<sup>115</sup> each of which deals with purchasers of promissory notes. More to the point, none of these three priority rules is designed to deal with the problem resulting from duplicate original notes. In other words, the court implicitly treated the two notes as the same piece of property, but nothing in the priority rules contemplates such a thing. While doing so has the advantage of protecting an unsophisticated home buyer duped into making the duplicate notes, it ignores an assumption underlying both Articles 3 and 9 that anything capable of being possessed is unique.

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108. U.C.C. § 9-322(a)(1) (2013).

109. 165 So. 3d 696 (Fla. Dist. Ct. App. 2015).

110. See U.C.C. § 9-109(a)(3) (2013).

111. *Perez*, 165 So. 2d at 699–701.

112. *Id.* at 701–702.

113. *Id.* Because the sale of a promissory note creates a security interest that is automatically perfected, see U.C.C. §§ 9-109(a)(3), 9-309(4) (2013), the court was incorrect to focus on which bank took possession first.

114. See, e.g., *Provident Bank v. Cmty. Home Mortg. Corp.*, 498 F. Supp. 2d 558 (E.D.N.Y. 2007), discussed in Stephen L. Sepinuck & Kristen Adams, *UCC Spotlight*, COM. L. NEWSL. 1, 1–2 (A.B.A., Bus. L. Sec., July 2007), <http://apps.americanbar.org/abanet/common/login/securedarea.cfm?areaType=committee&role=CL190000&url=/buslaw/committees/CL190000/newsletter/200707/spotlight.pdf>; *DLJ Mortg. Capital, Inc. v. Home Loan Mortg. Corp.*, No. B193493, 2008 WL 376941 (Cal. Ct. App. Feb. 13, 2008), discussed in Stephen L. Sepinuck & Kristen Adams, *UCC Spotlight*, COM. L. NEWSL. 2, 2–3 (A.B.A. Bus. L. Sec. July 2008), <http://apps.americanbar.org/buslaw/committees/CL190000pub/newsletter/200807/spotlight.pdf>.

115. U.C.C. §§ 9-330, 9-331 (2013).

### C. OTHER CLAIMANTS

In general, a security interest is effective against creditors of the debtor and purchasers of the collateral.<sup>116</sup> Article 9 does allow a licensee in ordinary course of business to take its rights under a nonexclusive license free of a security interest, even if that security interest is perfected,<sup>117</sup> but there is no protection for a licensee under an exclusive license.

In *Cyber Solutions International, LLC v. Priva Security Corp.*,<sup>118</sup> a secured party had a perfected security interest in the debtor's intellectual property, including the copyrights associated with a specific semiconductor chip. Subsequently, the debtor granted an exclusive license to the copyrights. In a later dispute between the secured party and the licensee, the court ruled that the licensee took subject to the security interest and that the secured party also had priority over derivative products developed by the licensee. As the court put it, although the license agreement purported to grant the licensee ownership over improvements, the debtor did not, in light of the security agreement, have authority to grant such ownership to the licensee.<sup>119</sup>

Article 9 protects depositary banks. Such a bank has no duty, beyond those to which it agrees, to anyone with a security interest in a deposit account.<sup>120</sup> If the bank has a security interest in a deposit account it maintains, that security interest will have priority over almost any other security interest.<sup>121</sup> And, the bank's setoff rights are largely unaffected by the debtor's grant of a security interest in a deposit account.<sup>122</sup> In spite of all this, in *American Home Assurance Co. v. Weaver Aggregate Transport, Inc.*,<sup>123</sup> the court ruled that a garnishee bank that had a perfected security interest in a deposit account it maintained for the debtor did not have setoff rights sufficient to defeat the rights of the garnishing judgment creditor. The court reasoned that, because the bank failed to declare the debtor in default before service of the writ of garnishment, the bank did not have a present right to the funds or a basis on which to object to their release.<sup>124</sup> The decision is wrong.

