UNIFORM COMMERCIAL CODE COMMITTEE

REPORT PREPARED FOR THE MARCH 8, 2012 COUNCIL MEETING

1. Next Scheduled Meeting of the Committee.

Next scheduled meeting of the Committee: None has been scheduled yet.

2. Council Approval.

No matters require Council approval.

3. Membership.

Attached to this Report are three communications that I have sent to Committee members on (i) December 20, 2011, (ii) January 18, 2012, and (iii) February 14, 2012. I believe that these are self-explanatory.

4. Accomplishments Toward Committee Objectives.

I will continue to monitor current developments in Michigan law relevant to the UCC and report on those developments to Committee members.

5. Meetings and Programs.

Nothing to report at this time. I have previously recommended to the Council the need for a seminar on UCC topics if and when the recent amendments to Articles 1, 7 and 9 are adopted by the Michigan legislature, as they are expected to be.

6. Publications.

By no later than July 31, 2012, articles on UCC topics must be submitted to Dan Kopka for editing and then publication in the Michigan Business Law Journal. Three individuals have volunteered to submit three separate articles on UCC topics and are coordinating with Dan Kopka at present.

7. Methods of Monitoring Legislative/Judicial/Administrative Developments and Recommended Action.

See response to #4 above.

8. Miscellaneous.

Nothing to report at this time.

Respectfully submitted,

Patrick E. Mears, Chairperson

IMPORTANT NOTICE

TO: All Members of the UCC Committee

FROM: Patrick E. Mears

DATE: December 20, 2011

RE: Articles on UCC Topics for Michigan Business Law Journal's Fall 2012 Issue

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Our Committee has been given the important assignment of preparing articles for the Fall 2012 issue of *The Michigan Business Law Journal.*

The deadline for submissions is **July 31, 2012**.

If you want to be an author, please send me an email message with your proposed topic. If you aren't sure about a topic, please give me a call to discuss. Also, please contact me if you have any questions, etc.

Thank you very much.

Patrick E. Mears

MEMORANDUM

TO: All Members of the UCC Committee

FROM: Patrick E. Mears

DATE: December 20, 2011

RE: Report of Committee Meeting on November 28, 2011

On November 28, 2011, a meeting of the UCC Committee was held at the offices of Barnes & Thornburg, LLP in Grand Rapids, Michigan. Committee members could also join in the meeting by telephone. The meeting featured Thomas Buiteweg, one of Michigan's Commissioners to NCCUSL, and another NCCUSL Commissioner, John McGarvey of Kentucky, both of whom addressed the status of efforts in the Michigan legislature to enact the 2010 Amendments to Article 9 of the Uniform Commercial Code along with recent amendments to Articles 1 and 7 of the UCC. Prior to the meeting, the author was informed by Professor James J. White of The University of Michigan (who is also a NCCUSL Commissioner for Michigan) that he had recently testified before the Michigan House Banking Committee and, to him, it appeared that "the skids are greased for Articles 1, 7 and 9. There were no questions and apparently general satisfaction." Presently, nine states have enacted the 2010 Amendments to Article 9: Connecticut, Indiana, Minnesota, Nebraska, Nevada, North Dakota, Rhode Island, Texas and Washington; and these amendments have been introduced in Massachusetts, Kentucky, Oklahoma, District of Columbia and Puerto, according to NCCUSL's website, www.NCCUSL.org.

Tom Buiteweg mentioned that, in the Michigan bill with changes to Article 1, the choice of law provisions contained in current UCC 1-105 is not altered by the three bills that have been introduced into the Michigan House, H.B. Nos. 5081, 5082 and 5083. (You all should have copies of these bills as I sent them to all of you last month before our meeting.). Tom also mentioned that over 40 states have already enacted revised Articles 1 and 7. The primary revisions to Article 7 occasioned by these bills will be to conform the statutory provisions to current practices involving the issuance of documents of title, etc. *See, e.g.*, revised 7-105 in H.B. No. 5082.

Tom described the changes contained in the 2010 Amendments to Article 9 as a "light dusting" of Article 9 to clean up some problem areas arising from current law. The most significant change to be made by these amendments is the treatment of the names of individual debtors in financing statement. Much litigation has arisen from the use of nicknames in financing statements, e.g., listing the debtor as "Mike D. Larsen" instead of the proper name of "Michael D. Larsen." *See, e.g., In re Larsen,* 2010 WL 909138 (Bankr.S.D.Iowa Mar. 10, 2010); *Genoa National Bank v. Sw. Implement, Inc. (In re Borden),* 353 B.R. 886 (Bankr.D.Neb. 2006). H.B. 5083, which contains the revisions to Article 9, adopts NCCUSL's "Alternative A," which Tom referred to as the "only if" rule. If the debtor is an individual, the proper debtor's

name to be used on a financing statement is the debtor's name as listed on the debtor's Michigan driver's license or state personal identification card "that has not expired." If the debtor does not have such a license or card, then the financing statement must contain "the individual name of the debtor or the surname and first personal name of the debtor," in effect adopting the old rules of determining if the proper name has been used. Finally, if Michigan has issued to an individual more than one driver's license or state personal identification card, then the name to be used is the one contained on the license or card that was most recently issued.

Tom also mentioned that there are useful changes in these bills to facilitate electronic transactions including a new definition of "sign" contained in revised Article 7. Finally, Tom noted that these three bills are being backed by the "large banks" and the Michigan Bankers Association, which bodes well for their eventual enactment here in Michigan.

The second topic addressed by Tom Buiteweg is what he described as a "UCC Fix Bill" aimed at cleaning up some problems that have arisen from nonuniform amendments to Article 9 that were enacted by the Michigan legislature in 2008, becoming effective on March 29, 2009. These nonuniform amendments are contained in MCL 440.9501a and MCL 440.9520(5)-(9), both of which were adopted to address perceived problems arising from the potential fraudulent filing or recording of financing statements naming individuals as debtors. Tom and others have drafted a new section of Part 5 of Article 9, proposed section 9-516a, to address the problems arising from these recent amendments. Accompanying this memorandum is a handout submitted by Tom explaining the basis for these proposed changes and containing a draft of them.

After Tom's presentation, the author polled those present regarding any new business that should come before the Committee. The only matter that was mentioned was the recent adoption by the Permanent Editorial Board of the Uniform Commercial Code of its Report on the Application of the Uniform Commercial Code to the Assignment of Mortgage Notes. Because this adoption was so recent, those Committee members on the call had not yet had a chance to review the Report in any detail. At that point, the meeting was adjourned upon consent.

Patrick E. Mears

Mears, Patrick

From: Buiteweg, Thomas [Thomas.Buiteweg@ally.com]
Sent: Friday, November 18, 2011 5:12 PM
To: Mears, Patrick
Subject: FW: UCC 9 / Fraud Filing Language
Attachments: MI Fraud Filing Amendment.doc

Pat,

I have attached the amendment we propose to address the fraud filing issue in lieu of the existing Michigan Non-Uniform Amendments. The language would replace the language implemented in 2008, and essentially put the concept into alt sections (as opposed to leaving the actual code sections non-uniform). We would like to do this in addition to making the 2010 Amendments, but no bill has yet been introduced.

Additional changes on this topic would essentially be to: repeal 2008 PA 383 (http://www.legislature.mi.gov/documents/2007-2008/billconcurred/Senate/pdf/2008-SCB-1236.pdf), and restore previous language; repeal 2008 PA 381 (http://www.legislature.mi.gov/documents/2007-2008/billengrossed/House/pdf/2008-HEBS-5934.pdf), and restore previous language; possibly amend, or at least review for consistency, 2008 PA 382 (http://www.legislature.mi.gov/documents/2007-2008/billengrossed/House/pdf/2008-HEBS-5935.pdf).

One thing we should note, as a disclaimer – these are not "official" or "sanctioned" amendments to UCC 9, nor are they part of the 2010 Amendments to UCC Article 9. Rather, this is an attempt by folks knowledgeable about and involved with the drafting of the code to assist unofficially with an issue that has arisen (obviously) in multiple jurisdictions and for which the covered folks are seeking help. The goal of this is to do as little violence to the article and its operation in uniform fashion while still getting at the underlying problem in effective fashion.

We proposed a slightly different version of this Amendment to the Michigan Secretary of State a few months ago. I am providing you an updated version that reflects our current thinking about the best approach. We would appreciate any help the members of your committee could provide in convincing the Secretary of State to abandon their current, overbroad approach in favor of this more narrowly tailored one. We would like to get these changes done in connection with the 2010 Amendments to UCC Article 9 if it can be done without jeopardizing the 2010 Amendments.

Sincerely,

Tom Buiteweg
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General Counsel, Ally Insurance Operations
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Section 9-510 of the UCC is amended to read:

SECTION 9-510. **EFFECTIVENESS OF FILED RECORD.**

(a) *Filed record effective if authorized.* A filed record is effective only to the extent that it was filed by a person that may file it under Section 9-509 or by the filing office under Section 9-513A.

(b) *Authorization by one secured party of record.* A record authorized by one secured party of record does not affect the financing statement with respect to another secured party of record.

(c) *Continuation statement not timely filed.* A continuation statement that is not filed within the six-month period prescribed by Section 9-515(d) is ineffective.

Section 9-513A is added to read:

Sec 9-513A. **HARRASSMENT FILINGS; TERMINATION AND REINSTATEMENT.**

(a) No person shall communicate a financing statement to a filing office for filing which is i) not authorized or permitted under sections 9-509, or 9-708 of this article; ii) is not related to a valid existing or potential commercial or financial transaction, and iii) which is filed with the intent to harass, hinder, or defraud a qualified person identified as an individual debtor in the financing statement.

(b) A qualified person may file in the office of the [Secretary of State's Department of Business Services] a notarized affidavit, signed under penalty of perjury, stating that:

(1) the affiant is a qualified person;

(2) none of the secured parties of record are financial institutions as defined in subsection (o);

(3) all secured parties of record are individuals; and

(4) the financing statement was filed by an individual not authorized or permitted to do so under sections 9-509 or 9-708.

(c) (1) The Secretary of State shall adopt and make available a form of affidavit for use under this section.

(2) The filing office shall not charge a fee for the filing of an affidavit or a termination statement under this subsection. The filing office shall not return any fee paid for filing the financing statement identified in the affidavit, whether or not the financing statement is subsequently reinstated.

(3) In a case where section 9-501 provides that the proper office to file a financing

statement is the office designated for the filing or recording of a record of a mortgage on real property, the Secretary of State shall promptly transmit to that office copies of all communications regarding an affidavit filed under this section, including the affidavit itself, any termination statement filed under subsection (d), and any amendment filed or preliminary or final court order received pursuant to subsections (g) or (h) of this section, and upon receipt the receiving office shall execute the actions described herein.

(d) If an affidavit is filed under subsection (b), the filing office shall promptly file a termination statement with respect to the financing statement identified in the affidavit. The termination statement must indicate that it was filed pursuant to this section. Except as provided in subsections (g) and (h), a termination statement filed under this subsection shall take effect 30 days after it is filed.

Comment [N1]: This is the "scarlet letter" identifying it as an improper filing.

(e) On the same day that a filing office files a termination statement under this subsection, it shall send to each secured party of record for the financing statement a notice advising the secured party of record that the termination statement has been filed. The notice shall be sent by certified mail, return receipt requested, to the address provided for the secured party in the financing statement.

(f) An individual indicated as secured party of record on a financing statement as to which a termination statement has been filed under this subsection may, before or after the termination statement takes effect:

(1) request from the [Office of the General Counsel of the Secretary of State] an expedited administrative review of the decision to terminate the filing; or

Comment [N2]: Where this occurs throughout, this may not be the appropriate reference for MI.

(2) bring an action against the individual who filed the affidavit under subsection (b) seeking a determination that the financing statement was filed by a person entitled to do so under Section 9-509(a). An action under this subsection shall have priority on the court's calendar and shall proceed by expedited hearing. If the individual who filed the affidavit resides in this State, the exclusive venue in this state for the action shall be in the circuit court for the county where the individual principally resides in this state. If the individual who filed the affidavit does not reside in this State, the exclusive venue in this state shall be in the circuit court for the county where the filing office in which the financing statement was filed is located.

(g) In an action brought pursuant to subsection (f), [Office of the General Counsel of the Secretary of State] or a court may, in appropriate circumstances, order preliminary relief, including but not limited to an order precluding the termination statement from taking effect or directing a party to take action to prevent the termination statement from taking effect. If the [Office of the General Counsel of the Secretary of State] or court issues such an order and the filing office receives a certified copy of the order before the termination statement takes effect as provided in subsection (d), the termination statement shall not take effect and the filing office shall promptly file an amendment to the financing statement that indicates that an order has prevented the termination statement from taking effect. If such an order ceases to be effective by reason of a subsequent order or a final judgment of that court or by an order issued by another court or [Office of the General Counsel of the Secretary of State], and the filing office receives a

certified copy of the subsequent judgment or order, the termination statement shall become immediately effective upon receipt of the certified copy and the filing office shall promptly file an amendment to the financing statement indicating that the termination statement is effective.

(h) If the [Office of the General Counsel of the Secretary of State] determines in an expedited administrative review initiated under subsection (f)(1), or if a court determines in an action brought pursuant to subsection (f)(2), that the financing statement was filed by a person entitled to do so under Section 9-509(a) and the filing office receives a certified copy of the administrative determination or court's final judgment or order before the termination statement takes effect, the termination statement shall not take effect and the filing office shall remove the termination statement and any amendments filed under subsection (g) from the files. If the filing office receives the certified copy after the termination statement takes effect and within 30 days after the final judgment or order was entered, the filing office shall promptly file an amendment to the financing statement that indicates that the financing statement has been reinstated.

(i) Except as provided in subsection (j), upon the filing of an amendment reinstating a financing statement under subsection (h) the effectiveness of the financing statement is retroactively reinstated and the financing statement shall be considered never to have been ineffective against all persons and for all purposes.

(j) A financing statement whose effectiveness was terminated under subsection (d) and has been reinstated under subsection (h) shall not be effective as against a person that purchased the collateral in good faith between the time the termination statement was filed and the time of the filing of the amendment reinstating the financing statement, to the extent that the person gave new value in reliance on the termination statement.

(k) (1) A person who violates subsection (a) shall be civilly liable to an injured qualified person for:

(A) actual damages caused by the violation;

(B) reasonable attorney fees;

(C) exemplary damages in an amount determined by the court.

(2) Civil damages under paragraph (1) are in addition to any recovery to which the qualified person is entitled under Section 9-625, or under law other than this Article, and criminal penalties under 720 ilcs 5/16h-32 may also apply.

(l) Neither the filing office nor any of its employees shall be subject to liability for the termination or amendment of a financing statement in the lawful performance of the duties of the office under this section.

(m) A person may not file an affidavit under this section with respect to a financing statement filed by a financial institution or a representative of a financial institution, as defined in subsection (o).

(n) In this section, the term "qualified person" means an individual who, at the time the financing statement referred to in subsection (b) was filed or within five years prior to the time of filing, was:

(1) an elected or appointed official of this State or a governmental unit of this State as defined in 9-102(a)(45);

(2) an officer or employee of a federal, state, or local judicial or prosecutorial office;

(3) an officer or employee of a federal, state, or local law enforcement office, including a correctional officer or employee; or

(4) an officer or employee of an office designated in Section 9-501 as a place to file a financing statement.

(o) In this section, the term "financial institution" means a person that is (1) in the business of extending credit and servicing loans, including acquiring, purchasing, selling, brokering, or other extensions of credit; and (2) where applicable, holds whatever license, charter, or registration required to engage in such business. The term includes banks, savings banks, savings associations, building and loan associations, credit unions, consumer and commercial finance companies, industrial banks, industrial loan companies, insurance companies, investment companies, installment sellers, mortgage servicers, sales finance companies, and leasing companies.

Section 9-516A is added to read:

9-516A. Administrative rejection of unauthorized records.