## V. ENFORCEMENT OF A SECURITY INTEREST

### A. NOTIFICATION OF DISPOSITION

After default, a secured party may repossess and dispose of the collateral.<sup>125</sup> Before most dispositions, the secured party must send notification of the dispo-

116. See *id.* § 9-201(a).

117. See *id.* § 9-321(b).

118. No. 1:13-CV-867, 2015 WL 852354 (W.D. Mich. Feb. 26, 2015), *aff'd sub nom.* *Cyber Sols. Int'l, LLC v. Pro Mktg. Sales, Inc.*, No. 15-1359, 2016 WL 106087 (6th Cir. Jan. 11, 2016).

119. *Id.* at \*6.

120. See U.C.C. § 9-342 (2013).

121. See *id.* § 9-327(3). The one exception is if the secured party has become the bank's customer with respect to the deposit account. See *id.* § 9-327(4).

122. See *id.* § 9-340.

123. 84 F. Supp. 3d 1314 (M.D. Fla. 2015).

124. *Id.* at 1325–26.

125. See U.C.C. §§ 9-609, 9-610 (2013).

sition to the debtor and any secondary obligor.<sup>126</sup> This duty cannot be waived or varied in the security agreement,<sup>127</sup> but can be waived in an agreement authenticated after default.<sup>128</sup>

In *Ross v. Rothstein*,<sup>129</sup> after the debtor defaulted on a secured loan, the debtor and secured party entered into a superseding security agreement in which the debtor acknowledged default, granted a security interest in additional collateral, and authorized the secured party to sell all the collateral without notification. At the same time, the parties entered into a forbearance agreement under which the secured party agreed not to foreclose for about four months. When the forbearance period expired, the secured party sold the collateral without sending notification to the debtor. In subsequent litigation, the court ruled that the debtor had waived the right to notification of the sale in the superseding security agreement, noting that the forbearance agreement did not extend the due date of the secured obligation or negate the existence of a default.<sup>130</sup>

In *Key Equipment Finance v. Southwest Contracting, Inc.*,<sup>131</sup> the debtor and guarantors similarly and effectively waived the right to notification of a disposition of the collateral—a dredge—by signing a workout agreement after default. The parties agreed that, upon breach of the workout agreement, “the total indebtedness then outstanding would be due and owing ‘without . . . any other notice to [the debtor or the guarantors] whatsoever.’”<sup>132</sup>

## B. CONDUCTING A COMMERCIALLY REASONABLE DISPOSITION

A secured party may dispose of collateral by a sale, lease, or license.<sup>133</sup> The disposition may be public—that is, an auction—or private.<sup>134</sup> However, every aspect of a disposition must be “commercially reasonable.”<sup>135</sup> If a secured party’s compliance with this standard is challenged, the secured party has the burden of proof.<sup>136</sup> There were several notable cases about commercial reasonableness last year.

In *Ross v. Rothstein*,<sup>137</sup> the debtor not only challenged the secured party’s failure to send notification of the disposition,<sup>138</sup> but also claimed that the disposition—a se-

126. See *id.* § 9-611(b)–(d).

127. See *id.* § 9-602(7).

128. See *id.* § 9-624(a).

129. 92 F. Supp. 3d 1041 (D. Kan. 2015).

130. *Id.* at 1060–61.

131. No. 14-cv-00206-RBJ, 2015 WL 5159073 (D. Colo. Sept. 3, 2015).

132. *Id.* at \*6 (quoting workout agreement). Even if the secured party failed to comply with Article 9 by not providing notification of the sale, the debtor and guarantors presented no evidence that they could have paid the debt or produced a buyer who would have purchased the dredge at a higher price. *Id.* at \*7. Accordingly, the court also ruled that the presumption that no deficiency is owing, which arises when a secured party’s enforcement does not comply with Part 6 of Article 9, see U.C.C. § 9-626(a)(3)–(4) (2013), was rebutted. *Key Equip. Fin.*, 2015 WL 5159073, at \*7.

133. U.C.C. § 9-610(a) (2013).

134. See *id.* § 9-610(b).

135. *Id.*

136. *Id.* § 9-626(a)(1), (2).

137. 92 F. Supp. 3d 1041 (D. Kan. 2015).

138. *Id.* at 1061–62; see *supra* notes 129–30 and accompanying text (discussing the case).



ries of sales of stock on the Over-The-Counter QB Tier Market (“OTCQB”)—was conducted in a commercially unreasonable manner because a sale a few hours later would have generated several thousand dollars more. The court rejected this argument on two grounds. First, the court noted that the secured party had, at the time, no benefit of hindsight and, pursuant to U.C.C. section 9-627(a),<sup>139</sup> the fact that a greater amount could have been obtained by disposition at a different time is not sufficient to show that the disposition was commercially unreasonable.<sup>140</sup> Second, the court concluded that sales of stock on the OTCQB were not the subject of individual negotiation, and thus the OTCQB is a “recognized market” within the meaning of section 9-627(b).<sup>141</sup> Because the shares were sold in the usual manner on that market, the court conclusively treated the sale as having been conducted in a commercially reasonable manner.

In *Bank of America v. Dello Russo*,<sup>142</sup> the foreclosing secured party relied on an investment broker hired by the debtor to market the collateral and find a buyer. The broker used a national marketing campaign to identify prospective purchasers for the assets: nearly all of the assets of three manufacturing companies. The secured party then, in an effort to increase the purchase price, negotiated with the only potential buyer expressing interest. The court held that the sale was commercially reasonable.<sup>143</sup> There was no conflict of interest arising from the fact that one of the debtor’s executives was hired by the buyer following the acquisition nor was there any inference of collusion to sell the collateral for less than its value, given that the secured obligation exceeded \$17 million, the purchase price was \$1.5 million, and the guaranty was capped at \$5.95 million, so that the secured party was not able to collect the full amount owed.<sup>144</sup>

In *Harley-Davidson Credit Corp. v. Galvin*,<sup>145</sup> the secured party sold a repossessed aircraft through a dealer specializing in the sale of repossessed aircraft. However, the plane had been vandalized while in the secured party’s possession and then sold without repair and while not “airworthy.” The court noted that a sale through a dealer, if fairly conducted, is normally commercially reasonable, but it was the secured party’s obligation to show that the sale was fairly conducted, which the secured party had not yet done.<sup>146</sup> The court concluded that a reasonable trier of fact could determine that the “sale after the vandalism fell below the standard of reasonable commercial practices among dealers.”<sup>147</sup>

Similarly, in *In re Godfrey*,<sup>148</sup> the court ruled that the secured party’s private disposition of equipment might not have been commercially reasonable because

139. U.C.C. § 9-627(a) (2013).

140. *Ross*, 92 F. Supp. 3d at 1062.

141. *Id.* at 1062–63.

142. 610 F. App’x 848 (11th Cir. 2015) (per curiam).

143. *Id.* at 854–56.

144. *Id.* at 855.

145. 807 F.3d 407 (1st Cir. 2015).

146. *Id.* at 411–12.

147. *Id.* at 413.

148. *Morgantown Excavators, Inc. v. Huntington Nat’l Bank (In re Godfrey)*, 537 B.R. 271 (Bankr. N.D. W. Va. 2015).

the secured party: (i) did not respond to other potential purchasers who had expressed interest; (ii) sold the equipment to an auctioneer, who two days later resold the equipment at a previously noticed public auction; and (iii) might not have provided the debtor an opportunity to arrange for friendly or competitive bidders and was not responsive to the debtor's request for the details of the sale.<sup>149</sup>

Finally, in *In re Estate of Nardoni*,<sup>150</sup> a bank received certificates in its own name for the pledged stock, placed the certificates in a vault, and for three years refused either to sell the stock or to permit the debtor to sell the stock to pay off the secured obligation. The court ruled that the bank acted in a commercially unreasonable manner, even though no sale had yet been conducted, and in so doing, discharged the guarantors from any further liability.<sup>151</sup>

### C. COLLECTING ON COLLATERAL

Upon default, or when otherwise agreed by the debtor, a secured party may notify account debtors to make payment directly to the secured party.<sup>152</sup> After receipt of such a notification and of proof of the secured party's security interest, if requested and not previously provided, an account debtor may discharge its obligation only by paying the secured party; payment to the debtor will not discharge the obligation.<sup>153</sup>