(a) Upon approval of the [Office of the General Counsel of the Secretary of State], a filing office may refuse to accept a record communicated for filing under this article if it is evident from the contents of the record, including the described collateral, or from information in a record accompanying the record communicated for filing, that the person filing the record is not authorized to do so under Sections 9-509 or 9-708.

(b) If a filing office refuses to accept a record pursuant to subsection (a), it shall immediately inform the person attempting to file the record and all persons identified on the record as secured parties that the record has not been accepted, and may request additional documentation supporting the filing. The [Office of the General Counsel of the Secretary of State] shall review all documentation received pursuant to a request under this subsection, and if it concludes that the record is authorized under Sections 9-509 or 9-708, it shall direct the filing office to promptly accept the record.

(c) A person indicated as secured party of record on a financing statement that is refused pursuant to subdivision (a) may request from the [Office of the General Counsel of the Secretary of State] an expedited administrative review of the decision to refuse filing.

(d) A person indicated as secured party of record on a financing statement refused filing pursuant to subsection (a) may bring an action against the Secretary of State seeking a determination that the financing statement was filed by a person entitled to do so under Section 9-509(a) and was authorized. An action under this subsection shall have priority on the court's calendar and shall proceed by expedited hearing. If the individual who filed the affidavit resides in this State, the exclusive venue in this state for the action shall be in the circuit court for the county where the individual principally resides in this state. If the individual who filed the affidavit does not reside in this State, the exclusive venue in this state shall be in the circuit court for the county where the filing office in which the financing statement was filed is located.

(e) If the Office of the General Counsel of the Secretary of State determines in an expedited administrative review initiated under subsection (c), or if a court determines in an action brought pursuant to subsection (d), that a rejected record was filed by a person entitled to do so under Section 9-509(a) and should have been accepted for filing, upon receipt of a certified copy of that determination the filing office shall promptly file the record. Upon the filing of a record improperly refused under subdivision (a), the record shall be treated as if it had been filed and effective as of the date originally submitted, except against a person that purchased the collateral in good faith between the date the record was rejected for filing and the subsequent actual date of the filing, to the extent that the person gave new value in reliance on the absence of the record from the files.

Section 9-520 is amended to read:

SECTION 9-520. ACCEPTANCE AND REFUSAL TO ACCEPT RECORD.

(a) **[Mandatory refusal to accept record.]** A filing office shall refuse to accept a record for filing for a reason set forth in Section 9-516(b) and may refuse to accept a record for filing only for a reason set forth in Section 9-516(b) or 9-516A.

(b) **[Communication concerning refusal.]** If a filing office refuses to accept a record for filing, it shall communicate to the person that presented the record the fact of and reason for the refusal and the date and time the record would have been filed had the filing office accepted it. The communication must be made at the time and in the manner prescribed by filing-office rule but [, in the case of a filing office described in Section 9-501(a)(2),] in no event more than two business days after the filing office receives the record.

(c) **[When filed financing statement effective.]** A filed financing statement satisfying Section 9-502(a) and (b) is effective, even if the filing office is required to refuse to accept it for filing under subsection (a) or refuses to accept for filing for a reason set forth in Section 9-516A. However, Section 9-338 applies to a filed financing statement providing information described in

Section 9-516(b)(5) which is incorrect at the time the financing statement is filed.

(d) **[Separate application to multiple debtors.]** If a record communicated to a filing office provides information that relates to more than one debtor, this part applies as to each debtor separately.

BARNES & THORNBURG LLP

MEMORANDUM

TO: All Members of the UCC Committee

FROM: Patrick E. Mears

DATE: January 18, 2012

Enclosed for your review and consideration please find the following items:

1. *EA Management v JP Morgan Chase Bank, N.A.*, 655 F.3d 573 (6th Cir. 2011), in which the Sixth Circuit permitted a depository bank to stop payment on third-party checks deposited to a customer's account at the drawer's direction and reverse a provisional credit granted by that bank to its customer. Because the provisional credit was used by the customer to purchase cashier's checks from the depository bank, the bank properly stopped payment on the two cashier's checks on the grounds that consideration for their issuance was lacking.

2. *Abtrex Industries, Inc. v National City Bank*, 2011 WL 3648240, 75 U.C.C. Rep. Serv. 2d 340 (E.D. Mich. 2011), where a bank customer commenced a civil action against the bank on account of the bank's denial of the customer's request to credit its account for funds embezzled by the customer's office manager. Of 25 checks that had forged signatures, the customer could only recover under Article 4 of the UCC funds represented by five of these checks. These five checks appeared on the bank statements sent to the customer within one year of the customer's report to the bank of the forged signatures. The remaining 20 checks were reported on earlier statements and, therefore, the funds evidenced by those checks could not be recovered by the customer.

3. A copy of the Winter 2011 issue of the Commercial Law Newsletter published jointly by the Commercial Finance and UCC Committees of the American Bar Association. Please take note of the two recent Michigan decisions cited in the article entitled "Enforcing the Commercial Guaranty Agreement": (i) *Flathead-Michigan I, LLC v Peninsula Development, L.L.C.*, 2011 WL 940048 (E.D. Mich. March 16, 2011), and (ii) *Comerica Bank v Cohen*, 291 Mich. App. 40 (2010).

4. An article entitled *The Revised Article 9 Filing System: Did It Meet Its Objectives*, published in Volume 44, No. 1 of the UCC Law Journal (2011) by our own Darrell W. Pierce of Dykema Gossett, LLC.

655 F.3d 573, 75 UCC Rep.Serv.2d 370
(Cite as: 655 F.3d 573)

H

United States Court of Appeals,
Sixth Circuit.
EA MANAGEMENT; William Elias,
Plaintiffs–Appellants,
v.
JP MORGAN CHASE BANK, N.A., Defendant–Appellee.

No. 09–2464.
Argued: Dec. 3, 2010.
Decided and Filed: Aug. 26, 2011.

Background: Presenter filed diversity action against bank alleging wrongful refusal to honor cashier's checks. Bank removed action. The United States District Court for the Eastern District of Michigan, Avern Cohn, J., 2008 WL 4534173, granted summary judgment to bank. Plaintiff appealed.

Holdings: The Court of Appeals, Kethledge, Circuit Judge, held that:
(1) defense of lack of consideration was available to bank;
(2) plaintiff was not entitled to enforce checks;
(3) damages did not result from bank's alleged wrongful refusal;
(4) bank did not breach account agreement; and
(5) bank did not breach alleged "duty to conduct itself reasonably in banking transactions."

Affirmed.

West Headnotes

[1] Banks and Banking 52 ⚿139

52 Banks and Banking
52III Functions and Dealings
52III(C) Deposits
52k137 Payment of Checks
52k139 k. Notice not to pay or revocation of check. Most Cited Cases

Banks and Banking 52 ⚿189

52 Banks and Banking
52III Functions and Dealings
52III(F) Exchange, Money, Securities, and Investments
52k189 k. Issue and payment of drafts. Most Cited Cases

Payor bank was within its rights and its obligations under Michigan law in complying with its customer's order to stop payment on checks deposited the day before by customer's former employee, who also had account there, and since bank did not get paid for those checks in its capacity as depository bank, when bank dishonored cashier's checks that it had issued to employee, lack of consideration was defense against employee's claim against bank as drawer of the checks and against employee's contract claim. M.C.L.A. §§ 440.3102(1), 440.3104 (3, 6), 440.3305, 440.4105(b, c), 440.4403(1, 3).

[2] Contracts 95 ⚿328(1)

95 Contracts
95VI Actions for Breach
95k328 Defenses
95k328(1) k. In general. Most Cited Cases

Lack of consideration is a defense to a contract claim under Michigan law. MCR 2.111(F)(3)(a).

[3] Banks and Banking 52 ⚿189

52 Banks and Banking
52III Functions and Dealings
52III(F) Exchange, Money, Securities, and Investments
52k189 k. Issue and payment of drafts. Most Cited Cases

Presenter of cashier's checks made out to other entities was not holder of instrument, nonholder in possession of instrument with rights of holder, or person otherwise entitled to enforce instrument, as required to be entitled to enforce cashier's checks under Michigan law. M.C.L.A. §§ 440.3301,

440.3411(2), 440.3412.

[4] Banks and Banking 52 ⚿189

52 Banks and Banking
52III Functions and Dealings
52III(F) Exchange, Money, Securities, and Investments
52k189 k. Issue and payment of drafts. Most Cited Cases

Customer did not suffer any damages as result of bank's alleged wrongful refusal to pay cashier's checks under Michigan law, where bank credited same amount of sum of cashier's checks two months after it refused to pay on those cashier's checks.

[5] Banks and Banking 52 ⚿139

52 Banks and Banking
52III Functions and Dealings
52III(C) Deposits
52k137 Payment of Checks
52k139 k. Notice not to pay or revocation of check. Most Cited Cases

Bank did not breach alleged "duty to conduct itself reasonably in banking transactions" under Michigan law by not complying with timely stop-payment order from another customer with respect to checks presented by customer and drawn on that other customer's account.

***574 ARGUED:** Jamie K. Warrow, Neuman Anderson, P.C., Southfield, Michigan, for Appellants. Jason P. Klingensmith, Dickinson Wright PLLC, Detroit, Michigan, for Appellee. **ON BRIEF:** Jamie K. Warrow, Leif K. Anderson, Kenneth F. Neuman, Neuman Anderson, P.C., Southfield, Michigan, for Appellants. Jason P. Klingensmith, Toby A. White, Dickinson Wright PLLC, Detroit, Michigan, for Appellee.

Before: MARTIN, GIBBONS, and KETHLEDGE, Circuit Judges.

OPINION

KETHLEDGE, Circuit Judge.

William Elias sued JP Morgan Chase Bank after Chase refused to honor three cashier's checks that Chase thought Elias had obtained by fraud. The district court granted summary judgment to Chase as to all of Elias's claims, finding among other things that Chase had reason to believe that Elias actually did commit fraud. Elias argues before us that the question whether he committed fraud is "disputed." We conclude that, under the Uniform Commercial Code as enacted in Michigan, Chase's actions were lawful even absent any finding of fraud. So we affirm.

I.

In 2005, Elias worked with Direct Lending, a Michigan lender and broker in the subprime-mortgage business. In that capacity, he had signatory authority for Direct Lending's bank accounts at Chase. Direct Lending revoked that authority in September 2006, which is when Elias left the company. Elias alleges that he was part owner of Direct Lending and that the company agreed to buy out his interest for $600,000. Direct Lending responds that it agreed to pay Elias an unspecified amount in severance, but that he owned no interest in the company. Either way, in October 2005 Direct Lending issued Check No. 2253 for $100,000 to EA Management, an assumed name used by Elias. He deposited the check into his account at LaSalle Bank, but the check bounced on October 4, 2006. LaSalle debited Elias's account $100,000 for the dishonored check and $5 as a returned-check fee, for a total of $100,005.

On October 9, 2006, Direct Lending issued Check No. 2275 in the amount of $100,005 to EA Management. The parties dispute whether this check was issued as a replacement for No. 2253; the check's amount strongly suggests it was, but Elias insists it was not—making this the first of several remarkable coincidences under his view of the facts of this case. For the most part we are constrained to accept his view for purposes of this ap-

peal. After receiving Check No. 2275, Elias opened a new account at Chase, deposited the check into it, and immediately withdrew $88,000.

Almost three months later—on December 26, 2006, at 5:53 p.m.—Elias visited a Chase branch in Canton, Michigan. There he deposited two instruments. The first was Check No. 2253—the same check that had bounced more than two months before. The second was a starter check (No. 99993), which Elias had signed and made out to himself in the amount of $80,000. That check was dated five months earlier, *i.e.,* July 26, 2006—which, again coincidentally, was back when Elias had signing authority for Direct Lending's accounts. Elias says he forgot about the check for five months after he wrote it. Another explanation—the one advanced by Chase—is that Elias made out the check on or around December 26 and backdated it to the same date in July. That explanation gains traction from the undisputed fact that the *preceding* check in the starter registry—No. 99992—was dated August 11, 2006, which is more than two weeks *after* Check No. 99993 was dated. But ***575** again we are constrained to accept Elias's story on this point.

Prior to these deposits, Elias's balance with Chase was $12,005. With them—assuming the checks cleared—his balance would rise to $192,005. Elias sought to withdraw $190,000 from his account on the spot, but the bank refused.

Later that night, someone shifted funds between several of Direct Lending's accounts with Chase. The apparent result of those transfers was that the accounts on which Check No. 2253 and the starter check were drawn, respectively, had sufficient funds to cover them. Although the fact of the transfers is not disputed, the identity of the person who shifted the funds is. Direct Lending says that person was Elias. Elias himself says nothing about the subject—making this, at best, the Mount Everest of coincidences in this case.

In any event, at 9:30 the next morning, Elias went to a different Chase branch—in Livonia—and asked for three cashier's checks totaling $191,251.31. This time he received them, likely because of the account transfers the night before. At Elias's request, two of the cashier's checks were made payable to third parties, Green Tree and Mortgage Service Center, to pay off mortgages on Elias's home. Those two checks totaled $121,251.31. The remaining $70,000 cashier's check was payable to Elias himself.

Hours later, Direct Lending's treasurer, Tina Shukeireh, discovered that "there had been several transfers done [between Direct Lending's accounts], early in the morning[.]" She testified that she "had not done" those transfers. Shukeireh also noticed that Elias had deposited Check No. 2253 and the starter check for payment. She immediately notified Chase that Elias was not authorized to sign or cash either check, and that the overnight transfers between Direct Lending's accounts were fraudulent. Shukeireh also ordered Chase to stop payment on both checks. Chase complied with that order.

Chase then unwound its transactions with Elias. First, it debited $180,000 (the total for both of the checks he had deposited) from Elias's account and credited that same amount to Direct Lending's account. That left Elias's account with an negative balance of $179,298.31. Second, Chase dishonored all three cashier's checks.

Elias's own bank statement shows that on February 28, 2007, Chase credited Elias's account in the amount of $191,251.31. (More on that below.) That same date, Elias withdrew the remaining funds and closed his account at Chase.

On March 6, 2007, Elias sued Chase in Wayne County, Michigan, alleging that Chase had wrongfully dishonored the three cashier's checks, causing him damages exceeding $191,251.31. Chase removed the action to federal court and thereafter moved to dismiss Elias's claims. The district court granted the motion. This appeal followed.

II.

[1] We review the district court's dismissal of Elias's claims de novo. *See Max Arnold & Sons, LLC v. W.L. Hailey & Co.*, 452 F.3d 494, 503–04 (6th Cir.2006). For the most part, Elias argues that the district court decided a genuine issue of material fact—namely, whether Elias obtained the cashier's checks by fraud—when it dismissed his claims. But we can affirm on any basis supported by the record. *See Angel v. Kentucky*, 314 F.3d 262, 264 (6th Cir.2002). We choose to determine first whether there is a basis here for affirmance independent of fraud.

A.

Elias's complaint included a claim under the Uniform Commercial Code (UCC or ***576** Code) as enacted in Michigan. Elias has cited the wrong sections of the Code throughout this litigation, but his argument essentially is that Chase lacked authority to dishonor the three cashier's checks that it issued at Elias's request on December 27, 2006. So we proceed to analyze whether Chase's actions were lawful under the Code.

First, Chase was entirely within its rights—and indeed its obligations—when it complied with Direct Lending's order to stop payment on Check No. 2253 and the $80,000 starter check (the "deposited checks"). Chase was both the payor bank and the depository bank for these checks. *See* M.C.L. § 440.4105(b), (c). Direct Lending issued the stop-payment order to Chase (in its capacity as payor bank) on the morning after Elias had deposited the checks with Chase. Elias does not allege in his complaint that any of the events recited in M.C.L. § 440.4303(1) had occurred by that time, which for our purposes means that the stop-payment order was timely. Chase was therefore correct to comply with the order, and indeed could have been liable to Direct Lending if it had not. *See id.* § 440.4403(1), (3).

That Chase stopped payment on the deposited checks in its capacity as the payor bank means that it did not get paid for those checks in its capacity as the depository bank. And that in turn knocks the bottom out of Elias's claim that Chase was required to honor the cashier's checks. A cashier's check is a negotiable instrument. *See id.* § 440.3104(3), (6). Article 3 of the Code applies to negotiable instruments. *Id.* § 440.3102(1). Section 440.3305 —which is part of Article 3 as enacted in Michigan—provides that "the right to enforce the obligation of a party to pay an instrument is subject to [,]" among other things, "[a] defense of the obligor stated in another section of this article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract." *Id.* § 440.3305(1)(b). (Some holders in due course are not subject to those defenses, *see id.* § 440.3305(2); but Elias does even not allege that he is a holder in due course with respect to the cashier's checks.)

[2] Lack of consideration is a defense available to "[t]he drawer or maker of an instrument" under M.C.L. § 440.3303(2). Chase was the drawer of the cashier's checks, *see* M.C.L. § 440.3104(7); and § 440.3303(2) is part of the same "article" as § 440.3305(1)(b), which means the defense is available to Chase in this action, so long as Chase can prove it. Lack of consideration is also a defense to a contract claim under Michigan law. *See* M.C.R. 2.111(F)(3)(a); *Sherman v. DeMaria Bldg. Co.*, 203 Mich.App. 593, 513 N.W.2d 187, 191 (1994). And that defense would be available to Chase if Elias were seeking to enforce a simple contract here. When Elias deposited Check No. 2252 and the $80,000 starter check, Chase credited his account $180,000. Elias used that credit to purchase the cashier's checks on December 27, 2007. But Chase reversed the $180,000 credit after it stopped payment on the deposited checks. Elias does not argue that Chase's reversal of that credit was itself unlawful under the Code. And the fact of that reversal means that—as a matter of law—Chase was not paid for the $191,251.31 of cashier's checks that it issued at Elias's request. That in turn means that Chase's obligation to pay the cashier's checks was not supported by consideration, which finally

means that Elias cannot enforce that obligation here. *See* M.C.L. § 440.3305(1)(b).

[3] Two other points bear mention. The first is that Elias is not entitled to enforce two of the cashier's checks in the first place. A bank is liable for a cashier's ***577** check only to "a person entitled to enforce" the instrument. M.C.L. §§ 440.3412, .3411(2). A person is entitled to enforce an instrument if he is the holder of the instrument, a nonholder in possession of the instrument with the rights of a holder, or a person otherwise entitled to enforce the instrument under UCC sections 3–309 or 3–418. M.C.L. § 440.3301. Elias is none of these things with respect to the cashier's checks made out to Green Tree and Mortgage Service Center, respectively. That is another ground for affirming the district court's judgment with respect to those checks.

[4] The second point is that Elias has not suffered any damages as a result of Chase's refusal to pay the cashier's checks. As noted above, on February 28, 2007—two months after it refused to pay the cashier's checks—Chase credited $191,251.31 to Elias's account, which is the same amount, to the penny, of the sum of the cashier's checks. That credit restored Elias to the same position he was in when he walked through the doors of Chase's Livonia branch office on December 27. And that means Elias has no damages as a result of Chase's refusal to pay the cashier's checks, at least as measured by his December 27 transactions with Chase as a whole. What Elias seeks in this litigation, in short, is a windfall in the amount of $191,251.31, for which he has not provided Chase a penny of consideration. His claims are frivolous.

B.

Elias's lack of any damages also scythes down his common law claims. And we offer some additional reasons why those claims are meritless. Regarding his breach of contract claim, Elias contends that Chase breached his account agreement with him "by allowing Direct Lending to stop payment on the Cashier's Checks and by failing to hold the disputed funds in [Elias's] account." Elias Br. at 42. But Direct Lending did not stop payment on the *cashier's* checks; rather, it stopped payment on the *deposited* checks, on which Direct Lending was the putative drawer (putative, because Direct Lending says it was only a drawer by means of Elias's fraud). Suffice it to say that nothing in Elias's account agreement forbade Chase from complying with a timely stop-payment order from another customer with respect to checks drawn on that customer's account. Nor is there anything in Elias's agreement that obligated Chase to pay him $180,000 on the spot when he deposited Check No. 2253 and the starter check—particularly under the circumstances present here.

[5] Finally, Elias argues that he has a viable negligence claim because Chase breached its "duty to conduct itself reasonably in banking transactions." Elias Br. at 43. That claim is very likely "displaced by the UCC[,]" since it "relate[s] to the Bank's handling of the [cashier's] checks." *Donovan v. Bank of Am.*, 574 F.Supp.2d 192, 200 (D.Me.2008). And relatedly—for the reasons explained above—there is not a shred of evidence that Chase acted unreasonably with respect to its actions here. All of the relevant evidence, instead, is to the contrary.

The district court's judgment is affirmed.

C.A.6 (Mich.),2011.
EA Management v. JP Morgan Chase Bank, N.A.
655 F.3d 573, 75 UCC Rep.Serv.2d 370

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Slip Copy, 2011 WL 3648240 (E.D.Mich.), 75 UCC Rep.Serv.2d 340
(Cite as: 2011 WL 3648240 (E.D.Mich.))

C
Only the Westlaw citation is currently available.

United States District Court,
E.D. Michigan,
Southern Division.
ABTREX INDUSTRIES, INC., Plaintiff,
v.
NATIONAL CITY BANK, a subsidiary of PNC Bank, Defendant.
and
PNC Bank, N.A., successor by merger and f/k/a National City Bank, Third–Party Plaintiff,
v.
JP Morgan Chase Bank, N.A.; and WAchovia Bank, N.A., Third–Party Defendants.

No. 09–12540.
Aug. 18, 2011.

Craig W. Horn, Braun, Kendrick, Saginaw, MI, for Plaintiff.

Jennifer K. Green, William G. Asimakis, Jr., Clark Hill, Detroit, MI, for Defendant.

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANT PNC BANK'S MOTION FOR SUMMARY JUDGMENT

DENISE PAGE HOOD, District Judge.

I. INTRODUCTION

*1 This matter is before the Court on Defendant PNC Bank's Motion for Summary Judgment **[Docket No. 41, filed on January 13, 2011].** Plaintiff's filed a response on February 1, 2011 **[Docket No. 44, filed on February 1, 2011],** to which Defendant filed a reply on February 15, 2011.

II. STATEMENT OF FACTS

Plaintiff Abtrex Industries, Inc. ("Abtrex" or "Plaintiff"), a small business, opened a checking account around or about September 1, 1996 with Valley American Bank & Trust, which later became National City Bank and, following a merger in 2008, became PNC Bank ("PNC" or "Defendant"). The account listed the following individuals as authorized signers: Harold Byars, Keith Byars, David Graham, Kurt Byars, and Kevin Byars. *See* Signature Card, Ex. A to Def.'s Mot. for Summ. J.

In 2006, Plaintiff employed Christina Robbins ("Robbins") as office manager for Plaintiff's Indiana division. In this position, Robins had direct access to Plaintiff's checks and account information, as she was responsible for bookkeeping, making deposits to Plaintiff's accounts, and reviewing and reconciling Plaintiff's bank statements. Robbins was supervised by Keith Byars.

Between November 24, 2006, and October 8, 2008, Robbins wrote twenty-five checks to her personal creditors, Juniper and Homecomings, embezzling $291,713.81 from Plaintiff. In early 2009, while Robbins was purportedly out of the office on medical leave, Keith Byar's wife, Judy Byar's, came into the office to help with the finances. Judy Byars discovered that there were missing cancelled checks and bank statements. Plaintiff requested copies of the checks from what was then National City Bank, beginning on March 24, 2009. Plaintiff formally notified Defendant that it was disputing the forged checks in May of 2009, by signing affidavits of forgery. Defendant denied Plaintiff's request to credit the account at issue for the embezzled funds on the grounds that Plaintiff failed to timely report the unauthorized activity. This lawsuit ensued.

Defendant contends that Robbins was able to embezzle this money due to a lack of oversight. Although Keith Byars supervised her, he did not review reconciliations prepared by Robbins, or account statements sent by the bank. Defendant supports its argument of lack of oversight citing the embezzlement of approximately $70,000 by one of Plaintiff's previous office managers. Defendant also states that Plaintiff had a highly informal hiring

process, noting that, although Robbins warned Plaintiff that her previous employer might not provide a favorable reference, Defendant failed to follow up with the employer and so did not discover tRobbins had embezzled from that employer.

According to Defendant, Plaintiff's checking account was governed by a National City Business Account Agreement ("Account Agreement"), effective July 22, 2006. Under the agreement, customers, including Plaintiff, had an affirmative duty to review each account statement "to discovery any alterations; unauthorized signatures, Items, Entries or indorsements; unauthorized transactions; or errors...." Account Agreement, Ex. B. to Def.'s Mot. for Summ. J. at 10. Following such a discovery, the depositor (in this case, Plaintiff) must notify the bank of the issue in writing within fourteen days. *See id.* Plaintiff contends that it is not bound by the Account Agreement.

*2 Defendant brings this motion for summary judgment on the grounds that Plaintiff's claims fail under the Account Agreement, under Michigan law, and under the Uniform Commercial Code.

III. SUMMARY JUDGMENT STANDARD

Pursuant to Fed.R.Civ.P. 56(c), summary judgment may only be granted in cases where "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." The moving party bears the burden of showing no dispute as to any material issue. *Equal Employment Opportunity Comm'n v. MacMillan Bloedel Containers, Inc.*, 503 F.2d 1086, 1093 (6th Cir.1974). A dispute must be clear from the evidence in order to deny such a motion. Such a dispute must not merely rest upon the allegations or denials in the pleadings, but instead must be established by affidavits or other documentary evidence. Fed.R.Civ.P. 56(e). When ruling, the Court must consider the admissible evidence in the light most favorable to the non-moving party. *Sagan v. United States of Am.*, 342 F.3d 493, 497 (6th Cir.2003).

IV. ANALYSIS

A. Account Agreement

Defendant contends that Plaintiff's claims are barred as a matter of law by the express agreement of the parties. According to Defendant, Plaintiff was bound to the terms of the Account Agreement because it was and continued to be a customer of PNC Bank. Plaintiff argues that it was never a party to the Account Agreement. When Plaintiff opened up an account with Valley American Bank & Trust Co., a signature card was signed, binding Plaintiff "to the terms stated on this contract and disclosures received on this date." The Account Agreement purported to bind Plaintiff, states that "Depositor, by signing the signature card for the Account, by using the Account or by permitting an authorized signer to use the Account, agrees to the provisions of this Agreement which are subject to amendment and further agrees that this Agreement is binding on Depositor's successors, representatives and assigns." Account Agreement, Ex. B to Def.'s Mot. for Summ. J. at 1. By continued use of the account, Plaintiff was bound by the terms of the agreement.

According to the deposition testimony of Anna Patterson, a PNC employee with responsibility for training on bank policies for detecting fraud, and the employee who completed the internal investigation of Abtrex's claim against PNC, Defendant never determined whether a copy of the agreement had ever been forwarded to Plaintiff. Defendant argues that the testimony of Keith Byars belies any argument that Plaintiff did not receive a copy of the Account Agreement. In actuality, Keith Byars testified that "... nobody would have seen [the Account Agreement] but me, and I don't know if I actually looked at it or not if I did receive it." Dep. of Keith Byars, Ex. A to Def.'s Reply Brief. The question of whether Plaintiff ever had a copy of the Account Agreement and whether it should have been on notice of the terms and conditions within remains a question of fact for the trier of fact, rendering sum-

mary judgment on the issue inappropriate.

B. Michigan Uniform Commercial Code

1. Exercise of Ordinary Care by Defendant

*3 Defendant contends that Plaintiff's claims are also barred under the Michigan Uniform Commercial Code, M.C.L. § 440.4406. Pursuant to M.C.L. § 440.4406(3),

> If a bank sends or makes available a statement of account or items pursuant to subsection (1), the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.

In this case, Plaintiff does not dispute that account statements were made available to it. Plaintiff also does not argue that it exercised reasonable promptness. Instead, Plaintiff argues that the bank could only transfer funds out of the account upon request by an individual authorized on the signature card, and Robbins was not authorized to remove funds. Plaintiff further argues that, pursuant to M.C.L. § 440.3403, the fact that Robbins forged the signature of Keith Byars does not provide Defendant the necessary authorization to transfer the funds. M.C.L. § 440.3403 states *"unless otherwise provided* ... an unauthorized signature is ineffective *except* as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it for value .... [t]he civil or criminal liability of a person who makes an unauthorized signature is not affected by any provision of this article *which makes the unauthorized signature effective for the purposes of this article."* (emphasis added). These provisions indicate that the state legislature contemplated that the bank should not be held liable for forged signatures, accepted in good faith and not disputed by the account holder.

Plaintiff argues that Defendant's failure to exercise ordinary care in accepting the forged checks renders Defendant liable in the amount of the unauthorized funds. Pursuant to M.C.L. § 440.4406(5), if a "customer provides that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer ... and the bank" to the extent each contributed to the loss. Defendant argues that it is entitled to summary judgment, as Plaintiff cannot make a showing that Defendant failed to exercise ordinary care. In this case, ordinary care is defined as:

> observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage not disapproved by this article or article 4.
>
> *4 M.C.L. § 440.3103(g).

According to the deposition testimony of Anna Patterson, a PNC employee whose responsibilities include training bank employees on policies for detecting forged signatures, it was not bank policy to "physically examine every check that comes through." Dep. of Anna Patterson, Ex. K to Def.'s Mot. for Summ. J. at 35:20–22. The Michigan statute does not require examination of the check. M.C.L. § 440.3103(g). However, Defendant has not demonstrated that its internal policy does not vary from reasonable commercial standards. Defendant states that signatures are not manually reviewed, due to the computerized and automated process of handling checks. Plaintiff provides evidence of one

check processed by Defendant that contained no signature at all. Ex. A to Pl.'s Response to Def.'s Mot. for Summ. J. Defendant has not proffered evidence that reasonable commercial standards do not require any signature. Summary judgment is not appropriate on this issue, as there remains a genuine issue of fact for the trier of fact as to whether Defendant exercised "ordinary care."

2. Exercise of Ordinary Care by Plaintiff

Defendant argues that Plaintiff's failure to exercise ordinary care in its business operations caused the loss, and, therefore, Plaintiff is barred from recovery. M.C.L. § 440.3406(1) provides that:

> A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

Before determining whether Plaintiff exercised ordinary care, it must be resolved that Defendant acted in good faith. Having already found a genuine issue of material of fact as to whether Defendant exercised ordinary care, whether Plaintiff's own failure to exercise ordinary care, if any such failure existed, caused or contributed to the loss in this case remains a genuine question of material fact.

Defendant argues that a drawer who fails to adequately supervise an employee responsible for all banking duties substantially contributes to the forgeries. Defendant then argues that Robbins, who handled bank account statements, accounts payable and receivable, made deposits, and had responsibility for other banking duties, was not supervised, and the failure to supervise Robbins caused Plaintiff's loss. Plaintiff argues Robbins was never authorized to remove funds from the Abtrex bank account and it reasonably believed that Plaintiff would be notified if its corporate checks were cashed by consumer credit card or mortgage companies. Whether Robbins was adequately supervised, and whether any lack of supervision contributed to Plaintiff's loss is an issue of fact to be decided by the trier of fact.

3. Limitation on Liability

Plaintiff concedes that M.C.L. § 440.4406(6) limits its recovery, if any, to $92,274.22. This section provides that *"without regard to care or lack of care of either the customer or the bank,* a customer who does not within 1 year after the statement or items are made available to the customer discover and report his or her unauthorized signature ... is precluded from asserting against the bank the unauthorized signature or alteration." (emphasis added). In this case, Plaintiff reported the forgeries to the bank in May of 2009, limiting any possible recovery to checks appearing on Plaintiff's statements after May of 2008. After May 2008, there were five checks that appeared on the statements, totaling $92,274.22. As a matter of law, Defendant's liability, if any, is limited to the amount of $92,274.22.