In *Swift Energy Operating, LLC v. Plemco-South, Inc.*,<sup>154</sup> a factor bought some accounts of an oilfield service company and obtained a security interest in the debtor's remaining accounts. Shortly thereafter, the accounts payable supervisor for one account debtor, Swift Energy Operating, LLC ("Swift Energy"), received an e-mail message from the factor instructing Swift Energy to pay the factor and requesting that the supervisor sign and return an acknowledgment form. The supervisor responded that she did not have authority to sign the form and advised the factor to make that request to the appropriate department. Soon thereafter, Swift Energy learned that the debtor was ceasing operations and wished to be paid the balance due on the account. Swift Energy complied and paid the debtor. Thereafter, the factor sued Swift Energy, claiming that the payment to the debtor had not discharged the obligation. The court<sup>155</sup> concluded that, because Swift Energy's accounts payable supervisor informed the factor that she was not the individual responsible for making payment decisions and informed the factor to whom it should send the assignment information, the factor had not

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149. *Id.* at 281–82.

150. No. 1-13-1075, 2015 WL 1514908 (Ill. App. Ct. Mar. 31, 2015).

151. *Id.* at \*8–11.

152. U.C.C. § 9-607(a)(1) (2013).

153. *Id.* § 9-406(a), (c).

154. 157 So. 3d 1154 (La. Ct. App. 2015).

155. The trial court based its decision on the fact that Swift Energy's account had not been sold to the factor, and thus the factor was not an "assignee" of the account within the meaning of section 9-406(a). *Id.* at 1161–62. The court of appeals rejected this conclusion and ruled that the factor was an "assignee" of all the debtor's accounts. *Id.* at 1162.

provided proper notification to Swift Energy prior to the time it paid the debtor.<sup>156</sup> This decision seems incorrect because it gives the account debtor the ability to control the effectiveness of a notification it receives.<sup>157</sup>

## VI. LIABILITY ISSUES

There were several interesting cases last year about liability in connection with a secured transaction. In *Macquarie Bank Ltd. v. Knickel*,<sup>158</sup> a secured party foreclosed on the debtor's oil and gas leases in apparent satisfaction of the secured obligation and then used the debtor's trade secrets that had also been pledged as collateral. The court held that the secured party did not have the right to use the trade secrets and was liable for misappropriation of those trade secrets.

In *Citigroup Global Markets, Inc. v. KLCC Investments, LLC*,<sup>159</sup> a securities intermediary faced with competing claims to the securities credited to the debtor's account refused to complete a transfer requested by the secured party with whom it had a control agreement. The intermediary then initiated an interpleader action. The secured party, which had priority in the securities at issue, filed a counterclaim against the intermediary for the lost value of the securities during the period when the intermediary refused to honor its instructions. The court dismissed the counterclaim. Noting that the "commencement of an interpleader action cannot itself give rise to liability,"<sup>160</sup> the court concluded that the damages the secured party claimed to have suffered arose from acts within the intermediary's rights granted by law.<sup>161</sup>

In *BancorpSouth Bank v. 51 Concrete, LLC*,<sup>162</sup> a secured party brought a successful conversion claim against the buyers of the debtor's equipment subject to the secured party's security interest for failing to turn over the proceeds they received upon resale. The secured party then sought to collect its attorney's fees from the buyers, claiming a right to them under both law and contract. The court rejected both claims. First, the court concluded that the secured party was not entitled to attorney's fees under U.C.C. section 9-607(d) because that provision allows a secured party to deduct attorney's fees from any collections made; it does not create a right to attorney's fees in addition to other damages.<sup>163</sup> The court also ruled the secured party was not entitled to attorney's fees pursuant to its security agreement with the debtor, even though that agreement became ef-

156. *Id.* at 1162–64.

157. See U.C.C. § 1-202(e), (f) (2011) (providing when an organization is deemed to have received a notification).

158. 793 F.3d 926, 937–38 (8th Cir. 2015).

159. No. 06 Civ. 5466 (LAP), 2015 WL 5853916 (S.D.N.Y. Sept. 28, 2015).

160. *Id.* at \*15 (quoting *Union Cent. Life Ins. Co. v. Berger*, No. 10 Civ. 8408 (PGG), 2012 WL 4217795, at \*11 (S.D.N.Y. Sept. 20, 2012)).