C. Conversion

***5** Defendant argues Plaintiff's conversion claim must fail as a matter of law. "[F]unds deposited in a bank account are not specific and identifiable, in relation to the bank's other funds, to support a claim for conversion against the bank." *Fundacion Museo de Arte v. CBITDB Union Bancaire Privee,* 160 F.3d 146, 148 (2nd Cir.1998). Under M.C.L. § 440.3420(1)(i), "[a]n action for conversion of an instrument may not be brought be the issuer." Plaintiff argues that the Uniform Commercial Code recognizes that the drawer [or issuer] of an instrument has an adequate remedy against the bank for a credit to the account for unauthorized payment of the check. That an adequate remedy is available to a party who establishes liability exists does not negate the statutory rule that the issuer of an instrument cannot bring an action for conversion. *See* U.C.C. § 3–420(i) ("An action for conversion of an instrument may not be brought by the issuer or acceptor of the instrument."); *see also Pamar Enters. v. Huntington Banks,* 228 Mich.App. 727, 580

N.W.2d 11, 16 (Mich.Ct.App.1998) (The "drawer of the check may not maintain an action for conversion."). As the issuer of the check, Plaintiff is barred from suing for conversion as a matter of law, and summary judgment is proper as a matter of law.

V. CONCLUSION

Accordingly,

IT IS ORDERED that Defendant PNC Bank's Motion for Summary Judgment **[Docket No. 41, filed on January 13, 2011]** is GRANTED IN PART (limiting any liability to $92,274.22 and dismissing Plaintiff's conversion claim) and DENIED IN PART (on whether liability exists under the Account Agreement or state statute).

E.D.Mich.,2011.
Abtrex Industries, Inc. v. National City Bank
Slip Copy, 2011 WL 3648240 (E.D.Mich.), 75 UCC Rep.Serv.2d 340

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Commercial Law Newsletter

Joint Newsletter of the Commercial Finance and Uniform Commercial Code Committees

ABA American Bar Association Business Law Section

December 21, 2011

Winter 2011

IN THIS ISSUE

Joint Report from the Chairs

Greetings and best wishes for a happy and healthy holiday season. Our Committees have had a very successful 2011 with outstanding programs, CLE sessions, and subcommittee and task force meetings at our Spring, Annual, and Fall meetings. We thank everyone who participated in, and attended, those programs, sessions, and meetings.

We look forward to another successful year in 2012. For those of you who have not already registered, the 2012 Spring Meeting will be held at Caesars Palace in Las Vegas from March 22 through 24. Both the UCC and Commercial Finance Committees have an outstanding series of programs and subcommittee meetings for your education and enjoyment. Our collective programs are as follows:

1. Current State of Syndicated Loan Markets 2012 -- Thursday, March 22, 2012
2. Ethical Issues in Commercial Transactions -- Thursday, March 22, 2012
3. Let's Play Doctor: Acquisition and Financing of Healthcare Facilities -- Friday, March 23, 2012
4. Recent Developments in Security Interests in Proceeds of Collateral -- Friday, March 23, 2012
5. Commercial Law Developments -- Saturday, March 24, 2012
6. Variation of the UCC by Agreement -- Saturday, March 24, 2012

These will be outstanding programs and we encourage all to attend. We thank the Program Chairs and panelists for their hard work in putting these programs together.

Our UCC/ComFin joint dinner will be held on Thursday, March 22 at Piero's in Las Vegas. Tickets will be available soon on either the UCC or ComFin website, or the ABA Business Law Section website.

Our subcommittees and task forces continue to remain active and are always looking for new and interested volunteers. We continue to be interested in volunteers for our Legislative Enactment of Revised Article 9 Task Force, which is working to ensure the enactment of the recently proposed amendments to Article 9 in the fifty states, our Task Force on Survey of State Guaranty Laws, which will produce a fifty-state summary of the law of guarantees, our Model Intellectual Property Security Agreement Task Force, which will produce a "standard form" intellectual property security agreement, and our Commercial Finance Terms "wiki" Task Force. Please go to the UCC or ComFin website for more information on these task forces.

MARK YOUR CALENDARS

January 10, 2012 – 1:00 to 2:30 p.m. ET – UCC Article 9 Update – Preparing for Pending Changes to Filing and Search Procedures, Lender Due Diligence and More (CLE Webinar). Click here for more information.

January 17, 2012 – 1:00 to 2:30 p.m. ET – Commercial Real Estate Loan Guaranty Enforcement – Maximizing Lender Recovery Upon Borrower Default (CLE Webinar). Click here for more information.

January 19, 2012 – 1:00 to 2:30 p.m. ET – Mortgage Fraud: New Litigation Threats; Asserting and Defending Claims by FDIC and Other Federal and State Agencies (CLE Webinar). Click here for more information.

March 22-24, 2012 – Business Law Section Spring Meeting – Ceasars Palace in Las Vegas, Nevada. Please join us in Las Vegas this Spring for numerous CLE programs, committee, subcommittee and taskforce meetings and social networking events. Spring Meeting program details and registration and hotel information are available here!

August 2-7, 2012 – ABA Annual Meeting – Chicago Marriott Downtown in Chicago, Illinois. Save the date!

November 14, 2012 – Commercial Finance Committee and Uniform Commercial Code Committee Joint Meeting. – JW Marriot Desert Ridge in Phoenix, Arizona.

We continue to seek new members, and in particular new members who would like to become active in the work of our Committees. If you would like to give a speech, participate in panels, or become active in the work of a subcommittee or task force, please contact either Penny Christophorou (pchristophorou@cgsh.com) or Jim Schulwolf (jschulwolf@goodwin.com). There is plenty of work to be done and there are plenty of great people to meet and with whom to work.

Upcoming Meetings. We are looking forward to our participation in the 2012 Spring, Annual and Fall meetings. The ABA Annual Meeting is in Chicago this year from August 2 through August 5. Our joint UCC/ComFin Fall Meeting will take place on Wednesday, November 14 in Phoenix, Arizona, from 11:00 a.m. to 4:00 p.m. Hotel details will be available on the ABA Business Law Section website, and, as always, the meetings will be full of informative educational panels.

We look forward to seeing you in Las Vegas in March!

Jim Schulwolf
Commercial Finance Committee Chair

Penny Christophorou
UCC Committee Chair

Featured Notes

The Permanent Editorial Board for the Uniform Commercial Code issued its final Report on Application of the UCC to Selected Issues Relating to Mortgage Notes on November 14, 2011. The report can be found here.

Also for those of you looking for good pro bono/volunteer opportunities, the ABA Business Law Section and Junior Achievement are partnering to promote youth financial literacy. Business lawyers often witness firsthand the high cost of ignorance about personal finances. Volunteer yourself and your firm to provide personal finance instruction to high school students within the Junior Achievement program. Check here for more information about the Section's efforts.

Featured Articles

ENFORCING THE COMMERCIAL GUARANTY AGREEMENT

By Anthony J. Jacob, Aric T. Stienessen and Jeremy D. Duffy, Hinshaw & Culbertson LLP

Over the past few years, there has been increased litigation over the enforcement of commercial guaranties by lenders. As more borrowers default on their loan obligations, lenders have more frequently taken action against guarantors to recover damages due to a borrower's default. In response, guarantors have raised a variety of defenses.

This article starts with a summary of the basic terms of a commercial guaranty and the purposes for which it is used. This article then examines the topics frequently encountered when enforcing a commercial guaranty agreement and sets forth recent noteworthy cases on each topic.

Terms And Purposes Of A Commercial Guaranty

A guaranty is an agreement made by a third party, whether a person, trust or a business entity, to pay and/or perform the obligations of a debtor for the satisfaction of a debt owed to a creditor upon the occurrence of an event, typically a default by the debtor, under the original loan agreement. A guaranty, like any contract, requires mutual assent, adequate

VIEW CURRENT REPORTS AND DEVELOPMENTS OF THE ...

COMFIN SUBCOMMITTEES AND TASK FORCES

- Subcommittee on Agricultural and Agri-Business Financing
- Subcommittee on Aircraft Financing
- Subcommittee on Creditors' Rights
- Subcommittee on Cross-Border and Trade Financing
- Subcommittee on Intellectual Property Financing
- Subcommittee on Lender Liability
- Subcommittee on Loan Documentation
- Subcommittee on Loan Workouts
- Subcommittee on Maritime Financing
- Subcommittee on Real Estate Financing
- Subcommittee on Secured Lending
- Subcommittee on Syndications and Lender Relations
- ADR Task Force
- Model Intercreditor Agreement Task Force
- Surveys of State Commercial Laws

UCC SUBCOMMITTEES

- Subcommittee on Annual Survey
- Subcommittee on Article 7
- Subcommittee on Commercial Law Newsletter
- Subcommittee on General Provisions and Relations to Other Law
- Subcommittee on International Commercial Law
- Subcommittee on Investment Securities
- Subcommittee on Leasing
- Subcommittee on Letters of Credit
- Subcommittee on Membership
- Subcommittee on Payments
- Subcommittee on Sale of Goods
- Subcommittee on Secured Transactions

COMFIN AND UCC JOINT TASK FORCES

- Commercial Finance Terms Joint Task Force
- Deposit Account Control Agreements Joint Task Force
- Filing Office Operations and Search Logic Joint Task Force
- Legislative Enactment of Article 9
- Model IP Security Agreement Joint Task Force

consideration, definiteness and a meeting of the minds. Under most states' Statute of Frauds, a guaranty must be in writing, signed by the guarantor(s) and delivered to the creditor.

In the context of a loan transaction, a guaranty serves as a form of collateral to support the debt obligation between the debtor and the creditor. But, the guaranty and the loan agreement evidence separate obligations, and their independence is not affected by the fact that both agreements are written on the same instrument or are contemporaneously executed. The guaranty cannot exist without a primary debt obligation. Thus, if the primary debt obligation has been fully satisfied, is void or is illegal, a guaranty of the debt obligation can also be deemed unenforceable.

Types of Guaranties

By way of background, there are varying types of guaranties.

- An absolute guaranty provides that the guarantor promises to pay or perform the obligations of the debtor upon the occurrence of an event of default (typically debtor's default). If a guaranty does not contain words of limitation or conditions, it is typically construed as an absolute guaranty.

- A conditional guaranty requires the happening of some contingent event (other than the default of the debtor) or the performance of some act on the part of the creditor before the guarantor will be liable.

- A payment guaranty obligates the guarantor to pay the debt at maturity (which may arise due to an event of default). Upon the occurrence of a debtor's default, the guarantor's obligation becomes fixed and the creditor does not need to make a demand on the debtor.

- A collection guaranty is a guarantor's promise that if the creditor cannot collect the claim with due diligence, usually after suit (and exhaustion of remedies) against the debtor, the guarantor will pay the creditor.

- A performance guaranty obligates the guarantor to perform some obligation on behalf of the debtor for the benefit of the creditor.

- A continuing guaranty is a guaranty that is not limited to a single transaction but contemplates a future course of dealing which may encompass a series of transactions, may be for an indefinite period and/or may be intended to secure payment or performance of an overall debt of the debtor. As such, a continuing guaranty may include subsequent indebtedness without new consideration.

- A guaranty is a restricted guaranty when it is limited to a single or limited number of transactions, to a certain part of the debt obligation and/or to a certain period of time.

- A downstream guaranty is a guaranty by a parent corporation for the obligations of its subsidiary. In this scenario, a lender will look to the parent corporation to back up the debt of a subsidiary corporation due to the parent corporation's superior assets and financial condition.

- An upstream guaranty is a guaranty by a subsidiary corporation for the obligations of its parent corporation. Typically, a creditor will require an upstream guaranty when debtor's, *i.e.* the parent corporation's, only assets are the stock of a subsidiary, and the subsidiary owns assets used

- Survey of State Guaranty Laws

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as collateral to secure the credit obligations.

- A cross-stream guaranty is a guaranty among affiliated corporations, whose stock are both owned by the same parent.

Commercial Guaranty: Topics And Cases

A party's enforcement of a commercial guaranty, like any other contract, requires the analysis of basic contract principles. What sets a commercial guaranty apart from other contracts is that a commercial guaranty may lie dormant and unattended to by the parties until the occurrence of some subsequent, triggering event. At that time, which may be months or years after the commercial guaranty and the underlying debt documents were originally executed, the party seeking to enforce the guaranty then has to examine the terms of the guaranty, the status and condition of the guarantor and other facts and circumstances existing at the time of enforcement.

Whether a party is seeking to enforce a commercial guaranty or defend against its enforcement, the party needs to start by identifying the particular type of guaranty, the lien placed on the guarantor, whether the guaranty is properly secured and perfected (if intending to do so), the existence and integrity of the guarantor's assets and collateral used to guaranty of debt, and how best to foreclose upon the guarantor and take possession of the guarantor's assets. The following sections summarize a few of the topics and current cases a party may need to consider when enforcing a commercial guaranty.

Consideration

A guaranty without consideration is merely an unenforceable gratuitous promise. While some guaranties are founded on separate consideration than the original credit transaction, the guarantor need not receive a direct benefit for consideration to exist. The consideration usually consists of a benefit to the debtor or a detriment to the creditor.

In the case of *In re Kraft, LLC*, 429 B.R. 637 (Bankr. N.D. Ind. 2010), a bank lent money to a debtor in return for a mortgage and subject to promissory notes signed by individuals, but not by the debtor. The bank sought to foreclose under the mortgage and to collect money under the promissory notes against the debtor. The debtor argued that because the mortgage was given by an entity which did not execute any of the underlying notes, the mortgage is essentially a guaranty. Under Indiana law, if the guaranty is executed after the underlying debt obligation is incurred, there must be additional consideration given. Because no further consideration was given at the time the mortgage was executed and delivered in debtor's case, the mortgage (again arguably akin to a guaranty) is voidable.

In its opinion, the court provided a detailed explanation of the laws of guaranties in Indiana. A guaranty is an independent contract to assume the liability for the payment of a debt if the primary obligor defaults in performance or payment. If the obligor subsequently defaults, the guarantor becomes primarily liable on the debt, subject to the terms of the guaranty. A mortgage is different than a guaranty in that a mortgage is a lien which secures an underlying debt, and when the obligation is discharged, the mortgage has no function and is legally extinguished. While additional consideration is necessary for a guaranty that is executed after the primary obligation, a pre-existing debt or liability is sufficient consideration to support a mortgage given as security, and no additional consideration is needed.

In another case, *Brown v. Lawrenceville Properties, LLC*, 710 S.E.2d 682 (Ga. Ct. App. 2011), a debtor argued that the parties' various corrections to a lease term, which lease included a guaranty, amounted to a novation and therefore invalidated the guaranty. The court disagreed. The court stated that a novation requires four essential elements: (1) a previous valid obligation, (2) the agreement of all the parties to the new contract, (3) the extinguishment of the old contract, and (4) the validity of the new contract. In this case, the amendment and assignment of the lease was executed by the guarantor. The guaranty then was continued and extended to the assigned obligations. Therefore, a default on the

Committee and the ComFin Committee. Articles can survey the law nationally or locally, discuss particular UCC or Commercial Finance issues, or examine a specific case or statute. If you are interested in submitting an article, please contact one of the following Commercial Law Newsletter Editors Annette C. Moore, Carol Nulty Doody, Kelly L. Kopyt, Christina B. Rissler, or Rebecca Gelfand.

assigned obligation would require that the guarantor be responsible for such default pursuant to the guaranty agreement.

Joint and Several Liability

A guarantor of a debt obligation is liable upon a default, and the person to whom the guaranty is made is not required to first resort to recover from the primary obligor. A guarantor of a promissory note may be held jointly and severally liable with the primary obligor, although the extent of the guarantor's liability depends upon the terms of the guaranty agreement.

In *Wachovia Bank, National Ass'n v. Horizon Wholesale Foods, LLC*, No. 09-0072-KD-8, 2009 WL 3526662 (S.D. Ala. Oct. 23, 2009), the bank sought to enforce a loan default against the guarantors at the first instance. Three individuals executed unconditional guaranties. Each guaranty provided that it was a continuing and unconditional guaranty of the payment and performance and that the guarantor in each instance was jointly and severally liable with the debtor. The court enforced the guaranties against the guarantors finding the guarantors liable for the principal, interest, miscellaneous fees and attorneys' fees.

Release of Co-Guarantors

When two or more persons guarantee the debt of another, they simultaneously enter into an implied promise on the part of each to contribute his or her share if necessary to meet the common obligation between the co-guarantors. The discharge of one co-guarantor's direct liability to the creditor does not relieve him or her from liability to contribute to the other co-guarantors. In addition, the fact that a creditor sues only some of the co-guarantors, or recovers a judgment against fewer than all of them, does not excuse those not sued or not included in the judgment from paying their part of the joint debt. Accordingly, as a general rule, one or more of the co-guarantors against whom the judgment is recovered may, upon paying the creditor, compel contribution from all other co-guarantors. A creditor's release of one guarantor does not necessarily release the co-guarantors.

In *Lestorti v. DeLeo*, 4 A.3d 269 (Conn. Super. Ct. 2010), the case dealt with a guaranty agreement whereby the plaintiff, defendant, and Otto Paparazzo and OJP Development Corp. each agreed jointly and severally to guaranty the liability of Pond Place Development II to First Union National Bank under a note. The note was secured by a mortgage. Wachovia Bank, the successor to First Union National Bank, commenced a foreclosure action against Pond Place and the plaintiff and defendant under the terms of the guaranty agreement. The plaintiff and defendant were originally named defendants in the foreclosure action, but that action was dismissed as to the plaintiff for failure to make proper service upon him. The defendant was found liable for the deficiency judgment. The defendant later settled and paid the judgment with Wachovia Bank. Defendant then filed a counterclaim against the plaintiff for half of the judgment. The trial court granted the plaintiff's motion to strike the counterclaim. The defendant then appealed. The Appellate Court found that Wachovia Bank's failure to obtain personal jurisdiction over the plaintiff impaired the defendant's right to contribution from the plaintiff, and thus, the defendant was not entitled to reimbursement from the plaintiff for any amount.

The issue in the case was whether the defendant could recover any portion of the judgment from the plaintiff where the bank failed to properly assert personal jurisdiction over the plaintiff. Under Connecticut law, the right of contribution between co-guarantors is based on the theory of implied contract. A co-guarantor, however, is not entitled to contribution for any amount paid to the creditor toward the common debt. Rather, under Connecticut law, a guarantor's right of contribution from a co-guarantor arises only when the guarantor has paid in excess of his or her share of the entire obligation and the amount of contribution he or she is entitled to collect is limited to the amount paid in excess of his or her share of the entire obligation. The reason this principle of limitation exists in Connecticut is because a guarantor, as among co-guarantors, is a principal for the portion of the debt which he or she ought to pay and is a secondary obligor for the remainder of the debt. Therefore, when a co-guarantor makes a payment to the creditor in an amount that is less than his or her share of the whole outstanding obligation, the co-guarantor has no right to contribution from the other co-guarantors.

The court concluded that the defendant had a right of recourse and right of contribution from the plaintiff and that the bank's failure to obtain jurisdiction over the plaintiff did not impair the implied contract between the plaintiff and defendant as co-guarantors and the right of contribution between them. In addition, the bank's release of one guarantor did not impair or release the obligations of any other guarantor.

Impracticability/Frustration of Purpose

In *Twin Holdings of Delaware LLC v. CW Capital, LLC*, 906 N.Y.S.2d 784, 2010 WL 309022 (Sup. Ct. 2010) unpublished table decision, a guarantor claimed that the decline in the real estate market, a factor outside its control, made it more difficult to lease out space in its building. The guarantor also alleged that the financial crisis in the real estate market made it more difficult for the debtor and guarantor to refinance the loan. In another case, *Flathead-Michigan I, LLC v. Penninsula Development, L.L.C.*, No. 09-14043, 2011 WL 940048 (E.D. Mich. Mar. 16, 2011), a guarantor claimed that the economic fallout in 2008 frustrated the terms of the guaranteed obligations.

For similar reasons, the courts in both cases held that the guarantors were not excused from performance of the guaranteed obligations on the ground of impracticability or frustration of purpose. Both courts found that the guarantors were sophisticated entities with knowledge of the pertinent business industry and they were aware of the possibility of volatility in the financial markets.

Misrepresentation

A guarantor may make a claim of fraudulent inducement of an agreement in response to the enforcement of a guaranty agreement, but must show the following: (1) a misrepresentation of material fact by the creditor, (2) the creditor knew the statement was false at the time or made the assertion without regard to its falsity, (3) the creditor intended the guarantor to act, (4) that the guarantor reasonably relied upon the statement, (5) that the guarantor acted to its detriment, and (6) that the guarantor incurred actual damages.

Courts do not look favorably upon a guarantor's claim of misrepresentation, especially when the guaranty agreement is absolute and unconditional. *See 627 Acquisition Co. v. 627 Greenwich, LLC*, 927 N.Y.S.2d 23 (Sup. Ct. 2011); *Alerus Fin., N.A. v. Marcil Grp. Inc.*, No. 20110113, 2011 WL 4924152 (N.D. Oct. 18, 2011) to be published in N.W.2d; *Outsource Servs. Mgmt, LLC v. Ginsburg*, No. 08-5897 (DWF/FLN), 2010 WL 5088190 (D. Minn. Dec. 7 2010).

Lack of Notice to Guarantor

In certain instances, a creditor must provide the guarantor with notice of a default or triggering event under the primary debt obligation before seeking to enforce a guaranty agreement. However, the language of the guaranty is controlling in determining whether the creditor is under a duty to notify the guarantor of a default, and notice need not be given when the terms of the guaranty expressly dispense with the need for the notice.

In a Michigan Appellate Court case, *Comerica Bank v. Cohen*, 291 Mich. App. 40 (2010), the court found a guarantor to be liable for a portion of the guaranteed debt even though the creditor did not give timely notice of a default. The court held that a failure to give notice of the default or negligence in giving such notice, in a case where the guarantor is entitled to notice, does not of itself discharge the guarantor from liability and bar a recovery upon the guaranty. Essentially, there must be not only a want of notice within a reasonable time, but also some actual loss or damage thereby caused to the guarantor. If such loss or damage does not go to the whole amount of the guaranteed claim, but is only in part of the claim, the guarantor is discharged only *pro tanto.*

In another case, *Vision Bank v. 145, LLC.*, No. 10-00521-KD-B, 2011 WL 5289070 (S.D. Ala. Nov. 4, 2011), a debtor applied for a loan from a bank and an individual executed an unlimited continuing guaranty agreement in favor of the bank. In the guaranty, the individual expressly waived notices of every kind. The individual later executed a second unlimited individual guaranty and again, waived notices of every kind. The debtor failed to satisfy the promissory note by its maturity date. The bank mailed a notice of foreclosure and a copy of the foreclosure publication only to the debtor.

The guaranty agreement in this case did not require notice to the guarantor. In fact, the guaranty agreement stated that all notices were waived, including notice of presentment for payment, demand, default, and non-payment pertaining to the primary debt obligation and the guaranty. As such, the bank was able to enforce the guaranty.

KEY ELEMENTS OF THE REVISED MODEL CREDIT AGREEMENT PROVISIONS

By Jason Kyrwood, Rachel Kleinberg and Brian Radigan, DavisPolk

In August 2011, the Loan Syndications and Trading Association ("LSTA") through its Primary Market Committee ("PMC") published its revised Model Credit Agreement Provisions 2011 ("Revised MCAPs"). This represented the first major over-haul of the MCAPs since 2005, and followed a more than 12-month process of discussion by the PMC and consultation with the LSTA's membership. The Revised MCAPs have quickly become, with certain variations, standard market terms in many bank forms. In this note we review key elements of the Revised MCAPs.

Defaulting Lender Provisions

Although defaulting lender provisions are not new, the dramatic increase in bank failures (including Lehman) following the credit crisis focused the attention of market participants on the issue of defaulting lenders, and highlighted some of the weaknesses of typical defaulting lender provisions. The PMC sought to address those weaknesses in the Revised MCAPs. A key objective of that effort was to craft a set of provisions that were crisp enough to address with certainty issuing lenders', swingline lenders' and borrowers' exposure to defaulting lenders, but flexible enough to address issues that might arise in the bankruptcy or receivership of the defaulting lender (*e.g.*, the automatic stay).

Under the Revised MCAPs, a lender will be a defaulting lender if:

- it fails to fund borrowings or to meet its funding obligations to the administrative agent, issuing bank or swingline lender within two days of the date when due;
- it delivers a written notice to the borrower, the administrative agent or any issuing bank or swingline lender that it does not intend to comply with its funding obligations (or makes a public statement to that effect);
- it fails to confirm its intention to comply with its prospective funding obligations following written request by the administrative agent or the borrower (the "Failure to Confirm Limb"); or
- it or its parent becomes subject to any bankruptcy or receivership proceedings.

Note three things about the defaulting lender definition. First, a lender will not be a defaulting lender due to its failure to fund borrowings or its delivery of a notice of intent not to fund (or public statement to that effect) if it expressly states that such failure or notice is the result of its determination that one or more conditions precedent have not been satisfied (the so-called "Good Faith" exception). Second, the Failure to Confirm Limb is designed to be a useful self-help tool. For example, many earlier formulations would have rendered a lender a defaulting lender if it failed to satisfy its obligations under, or was a defaulting lender for the purpose of, other credit facilities. The PMC dropped that difficult-to-pin-down limb and took comfort that if there was any question of a lender's willingness to fulfill its prospective obligations, the Failure to Confirm Limb would offer the agent and the borrower a mechanism for clarifying that lender's status. Finally, the list of criteria for defaulting lenders is an objective one (rather than, as was the case in many prior formulations, one that is dependent on an agent and/or the borrower determination). However, to settle any uncertainty that might arise, the agent may determine that, applying the limbs referred to above, a lender is a defaulting lender, and such determination will be conclusive.

The consequences of becoming a defaulting lender have also been clarified and expanded. A defaulting lender may be replaced, its vote will not be counted with respect to majority vote items, and it will not be entitled to receive certain fees. Furthermore, any fronting exposure of a letter of credit issuer or swingline lender to a defaulting lender will, subject to satisfaction of normal borrowing conditions, be reallocated to non-defaulting lenders up to the amount of such non-defaulting lenders' unused commitments. To the extent that the letter of credit issuer or swingline lender has any fronting exposure to a defaulting lender following such reallocation, the borrower is required to repay (in the case of swingline loans) or cash collateralize (in the case of letters of credit) that exposure. Letters of credit need not be issued, and swingline loans need not be made, if after giving effect thereto there would be any remaining uncollateralized fronting exposure to a defaulting lender. It should be noted that there is a continuing debate about the extent to which the reallocation of exposure should be subject to conditions, and the market practice on this is not yet settled.

The Revised MCAPs also require that payments otherwise due to a defaulting lender be diverted to support the defaulting lenders' present and future funding obligations pursuant to a detailed waterfall. To address concerns that this might run afoul of various bankruptcy/receivership regimes, certain safety valves were included to ensure that the agent would not be required to apply amounts in accordance with the waterfall if that would be contrary to law, and to enable the agent to place an administrative hold on funds pending receipt of a court order.

Tax Provisions

The Revised MCAPs divides the universe of taxes into those imposed on payments, which are covered by the tax gross-up and tax indemnity, and those that are not, which are addressed instead by the increased costs provision. Thus, subject to various exclusions, typical withholding taxes are covered by the tax gross-up and tax indemnity, while bank taxes on a lender's capital or liabilities are covered by the increased costs provision.

Scope of the Tax Gross-up and Tax Indemnity

Consistent with prior versions of the MCAPs, certain taxes are excluded from the tax gross-up and tax indemnity. Some of the exclusions did not change; others are new to, or have been modified in, the Revised MCAPs.

The PMC broadened slightly the exclusion for net income taxes. As in the prior version, the Revised MCAPs excludes net income taxes, franchise taxes and branch profits taxes, but rather than merely excluding such taxes to the extent they are imposed by the

jurisdiction of the lender, the lender's principal office or the lending office, the Revised MCAPs excludes such taxes to the extent they result from any connection between the lender and the taxing jurisdiction.

The PMC also excluded taxes imposed under the recently enacted FATCA regime, under which a U.S. withholding tax will be imposed on interest and gross proceeds paid to certain foreign entities that fail to comply with new U.S. tax reporting requirements. For purposes of this exclusion, FATCA is limited to the statutory provisions as of the date of the agreement or any amended or successor version that is "substantively comparable and not materially more onerous to comply with" and any current or future regulations or official interpretations thereof. Thus, the LSTA struck a balance between protecting borrowers in the event of minor future amendments and protecting lenders from an unknown, potentially onerous modification to the statute.

The Revised MCAPs now allow a participant to receive a greater payment under the tax gross-up and tax indemnity than the participating lender would have received, provided that the additional tax is due to a change in law that occurred after the participant acquired its participation interest. The revised tax sections also acknowledge that the administrative agent, rather than the borrower, will often be the withholding agent, and include more extensive tax forms provisions.

Increased Costs

One of the most significant tax changes to the Revised MCAPs, the new increased costs provision, was drafted with an eye to protecting lenders from the various proposed bank taxes. The PMC took the view that a newly imposed bank tax is similar to an increased cost resulting from a regulatory change and, therefore, should be similarly covered by the increased costs provision.

While the increased costs provision has some complicated cross-references, essentially the provision covers taxes that (i) are not imposed on payments and (ii) are not net income or franchise taxes imposed because of a lender's connection with the taxing jurisdiction.

Participation Register

Also new to the Revised MCAPs is the inclusion of a participation register. Non-U.S. lenders that are not in treaty jurisdictions or engaged in a U.S. trade or business rely on the "portfolio interest" exemption to receive interest without U.S. withholding tax; this exemption requires that the debt be in registered form for U.S. federal tax purposes. For this reason, it has long been market practice for the administrative agent to maintain a register of assignments.

More recently, parties to credit agreements have been concerned that a register may also be required for participations on the theory that participations may represent beneficial ownership in the underlying loan for U.S. federal tax purposes. The Revised MCAPs requires lenders to maintain a register of their participations. Because lenders are typically reluctant to reveal the identity of participants, the provision only requires lenders to disclose the information contained in the register when necessary to establish that the loan is in registered form.

Lender Tax Indemnity

The Revised MCAPs also requires each lender to indemnify the administrative agent for taxes attributable to the lender or taxes attributable to the lender's failure to maintain a participation register.

Other Provisions

The PMC also made certain modifications in the Revised MCAPs designed to update the form for recent regulatory developments and market trends. The increased cost protections provided to lenders now expressly include Basel III and Dodd-Frank, to address uncertainties regarding implementation and timeline of those new regulations and standards. In response to cases like *Clear Channel* and *Hexion*, and consistent with now standard market practice, the borrower's submission to jurisdiction has been modified to be exclusive (typically New York). The indemnification provisions were modified to ensure that the lenders' obligation to indemnify the agent in connection with suits by lenders was clear, in part driven by arguments raised in the *Harbinger* case. Other provisions, such as agency, assignment and electronic communications, have also been augmented and modernized, including by adding a mechanism in the agency provision for the removal of an agent that has become subject to bankruptcy or receivership proceedings (addressing a challenge many faced following the Lehman bankruptcy).