161. *Id.* at \*15–16.

162. No. W2013-01753-COA-R3-CV, 2015 WL 340364 (Tenn. Ct. App. Jan. 27, 2015). The Tennessee Supreme Court remanded the case "solely for the purpose of full consideration of BancorpSouth Bank's prejudgment interest issue." *BancorpSouth Bank v. 51 Concrete, LLC*, No. W2013-01753-SC-R11-CV (Tenn. June 11, 2015) (per curiam) (order at 1).

163. *BancorpSouth Bank*, 2015 WL 340364, at \*4.

fective against the buyers under section 9-201(a),<sup>164</sup> because the agreement stated only that the secured party could “apply the proceeds of any collection or disposition first to . . . reasonable attorney’s fees,” and this case did not involve any collection or disposition.<sup>165</sup> The result might have been different if the language of the security agreement was different, such as by referring to the “enforcement” of the security interest.

In *Peterson v. Katten Muchin Rosenman LLP*,<sup>166</sup> the bankruptcy trustee for some investors that made loans secured by nonexistent collateral sued a law firm for malpractice in connection with an accounts financing transaction. The trustee claimed that the firm negligently failed to advise the investors that, by not confirming with the account debtor the existence of the accounts while simultaneously structuring the transaction so that the funds putatively coming from the account debtor actually flowed through another entity owned and controlled by the borrower, there was a risk that the borrower was engaged in a massive Ponzi scheme. The court concluded that there was no principled distinction between business advice and legal advice,<sup>167</sup> and that, in any event, the claim was not for failing to advise the investors not to do business with the debtor, but for failing to advise the client about the risks associated with the structure of the transaction.<sup>168</sup>

A buyer of collateral at an Article 9 disposition acquires the debtor’s rights in the collateral,<sup>169</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>170</sup> There were two notable cases last year on successor liability that involved asset purchases at foreclosure sales.

In *Millbrook IV, LLC v. Production Services Associates, LLC*,<sup>171</sup> the court held that a new entity formed to purchase the assets of the debtor at an Article 9 disposition was merely a “continuation” of the debtor because all four members of the board of managers of each entity were the same, the new entity voluntarily assumed the compensation and bonus agreements of the managers as well as

164. See U.C.C. § 9-201(a) (2013) (“[A] security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.”).

165. *BancorpSouth Bank*, 2015 WL 340364, at \*5.

166. 792 F.3d 789 (7th Cir. 2015).

167. *Id.* at 791.

168. *Id.* at 793.

169. See U.C.C. § 9-617(a)(1) (2013).

170. See, e.g., *Call Ctr. 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); *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).

171. No. 2-14-0333, 2015 WL 1516531 (Ill. App. Ct. Apr. 1, 2015).

specified debts to suppliers and vendors, and two of the three owners of the debtor owned a majority of the new entity.<sup>172</sup>

In contrast, the court, in *Celestica, LLC v. Communications Acquisitions Corp.*,<sup>173</sup> ruled that an entity formed to buy the debtor's assets at a foreclosure sale did not have successor liability under the *de facto* merger doctrine. Although the buyer did initially conduct the same business from the same location with the same management, the buyer did so to preserve the value of the assets as a going concern and, in the ensuing months, the management, location, and nature of the business changed.<sup>174</sup> Although the owners of the buyer collectively owned 40.5 percent of the debtor, the majority owner of the debtor had no stake in the buyer, and the owners of the buyer paid \$600,000 in cash to acquire the debtor's assets.<sup>175</sup> Finally, although the buyer did assume selected liabilities of the debtor, it assumed only those necessary to ensure continued operation of the business and did not assume substantial debts to insiders, including the two individuals who owned the buyer and who lost millions of dollars.<sup>176</sup>

172. *Id.* at \*3, \*5–7.

173. 126 A.3d 835 (N.H. 2015).

174. *Id.* at 839–41.

175. *Id.* at 841.

176. *Id.* at 842.