FIXATED ON FIXTURES: AN OVERVIEW OF PERFECTING AND ENSURING PRIORITY OF SECURITY INTERESTS IN FIXTURES

By Brennan Posner, Sutherland Asbill & Brennan LLP

More than half a century after the Uniform Commercial Code ("UCC") was first adopted, courts, creditors, attorneys and scholars still find themselves puzzling over what constitutes a "fixture." How to define "fixture" has been analyzed extensively and is only summarized briefly here.[1] The goal of this article is not to add to that discourse, but instead to provide a foundation for creditors and practitioners to determine how best to protect their or their clients' interests when confronted with collateral that may consist of fixtures. This article begins with an overview of how fixtures are defined—or, perhaps more appropriately, are undefined—under the UCC and state law. It then summarizes the methods to perfect a security interest in fixtures and the special rules that apply if the debtor is a "transmitting utility." The article continues with a description of the priority rules contained in Section 9-334 of the UCC, and concludes with practical advice for protecting the priority of security interests in fixture collateral.

I. What is a "fixture"?

Fixtures are defined in Article 9 of the UCC to include "goods that have become so related to particular real property that an interest in them arises under real property law."[2] "Goods" is a broad category of property under the UCC that includes "all things that are movable when a security interest attaches.[3] Since state law governs whether or not a real property interest may arise in a particular piece of property, the UCC definition of "fixture" is not a definition so much as it is a nod to the real property law of each state to determine if a "good" constitutes a fixture. Most states have looked to the factors established by the Supreme Court of Ohio in *Teaff v. Hewitt* to determine whether or not a good is a fixture. Those factors include the following: (1) whether the good is attached to the real property, (2) whether the good has been adapted for the use of the real property, and (3) whether the party making the annexation intended the good to be permanently attached to the real property.[4] Of those factors, intent is regarded as the most important, and must be evidenced by some objective manifestation so as to put third-parties on notice.[5] Courts often look for evidence of intent in how firmly the goods are attached to the real property and how difficult it would be to detach and remove them.[6]

Under the "half-inch formula" proposed by Professors White and Summers, "anything which could be moved more than a half inch by one blow with a hammer weighing not more than five pounds and swung by a man weighing not more than 250 pounds would not be a fixture."[7] Unfortunately, the line between fixture and non-fixture is no more certain than the amusing image presented by this analogy. Since the UCC defers to state real property law to define fixtures, what may or may not be a fixture is not uniform amongst the states. Moreover, because the attachment of the goods and their adaptation for the use of the real property are considered together with, and may be overridden by, the intent of the annexing party, it is difficult to predict whether or not a good is or may become a fixture based on the characteristics of the good alone. A sampling of case law illustrates this predicament. Examples of property that have been determined not to constitute fixtures include a machine weighing 45,000 pounds, measuring approximately 10.5 feet wide by 8 feet long, anchored in place by two or three leg screws on each side, and connected to a 220 volt electrical line;[8] a five bedroom house constructed by the lessee of land;[9] a grain bin measuring 30 feet in diameter with a 14,000-bushell capacity which was bolted to a concrete slab;[10] and a modular building used as a drive-through fast-food restaurant.[11] On the contrary, a court determined that a *mobile* home was a fixture where "[t]he bankrupt's actual intention pointed definitely toward affixing the mobile home to the land as a permanent residence, as seen in his application for a building permit (which, by law, required him to erect a concrete slab as a permanent foundation within one year), his purchase of a homeowner's insurance policy, and his requests made to the seller to have the wheels of the home removed."[12] In attempting to determine whether or not collateral consists of goods that are or may become fixtures, the best a creditor can do is make an educated guess.

II. Perfecting a Security Interest in Fixtures

Section 9-334 of the UCC provides that a security interest under Article 9 "may be created in goods that are fixtures or may continue in goods that become fixtures."[13] There are three principal methods to perfect a security interest in goods that are fixtures. A creditor may file a financing statement with the applicable Secretary of State or such other office where it would normally file a financing statement covering personal property.[14] Alternatively, the creditor may file a "fixture filing" in the local office where it would normally record a mortgage to encumber the related real property.[15] A fixture filing contains the same contents as a personal property filing, and in addition it must also (i) specify that the collateral includes fixtures, (ii) indicate that it is to be filed in the real property records, (iii) provide a description of the related real property (a complete and recordable description is not necessary, but advisable), and (iv) provide the name of the record owner if the debtor does not have an interest of record.[16] The third method, available in most jurisdictions, is to record a record of mortgage in the real property records that identifies the goods that it covers and meets the requirements of a fixture filing.[17] In practice, however, a lender that obtains a real estate mortgage that covers fixtures will typically still file a separate fixture filing.

Each of the foregoing methods will result in the creditor having a perfected security interest in the fixtures of the debtor covered by such filing or recording. However, there are two principal distinctions that result from the manner of perfection. First, the personal property filing and the fixture filing will both lapse after five years unless properly continued. A record of mortgage on the other hand will remain effective to perfect against fixtures until the mortgage is satisfied or expires by its own terms or state real property law.[18] Second, the personal property filing only gives protection against subsequent (and sometimes prior) personal property filings, subsequent (and sometimes prior) lien creditors, and "certain other claimants where the fixture involved is not considered to be important to mortgagees and the like."[19] On the other hand, a fixture filing or record of mortgage may also provide protections against certain parties with interests in the real property to which the fixture is attached. These priority issues are examined in Part III below.

Special rules for perfecting security interests in fixtures are available to creditors when the debtor is a "transmitting utility." There is some variation among the states as to what constitutes a transmitting utility,[20] and very little case law on the issue, but generally the definitions include rail transportation operators, telecommunication operators, persons that transmit goods by sewer or pipeline or producers and transmitters of electric, gas, steam or water.[21] Most jurisdictions allow a creditor to perfect against a transmitting utility's fixtures by filing a financing statement in the same office where the creditor would file to perfect against personal property.[22] The obvious advantage is that a single filing supplants the multitude of fixture filings that may be required to perfect against all of a debtor's fixtures within a state. However, since the local law of the jurisdiction where the fixtures are located governs perfection of a security interest in goods by filing a fixture filing, [23] a central transmitting utility filing will be required in each state where goods that are or are to become fixtures are located. Another significant advantage of a transmitting utility filing is that, in most states, the filing remains effective until it is terminated.[24] The only requirements to obtain transmitting utility status for a financing statement are that the debtor must satisfy the definition of "transmitting utility" and the filing must indicate such status of the debtor.

III. Priority Issues

Among dueling creditors with security interests in the same fixture but without interests in the realty to which such fixture is attached, the normal rules in Article 9 governing the priority of competing claims to personal property apply. However, between the fixture creditor and an owner or encumbrancer of the real property to which a fixture is affixed, the priority of these competing interests begins at the "residual rule" that "a security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property other than the debtor."[25] Fortunately for the fixture creditor, this rule is subject to a number of exceptions. If the fixture creditor satisfies one or more of these exceptions, then its security interest may have priority over subsequent or prior (and in some cases both) interests in the related real property.

The first exception to the residual rule "contains the usual priority rule of conveyancing, that is, the first to file or record prevails."[26] In order for a fixture creditor to avail itself of the first to file exception, the following three criteria must be satisfied: (i) the debtor must have an interest of record in the real property or be in possession of it, (ii) the security interest must be perfected by a fixture filing before the interest of the encumbrancer or owner, and (iii) the security interest must have priority over an encumbrancer's or owner's predecessor in title.[27] This exception is where, in the priority context, the distinction between the fixture filing and the personal property filing first becomes apparent. The first to file exception only affords priority to the fixture creditor if its security interest is perfected by a fixture filing. As a result, unless another exception described below applies, a security interest in fixtures that is perfected by a personal property filing will be subordinate to a subsequent interest of an encumbrancer or owner of the related real property.

Another exception to the residual rule, which is also an exception to the first to file principle, applies to purchase-money security interests in fixtures. A purchase-money security interest (within the requirements of Section 9-103 of the UCC) that is perfected by a fixture filing before or within 20 days after the goods become fixtures will have priority over the interest of an owner or encumbrancer of real estate whose interest arises before the goods become fixtures.[28] This exception also requires that the debtor have an interest of record in the real property or be in possession of it so that the fixture filing will put third parties on notice of the purchase-money creditor's interest. Under the first to file exception, the purchase-money creditor may also have priority over interests in the related realty that arise after the fixture creditor perfects its interest.

A potential (albeit remote) trap awaits the unwary creditor that fails to appreciate the interplay of the first to file and the purchase-money exceptions to the residual rule. The first to file exception affords priority against competing claims that arise *after the fixture filing is filed*, but the purchase-money exception affords priority against claims arising *before the goods become fixtures*. Thus, absent another applicable exception, a purchase-money security interest that is perfected in the 20-day window after the goods become fixtures will be subordinate to an interest that arises after the goods become fixtures but before the purchase-money creditor perfects its interest.

The priority afforded to purchase-money fixture creditors is subject to an exception for the interest of a mortgagee under a construction mortgage. A construction mortgage is defined as a mortgage that "secures an obligation incurred for the construction of an improvement on land, including the acquisition cost of the land, if a recorded record of the mortgage so indicates."[29] A purchase-money security interest in fixtures is subordinate to a construction mortgage if a record of the mortgage is recorded before the goods become fixtures, and the goods become fixtures before the construction is completed.[30] A mortgage given to refinance a construction

mortgage will be afforded the same priority as the original mortgage.[31] The preference given to this class of mortgagees does not apply to the other exceptions to the residual rule. Thus, a fixture creditor may prevail over the interest under a construction mortgage if, for example, it is first to file in the real property records or, as discussed below, the fixture creditor is perfected in certain readily removable goods.

Priority is also provided to the fixture creditor in certain readily removable goods. White and Summers describe such goods as " 'non fixture' fixtures", and the drafters of the 1972 version of Article 9 classified them as "items that are 'fixtures' under state law [but] would never be relied upon by a mortgagee."[32] Goods that fall within this exception must be "readily removable" and constitute factory or office machines, equipment that is not primarily used or leased for use in the operation of the real property, or replacements of domestic appliances that are consumer goods.[33] A security interest in such goods may be perfected by any method permitted pursuant to Article 9, but must be perfected before the goods become fixtures. This rule is also an exception to the first to file principle, and affords priority over prior and subsequent owners or encumbrancers of the related realty.[34]

There are three other priority rules in Section 9-334 of the UCC that warrant mention. A security interest perfected by any method permitted by Article 9 will have priority of a later lien obtained by legal or equitable proceedings, including a trustee in bankruptcy.[35] Thus, a perfected security interest in fixtures may not be avoided by a trustee in bankruptcy under Section 554(a) of the Bankruptcy Code.[36] A security interest in a "manufactured home" obtained in a "manufactured home transaction" (each as defined in Article 9) that is perfected pursuant to a certificate of title statute has priority over prior and subsequent interests of encumbrancers and owners of the related real property.[37] Finally, perfected and unperfected security interests in fixtures have priority over an owner or encumbrancer of the related real property if the encumbrancer or owner, in an authenticated record, consents to the interest or disclaims an interest in the goods as fixtures, or if the debtor has a right to remove the goods as against the encumbrancer or owner.[38] Thus, a fixture creditor, regardless of whether its security is perfected, may rely on the debtor's right to remove a fixture to establish priority over the landlord of the debtor or such landlord's creditor.

IV. Conclusion: Belt-and-Suspenders Protection is Best

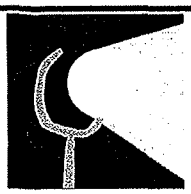
When collateral consists of goods that might be or become fixtures, "belt-and-suspenders" protections should be the creditor's guiding principle. A creditor cannot conclusively determine in many instances whether a good is or is not a fixture, and it cannot predict or prevent all circumstances under which that good might become a fixture. As a result, the creditor must analyze the competing claimants that exist in the case of non-fixture goods and in the case of fixtures, and take steps to protect itself in either result. Where collateral might be or becomes fixtures, it is generally advisable to file both a fixture filing and a personal property filing. Both filings will result in perfection in the fixtures, but without the personal property filing the creditor will likely be unperfected if the goods turn out not to be fixtures. Moreover, the fixture filing is required for the creditor to obtain first to file and purchase-money priority over owners and encumbrancers of the related real estate.[39] If the debtor may be a transmitting utility, it would be advisable to file a fixture filing in addition to the central transmitting utility filing so that the creditor will be protected if it is determined that the debtor is not a transmitting utility. In each instance, an unnecessary fixture filing is unlikely to impair the creditor's position, since "[c]ourts should not infer from a fixture filing that the secured party concedes that the goods are or will become fixtures."[40]

In addition to covering all of the bases for filing, the fixture creditor should consider existing real and personal property claimants and consider whether steps are necessary to obtain a subordination of those interests. In order to identify competing personal property interests, the creditor should obtain a lien search from the Secretary of State or other appropriate office in the jurisdiction where the debtor is "located."[41] Identifying parties with interests in the related real property could be more difficult. To identify owners of the real property, the creditor must either rely on information from the debtor or search the real property records where the subject collateral will be located. A local fixture filing search will be helpful in identifying mortgagees of the related real property, but these searches might omit a mortgagee that did not file a fixture filing separate from its mortgage. The extent to which a creditor should go to identify such interests will depend on the value and importance of the collateral.

Earlier owners and encumbrancers of real property will generally prevail over later creditors, so once such competing interests are identified the fixture creditor must consider how to protect its security interest against such parties. The creditor might seek to obtain subordination agreements from prior real and personal property claimants. The creditor should consider whether a lessor or mortgagee has already subordinated any interest in the debtor's fixtures by disclaiming an interest in the goods as fixtures in the lease or mortgage or providing therein that the debtor has a right to remove fixtures. If feasible, the creditor should include a clause in its loan agreement providing that the debtor agrees not to affix goods to any real property. Such a provision will help prove that the debtor did not intend for the goods to become fixtures if a court ends up analyzing the issue. The creditor should also consider whether it can prime such earlier interests through one or more of the priority rules set forth in Section 9-334 of the UCC. If it can, the creditor must study the rule carefully to ensure compliance with each discrete requirement.

In approaching fixtures, creditors must remember that "[p]erfection is not perfect; it gives the secured party the most that it can gain in a priority dispute but does not assure victory."[42] If a fixture creditor determines the most that it can gain before it extends credit, it will be in the best position to ensure that it realizes the benefit of its bargain if it must look to the collateral to be made whole.

UCC Spotlight



By Stephen L. Sepinuck and Kristen Adams

The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. 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 decisions.

In re Ruiz, 455 B.R. 745 (B.A.P. 10th Cir. 2011)

The Spring edition of this column heavily criticized the decision, currently on appeal, in *In re Mwangi*, 432 B.R. 812 (B.A.P. 9th Cir.. 2010). In that case, the court ruled that Wells Fargo Bank violated the automatic stay by refusing to release to the debtor funds on deposit that the debtor had claimed as exempt, even though the time for objecting to the claimed exemption had not yet expired. In making the ruling, the court repeatedly referred to the "account funds," as if they were a *res* at issue in the case, and ignored the true nature of a deposit account: merely the unsecured promise of the bank to repay the deposit. Well, Tenth Circuit BAP has now committed the same analytical error, but this time quite deliberately.

The case involved several checks that the individual debtors had written pre-petition but which the drawee bank honored post--petition. Instead of suing the payees under § 549 to recover unauthorized post-petition transfers, the trustee moved for an order under § 542 requiring the debtors to turn over the amount that had been on deposit on the date of the petition. The bankruptcy court denied the motion, concluding that the debtor's checking account was merely a debt owed by the bank to the debtors, and it was this receivable, rather than the funds themselves, that constituted property of the estate. The court then concluded that the debtors had no duty to collect on that promise for the benefit of the estate and that they had constructively turned over this property by disclosing it in their schedules. *See In re Ruiz*, 440 B.R. 197 (Bankr. D. Utah 2010). The trustee appealed.

The BAP began by acknowledging that the Supreme Court's language in *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995), supported the position of the debtors and the bankruptcy court. However, the BAP then noted that the context of that case – which involved whether freezing a deposit account violated the automatic stay's prohibition on setoff – was different, and thus the case was not dispositive. True, but that does not mean that the Supreme Court's observations about the nature of a deposit account were incorrect or irrelevant.

The BAP then stated that the debtors' relationship with their bank was "considerably different than the typical debtor-creditor relationship" because the debtors maintained the right to withdraw the funds at any time, to direct the bank to deliver the funds to a third party, or to leave the funds on deposit. In fact, these rights are not all that different from those possessed by the holder of a demand note. The holder can demand payment at any time, negotiate the note to a third party (to whom the maker would then be obligated to remit payment), or simply refrain from making a demand while interest accumulates on the obligation. In short, none of the debtors' rights as depositors against their bank are inconsistent with a debtor-creditor relationship. More to the point, nothing about depositors' rights in any way gives depositors ownership of funds in the bank's possession. Indeed, as a group, depositors cannot possibly "own" their deposited funds because no bank retains 100% of its deposits on hand; instead banks loan out the great percentage of what they take in as deposits. The bulk of banks' assets are secured and unsecured receivables, not "funds."

Nevertheless, without any real explanation or any discussion of how banking actually works, the BAP concluded that these rights of depositors somehow rendered the deposited funds property of the estate. As a result, the debtors could be ordered to turn over the amount on deposit even though those funds had since been dissipated by the bank's honor of the checks.

The correctness of the BAP's ultimate ruling – that the debtors could be ordered to turn over the account balance as of the petition date – is beyond the scope of this critique. It may be, although it seems unlikely, that § 542 can properly be used to order a debtor to "turn over" the obligation owed by a third party. *But cf. In re Falzerano*, 2011 WL 3477218 (B.A.P. 8th Cir. 2011) (§ 542(b), not turn over under § 542(a), is the appropriate provision to use to recover a debt owed to the estate). Certainly the court went on at length as to why its decision was sound as a matter of policy. However, the fact remains that depositors do not own the funds on deposit and courts need to stop analyzing legal problems as if they did.

In re Harbour East Development, Ltd., 2011 WL 3035287 (Bankr. S.D. Fla. 2011)

This case involved a mortgagee's right to funds forfeited by realty purchasers. The debtor was a condominium developer that entered into contracts to sell units to numerous purchasers. The purchasers paid deposits of approximately $3 million, which were put in escrow pending completion of construction and consummation of the sales. Subsequently, the debtor borrowed $16 million to finance construction and gave the lender a mortgage on the real estate. Neither the mortgagee nor its assignee ever filed a financing statement or entered into a control agreement.

After the debtor filed for bankruptcy protection, the bankruptcy court determined that several purchasers had forfeited their deposits, totaling $550,000. The debtor moved to avoid the mortgagee's lien on the escrowed deposits, claiming that the lien was an unperfected security interest governed by UCC Article 9.

The bankruptcy court ruled for the mortgagee, concluding that the mortgagee's interest extended to the escrowed deposits. In doing so, the court relied heavily on the Eleventh Circuit's decision in *In re Aldersgate Foundation, Inc.*, 878 F.2d 1326 (11th Cir. 1989). In that case, the bankruptcy trustee contracted to sell some of the bankruptcy estate's mortgaged real property. Two purchasers defaulted and the issue was whether the forfeited deposits were proceeds of the real property and subject to the mortgage. The court, relying partly on the definition of "proceeds" in Article 9, concluded that they were. Based on that precedent, the bankruptcy court in this case concluded that the mortgagee's lien reached the escrowed deposits.

Unfortunately, while that was all the court needed to say, the court said much more. The court began its analysis by stating that the threshold question was whether the escrowed deposits were proceeds of the condominium units themselves, "taking them outside the scope of the Uniform Commercial Code and . . . making them . . . subject to [the] Mortgage," or non-realty collateral subject to the Uniform Commercial Code. This was a false choice. The escrowed deposits – or more precisely, the debtor's interest in the escrowed deposits – may well be proceeds of the real estate and subject to the mortgage. Whether they are or are not is a question of the applicable real property law and the language of the mortgage documents. Given the Eleventh Circuit's decision in *Aldersgate*, the court in this case was probably correct that the mortgage did cover the escrowed deposits. However, the debtor's interest in the escrowed deposits was unquestionably personal property. There is therefore no reason why a security interest in them could not *also* be obtained and perfected pursuant to Article 9. In short, assets can be both personal property and proceeds of real property. There is nothing inconsistent in those two classifications.

The court's remaining discussion was even more troublesome. In discussing whether Article 9 would apply, and specifically whether the debtor's right to the deposits would be an "account," the court correctly noted that revised Article 9 expands the definition to include rights to payment from the sale of "property," rather than merely rights to payment from the sale of "goods." *See* § 9-102(a)(2) & cmt. 5a. However, the court suggested that this was irrelevant because § 9-109(d)(11) still excludes from the scope of Article 9 the creation or transfer of an interest in or lien on real property. In this the court was confused, again failing to appreciate the difference between a lien on real property and a lien on the personal property proceeds of real property. Nothing in § 9-109 excludes from the scope of Article 9 a security interest in personal property merely because it happens to be proceeds of real estate.

Finally, as an apparent alternative holding, the court indicated that even if Article 9 did apply, the mortgagee was perfected by possession because the escrow agent had acknowledged, in an authenticated record, that it was maintaining possession of the deposits for the benefit of the mortgagee. In connection with this, the court stated expressly that "money, when deposited into a bank account, is still money and therefore perfection can be achieved through possession." This is patently incorrect. The depositor's interest in a deposit account is not "money" within the meaning of § 1-201(b)(24), which defines money as a medium of exchange authorized or adopted by a domestic or foreign government." The depositor's interest is a "deposit account," *see* § 9-102(a)(29), and the only way a security interest in it as original collateral can be perfected is by control. *See* § 9-312(b)(1). Indeed, the escrowed deposits were likely never "money" within the meaning of the UCC. In all probability, the purchasers had paid their deposits by check (an instrument) or by funds transfer, not in coin or paper currency. While it may be that the mortgagee's interest was perfected by control under § 9-104(a)(3) – because the escrow agent was both the bank's customer and the acknowledged agent of the mortgagee – perfection by possession was not possible. *See also Laborers Pension Trust Fund-Detroit and Vicinity v. Interior Exterior Specialists Co.*, 2011 WL 5211481 (E.D. Mich. 2011) (improperly characterizing as "money" a special account created and funded by a judgment defendant to provide a source for payment of the judgment the defendant lost on appeal, and ruling the judgment creditor was perfected by possession).

In re Westbay, 2011 WL 2708469 (Bankr. C.D. Ill. 2011)

This is a fairly simple case in which the court reached the correct result but its analysis was far more complex than it needed to be.

The debtor in the case was a member of an LLC. He had pledged his LLC interest to secure a loan used to finance the LLC. Within the preference period, the debtor sold his LLC interest and the loan proceeds were paid to the lender. During the bankruptcy, the

trustee sued to recover the payment as a preference, claiming that the lender had no security interest in the debtor's LLC interest because the LLC agreement required the unanimous written consent of all members to any transfer of a member's interest and no such written consent was provided.

The court decided the matter based on waiver, holding that requirement of written consent had impliedly been waived because all the members knew of and benefitted from the transaction, which was in exchange for a loan of working capital to the LLC. However, there was a far simpler approach. Section 9-408(a) overrides contractual terms that restrict or require consent to the transfer of or creation of a security interest in a general intangible. Although a member's interest in a closely-held LLC can qualify as a security, *see* § 8-102(a)(15), it is far more commonly a general intangible. Because the LLC was apparently created under Illinois law, and Illinois has enacted the uniform text of § 9-408, *see* 810 Ill. Comp. Stat. ¶ 5/9-408, the consent requirement was invalid and it should not have been necessary to inquire into whether the parties had waived it.

In re American Cartage, Inc., 656 F.3d 82 (1st Cir. 2011)

This is the first of two cases that significantly misconstrue the term "proceeds." The essential facts are as follows. The debtor, a waste-disposal firm, granted a security interest in virtually all its personal property to Financial Federal Credit, Inc. ("FFC"). After the debtor went into bankruptcy, FFC obtained relief from the stay and sold the collateral to a buyer who later re-sold it to City Sanitation LLC ("City"). City brought four tort claims against an individual and a business that the bankruptcy trustee had hired to manage the debtor's assets. The claims were for (i) conversion; (ii) breach of fiduciary duty; (iii) interference with contract; and (iv) civil conspiracy. After the trustee learned of the pending action, the trustee intervened claiming that the claims were estate property. City objected, asserting that the claims were proceeds of the collateral it had purchased. The bankruptcy and district courts ruled for the trustee and City appealed.

The circuit court treated the case as raising a broad question: whether a commercial tort claim can ever be proceeds of other collateral. The court ruled that it could not be. While it agreed that the right to a tort *recovery* can be proceeds of other collateral, the commercial tort *claim* itself – and hence standing to pursue a commercial tort claims – cannot be proceeds of other collateral.

To reach its conclusion, the court reasoned that "treating commercial tort claims themselves as proceeds would blur any meaningful distinction between the two categories." Yet it offered no reason why these two categories are supposed to be mutually exclusive. It also ignored § 9-102(a)(64)(D), which defines "proceeds" to include "*claims* arising out of the loss, . . . interference with the use of, . . . or damage to, the collateral" (emphasis added).

Certainly many of Article 9's classifications of collateral are mutually exclusive. While a piece of machinery can be both "goods" and "equipment," for example, it cannot be both "equipment" and "inventory." *See* § 9-102(a)(33) (defining "equipment" to be goods other than inventory, farm products, or consumer goods). Similarly, a receivable can be an account, chattel paper, or payment intangible, but cannot be more than one of them. *See* § 9-102(a)(2), (42), (61) (defining "account" to exclude "chattel paper" and defining "payment intangible," a type of general intangible, to exclude anything qualifying as an account or chattel paper). However, "proceeds" is a term that cuts across the classifications of collateral. All proceeds must also fall into one of the Article 9 classifications and no classification is inconsistent with the scope or definition of proceeds. It was the court's understanding of Article 9 that has blurred, not the false distinction the court tried to preserve.

Still, the court's ultimate conclusion may be at least partially correct. The court never identified precisely what property FFC had sold and City had acquired. The court also did not specify whether the tort claims related to conduct that occurred before or after the sale. Therefore, it is difficult to evaluate whether the tort claims were in fact either: (i) proceeds of the collateral that City had previously purchased; or (ii) generated prior to and included in the assets sold. If the tortious conduct predated the sale but the sale did not purport to include the tort claims, then the court was probably correct in concluding that the claims did not belong to City. Moreover, while it seems likely that the conversion claim was proceeds of the property converted and the interference with contract claim was proceeds of the contract rights to which it related, it would be more difficult to conclude that the breach of fiduciary duty and civil conspiracy claims were proceeds of any of the debtor's assets. Therefore, the court was likely correct as to those claims.

Putting the ultimate conclusion aside, the fact remains that the court's analysis leads to very troubling results. In the normal course of events, collateral that becomes subject to a claim for conversion could be expected to transmute as follows:

original collateral ⟶ claim for conversion ⟶ recovery

The court indicates that the middle step is not proceeds, only the last step is. But it is not clear that the last step can be proceeds of the original collateral if it is not proceeds of the claim. If the security interest has in fact been lost when the collateral is converted, can it really magically reappear – that is, re-attach – when the recovery is obtained? The concept of proceeds and the rule of § 9-315(a)(2) are designed to provide continuity; the loss of continuity implies a loss of attachment. Even if this metaphysical problem can be resolved, the court's conclusion unquestionably – and unnecessarily – results in a period in which there is no collateral, leaving the secured party vulnerable to preference attack if the recovery is obtained in the preference period. That may not be a major problem if

the court's conclusion is limited to claims for conversion or other torts. However, if the court's conclusion were to apply to insurance – so that the claim against the insurer is not proceeds, only the later recovery is, then the potential preference problem becomes much more serious.

In re Young, 2011 WL 3799245 (Bankr. D.N.M. 2011)

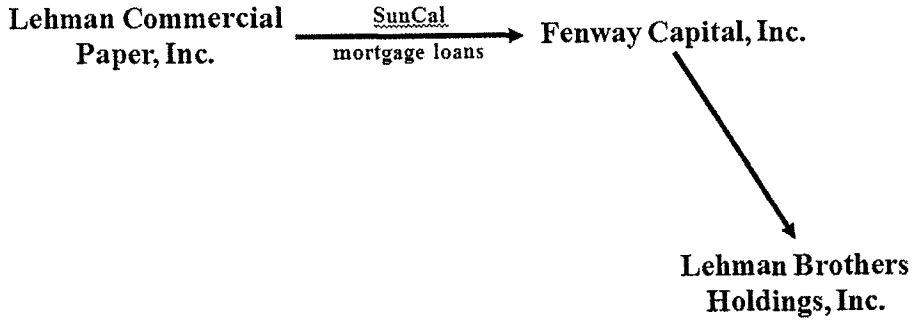
This is the other case that adopts a miserly interpretation of the term "proceeds." While much was going on in the case, for the purposes of this column, the facts are simple. Post-petition, the debtors received member withdrawals from an LLC they owned. The issue was whether these withdrawals were proceeds of a bank's prepetition security interest in the debtors' general intangibles, which encompassed their LLC interests. The court expressly regarded the withdrawals as "a form of distribution on account of their equity interests," but nevertheless concluded that they were not proceeds. The court treated as "dispositive" the Tenth Circuit's ruling in *In re Hastie*, 2 F.3d 1042 (10th Cir. 1993), which held that corporate dividends were not proceeds of the stock in the corporation.

What the court overlooked was the fact that *Hastie* – questionable when decided – has since been legislatively overruled. The definition of "proceeds" in revised Article 9 expressly includes "whatever is collected on, or distributed on account of, collateral." § 9-102(a)(64)(B). Someone involved in this case – the lawyers, the judge, the law clerks – needs to be more careful.

In re Palmdale Hills Property, LLC, 457 B.R. 29 (B.A.P. 9th Cir. 2011)

This is a rather lengthy case about who has authority to file a proof of claim in bankruptcy. The court reached the correct result but its analysis of repurchase agreements was significantly off the mark.

The facts of the case can be simplified as follows. Lehman Commercial Paper, Inc. sold SunCal mortgage loans to Fenway Capital, Inc. pursuant to a repurchase agreement. Fenway then, indirectly, pledged the loans as collateral to Lehman Brothers Holdings, Inc. ("LBHI"):



When SunCal went into bankruptcy, the Lehman entities filed a proof of claim. SunCal objected to the claim, arguing that the Lehman entities were neither creditors nor a creditor's authorized agent as required by Bankruptcy Rule 3001(b). Lehman responded that it was the creditor because the repo transaction with Fenway was really a secured loan. Alternatively, it argued that it was, as the servicer of the loans, Fenway's authorized agent.

The bankruptcy court ruled that Lehman was not the creditor because it had sold the loans to Fenway under the repurchase agreement. However, it ruled that Lehman, as an agent of Fenway, did have authority to file the proofs of claim. SunCal appealed the agency rule and Lehman appealed the ruling that the repurchase agreement was a true sale.

The BAP began its analysis by examining whether the repurchase agreement was a true sale. Its analysis was rather brief. The court concluded that the repurchase agreement was unambiguous in describing the parties as buyer and seller, and thus the parties "intended the transaction to be a sale." Because of that, the bankruptcy court was not required to look beyond the four corners of the agreement to determine the parties' intent.

The problem with this analysis is that the characterization of the transaction should be based on its economic substance, not the parties' intent. This is evidenced most clearly by § 9-109(a)(1), which provides that Article 9 applies to any transaction, regardless of its form, that creates a security interest in personal property by contract. *See also* § 1-203 (distinguishing a lease from a sale with a retained security interest). This language is notably different from the language of old Article 9, which covered "any transaction (regardless of its form) which *is intended to create* a security interest in personal property." § 9-103(1)(a) (repealed) (emphasis added). Even under this

original phrasing, the matter was supposed to be determined based on an objective review of the transaction, not the subjective intent of the parties. That is because the rights of third parties can be greatly affected by whether Article 9 applies, and the two parties to the transaction should not have unfettered discretion to avoid Article 9. The revision to Article 9, by removing all reference to intent, made this even more clear. Unfortunately, the BAP never even cited to § 9-109.

More to the point, the court overlooked some rather simple points. In a true sale, the buyer gets and keeps the property; the seller does not get it back. If one of the parties has an obligation to reverse the transaction – that is, if the seller has an obligation to sell the property back or the buyer has an obligation to repurchase it – the transaction may or may not still be a true sale. If there is a reasonable chance that the buyer may keep the property (*i.e.*, there is a realistic possibility that whoever has the option to reverse the transaction will not exercise that option), then the form of the transaction as a sale will be respected. If, however, it can be predicted at the outset that the buyer will in fact return the property to the seller, then the transaction really does not look like a sale at all, but like a loan by the buyer to the seller with the property as collateral. In a repurchase agreement where both the buyer and the seller have an obligation to reverse the transaction, there is no doubt that the transaction will be reversed. That is not a sale; it is a secured loan.

Other facts in this specific case made this conclusion even more appropriate. The repurchase agreement expressly provided that Fenway's rights on default were limited to selling the underlying assets in a commercially reasonable manner under § 9-610, applying the proceeds to the repurchase price, and turning over any surplus. In addition, Fenway was obligated to transfer back identical securities, and because the securities were unique mortgage loans, that meant Fenway had to return the original securities. The court rejected these points as not determinative. Perhaps they are not, but they are both individually and collectively highly probative of the true nature of the transaction. The court, however, entertained no real analysis of the substance of the transaction. It offered no explanation of why it was a real sale instead of a loan. It basically concluded that because the parties called it a sale, then it must be one. That is overly simplistic and simply not what the UCC says.

Because the court also affirmed the agency ruling, it ruled that Lehman's claims were authorized. Thus, the court did reach the correct result. Unfortunately, it left a bad precedent that raises form over substance.

In re Knowling, 2011 WL 2632153 (Bankr. D. Or. 2011)

This is a case about attachment of a security interest in which the court was led to the wrong result apparently because of some rather poor lawyering.

In return for a loan, the debtor signed a security agreement purporting to grant the lender a security interest in, among other things, a boathouse. Probably because neither party was represented by counsel, the lender took no steps to have his interest noted on the certificate of title for the boathouse. Three months later, the lender learned that, contrary to the debtor's representations, the debtor's wife had an interest in the boathouse. The lender assigned the loan to a corporation he owned and corporate counsel prepared a revised security agreement. The debtor signed the new security agreement, which gave the corporation a security interest in certain equipment. The corporation promptly perfected that interest. Less than 90 days later, the debtor went into Chapter 7 bankruptcy and the trustee sought to avoid the security interest in the equipment as a preference. The corporation claimed that the security interest was unavoidable under § 547(c)(1) because the debtor received new value in return: release of the security interest in the boathouse. In this respect, it is worth remembering that release of an unperfected security interest can still qualify as new value for the purposes of § 547(c)(1). *See In re Nucorp Energy, Inc.*, 902 F.2d 729 (9th Cir. 1990).

The bankruptcy court rejected the new value defense after concluding that the corporation did not in fact have a security interest in the boathouse. This conclusion was, remarkably, based on the language of the revised security agreement itself, which included as a recital a statement that "the [d]ebtor was not able to grant a security interest in a boathouse."

It is difficult to imagine why such a recital would be included in the revised security agreement. It could not possibly be of benefit to the corporate secured party, whose counsel had prepared the agreement. More to the point, the recital would seem to be incorrect. Even if the debtor did not have full ownership of the boathouse, presumably the debtor could have granted – and had in fact granted – a security interest in his co-ownership rights in the boathouse. Perhaps he could have, through agency principles, also encumbered his wife's interest.

Beyond all this, it is not clear why that statement in the security agreement should matter at all. The statement was merely a recital, not an operative provision. What's more, the debtor was presumably the only one who signed the security agreement; secured parties do not normally sign security agreements. Thus, the statement might qualify as a representation *by* the debtor, but it would not be a representation *to* the debtor by the corporate secured party. If a basis for estoppel existed, given that the agreement was prepared by the secured party's counsel, the court never discussed what that basis might be.

In re Inofin, Inc., 455 B.R. 19 (Bankr. D. Mass. 2011)

This is another case largely about attachment. Much of the court's analysis is sound, but two egregious errors render the entire decision suspect.

The debtor in the case was a financial service company specializing in financing sales of used motor vehicles. The debtor's business thus generated a large amount of chattel paper. RCG was one of the debtor's principal lenders and had purported to conduct a foreclosure sale of chattel paper. After an involuntary bankruptcy petition was filed against the debtor, RCG sought a determination that much of the chattel paper was its property or, in the alternative, for relief from the stay. The court ruled against RCG.

RCG's original security agreement and financing statement described the collateral to be chattel paper "purchased by Debtor with the proceeds of loans from Secured Party." A subsequent loan agreement required the debtor to assign all chattel paper to RCG, thereby apparently removing the limitation that RCG provide the financing for the chattel paper. The court correctly concluded that the original security agreement did not cover chattel paper financed by lenders other than RCG. With respect to the subsequent agreement, the court concluded that although the parties attempted to grant RCG a security interest in chattel paper financed by other lenders, because RCG did not make any further advances, it gave no value for that additional collateral and hence the security interest did not attach. This second conclusion is patently incorrect.

Section 9-203(b) identifies three requirements for a security interest to attach. One of those is that "value has been given." § 9-203(b)(1). For this purpose, § 1-204 provides that a person gives value for rights if the person acquired the rights "as security for . . . a preexisting claim." While Massachusetts has not yet enacted revised Article 1, virtually identical language appears in old § 1-201(b)(44). In short, antecedent debt is value that supports the attachment of a security interest. Therefore, RCG had given value for the additional collateral and, so long as the language of the agreement so provided, the security interest did in fact cover the chattel paper financed by other lenders.

The court's alternative holding is even more problematic. Turning to RCG's foreclosure sale, the court noted several irregularities: (i) the first and third notifications contained the wrong date and the second was sent only two days before the date of sale; (ii) the secured party's attorney was unaware whether the debtor was in default and did not cause notification of default to be sent to the debtor; (iii) and no effort was made to solicit bids from individuals or entities in the industry by placing advertisements in trade publications, instead only two notices were published in the *Boston Herald.* From this, the court concluded that RCG's foreclosure sale was not commercially reasonable. Because of that, the court ruled, the chattel paper remained property of the estate.

There are two main errors in this analysis, one minor and one major. The minor error deals with the bases for the court's conclusion that the sale was not commercially reasonable. Two of the three irregularities noted simply are not relevant to this conclusion. The first irregularity – the errors with the sale notifications – does not relate to the commercial reasonableness of the sale at all. Article 9 has two independent rules relating to dispositions: (i) all aspects of the disposition must be commercially reasonable, *see* § 9-610(b); and (ii) notification of the disposition must normally be provided to the debtor, secondary obligors, and other creditors who have filed a financing statement against the collateral, *see* § 9-611. The court's discussion improperly conflated these two requirements. Failure to provide proper notification may subject a secured party to liability, but it does not mean the sale itself was commercially unreasonable. The second irregularity is completely irrelevant. What the RCG's attorney knew or did not know is immaterial. There was no dispute that the debtor was actually in default and nothing in Article 9 requires that the secured party provide the debtor with notification of default. If the security agreement contained such a requirement, the court did not mention it. Thus, there was really only one basis for concluding that the sale was commercially unreasonable, not three.

The court's major error was in thinking that the failure to provide proper notification or to conduct a commercially reasonable sale invalidates the sale. In fact, Article 9 says almost the exact opposite: a transferee that acts in good faith takes free of the debtor's interest in the collateral even if the secured party fails to comply with Article 9 when conducting the disposition. § 9-617(b). While RCG did err in several important respects, those errors do not necessarily mean that it failed to act in good faith. Good faith is about honesty and fair dealing. *See* §§ 1-201(b)(20); 9-102(a)(43). A failure to provide proper notification or to conduct a commercially reasonable sale does not imply either dishonesty or unfairness. More to the point, the court did not even discuss whether RCG lacked good faith. So, the commercial unreasonableness of the sale was not, by itself, sufficient to show that the debtor still owned the chattel paper on the petition date.

In re Moberg, 2011 WL 3745889 (Bankr. D.N.M. 2011)

This is a brief decision about whether a creditor who had not filed a claim had standing to object to the debtors' Chapter 13 plan. The creditor claimed to have a security interest in both some vehicles and some business equipment that the debtor was proposing to sell. As to the equipment, the court correctly ruled that a factual issue remained as to who owned the collateral: the individual debtors,

who had not signed the security agreement, or the corporation they owned, which had.

As to the vehicles, the creditor submitted into evidence certificates of title showing the corporation as the owner and the creditor as the lienholder. The debtors responded with subsequent certificates showing themselves as the owner, free and clear. From this the court concluded, without any analysis, that the debtors were subsequent transferees who owned the vehicles free and clear. For several reasons, this is not correct.

First, if, as is likely, the creditor's interest was perfected when the debtors acquired the vehicles from the corporation, then the debtors took subject to the security interest. *See* § 9-201. Second, if for some reason the creditor's interest was unperfected even though noted on the certificates of title, the debtors would still take subject to it unless they gave value and received delivery without knowledge of the security interest. *See* § 9-317(b). The court did not discuss whether the debtors gave value or what they knew, but it seems likely that they did know about the security interest granted by the corporation they apparently owned and controlled. In any event, under no possible interpretation of Article 9 could the debtors' ownership of the vehicles free and clear be so evident that no factual issue remained.

Admittedly, the security interest in the vehicles would presumably now be unperfected by the issuance of clean certificates of title, although to confirm that one would need to consult the applicable certificate of title statute. But that should not interfere with the creditor's standing. Unless and until an adversary proceeding to avoid the security interest is brought and won, the creditor's security interest would remain intact. Moreover, it is far from clear that Chapter 13 debtors have the authority to bring such an adversary proceeding. While the Bankruptcy Code expressly grants the trustee's avoiding powers to a Chapter 11 debtor in possession, *see* § 1107(a), there is no such grant of authority to a Chapter 13 debtor, a fact which has prompted several courts to rule that the debtor has no such power. *See In re Knapper*, 407 F.3d 573 (3d Cir. 2005) (Chapter 13 debtor could not invoke trustee's strong-arm powers); *In re Stangel*, 219 F.3d 498 (5th Cir. 2000) (debtor lacked standing to bring § 545 action); *In re Hanson*, 332 B.R. 8 (B.A.P. 10th Cir. 2005). *Contra In re Dickson*, 427 B.R. 399 (B.A.P. 6th Cir. 2010) (debtor has derivative standing to pursue avoidance claims under §§ 544 and 547 when the trustee declines to do so); *In re Cohen*, 305 B.R. 886 (B.A.P. 9th Cir. 2004) (debtor has standing to use trustee's § 544 strong-arm powers).

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Compiled by Commercial Law Newsletter Co-Editors Annette C. Moore, Carol Nulty Doody, Kelly Kopyt, Christina Rissler and Rebecca Gelfand

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3. The American Law Institute – http://www.ali.org/index.cfm?fuseaction=projects.proj_ip&projectid=21
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5. Pace University's database of the United Nations Convention on Contracts for the Initiation Sale of Goods and International Commercial Law Database can be accessed at http://cisgw3.law.pace.edu
6. Gonzaga University's new Commercial Law Center has a variety of links to useful sites and can be accessed at http://www.law.gonzaga.edu/Centers-Programs/commercial_law_center/default.asp
7. The International Association of Commercial Administrators (IACA) maintains links to state model administrative rules (MARS) and contact information for state level UCC administrators. This information can be accessed at http://www.iaca.org
8. The Uniform Law Commissioners maintains information regarding legislative reports and information regarding upcoming meetings, including the Joint Review Committee for Uniform Commercial Code Article 9. You can access this information at http://www.nccusl.org/Committee.aspx?title=Commercial Code Article 9

9. Information on the work of The United Nations Commission on International Trade Law (UNCITRAL) (including the work of its working groups on Procurement, International Arbitration and Conciliation, Transport Law, Electronic Commerce and Insolvency Law) is available at http://www.uncitral.org/uncitral/en/index.html
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11. The Secretariat of Legal Affairs (SLA) develops, promotes, and implements the Inter-American Program for the Development of International Law. For more information, go to http://www.oas.org/DIL/
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ENDNOTES:

[1] For an extensive examination of how "fixtures" are defined in law, *see generally* Marc L. Roark, *Groping Along Between Things Real and Personal: Defining Fixtures in Law and Policy in the UCC*, 78 U. CIN. L. REV. 1437 (2010).

[2] U.C.C. § 9-102(41) (2001).

[3] *See id.* § 9-102(44); *see also id.* § 9-104 cmgt. 4.a. (identifying goods as consisting of consumer goods, equipment, farm products and inventory).

[4] 1 Ohio St. 511, 529-30 (1853).

[5] JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 33-5, at 341 (6th ed. 2010).

[6] *Id.* at 342.

[7] JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 24-8, at 872 n.5 (4th ed. 1995).

[8] *In re Park Corrugated Box Corp.*, 249 F. Supp. 56, 58-59 (D.N.J. 1966) (determining that machine could be move easily, without damage to the structure to which it was affixed and without preventing such structure from being used for the purposes for which is was constructed).

[9] *Bank of Valley v. U.S. Nat'l Bank of Omaha*, 341 N.W.2d 592, 594 (Neb. 1983) (holding that a lease clause allowing the lessee to remove all improvements made by the lessee on the land evidenced the parties' intention that the house remain the personal property of the lessee).

[10] *Fed. Land Bank of Omaha v. Swanson*, 438 N.W.2d 765, 769 (Neb. 1989) (concluding that the grain bin could be removed from the realty and that the debtor intended that it remain personal property).

[11] *In re Hot Shots Burgers & Fries, Inc.*, 169 B.R. 920, 925 (Bankr. E.D. Ark. 1994) (finding persuasive, among other factors, that the modular building had been previously moved to other locations).

[12] *George v. Commercial Credit Corp.*, 440 F.2d 551, 554 (7th Cir. 1971).

[13] U.C.C. § 9-334(a) (2001). Note, however, that a security interest under Article 9 of the UCC may not be created in ordinary building materials incorporated into an improvement on land. *Id.*

[14] *Id.* § 9-501(a)(2).

[15] *Id.* § 9-501(a)(1)(B).

[16] *Id.* § 9-502(b).

[17] *Id.* § 9-502(c); *but see* GA. CODE ANN. § 11-9-502(c) (2001) (providing that a real estate mortgage may not be filed as a fixture filing), LA. REV. STAT. ANN. § 10:9-502 (2001) (omitting the model provision allowing a record of mortgage to constitute a fixture filing).

[18] *Id.* § 9-515(g).

[19] 4 White & Summers, supra note 4, § 33-5, at 340.

[20] *See* ALA. CODE § 7-9A-102(a)(80) (2001) (including "owning, operating, leasing or controlling a 'utility' as defined in Section 37-1-30."), ARK. CODE ANN. § 4-9-102(a)(81) (West 2001) (minor variation to clause (D) of the model code), LA. REV. STAT. ANN. § 10:9-102(a)(80) (2001) (including as a transmitting utility any combination of clauses (A) through (D) of the model code), MINN. STAT. § 336.9-102(a)(80) (2000) (including as a transmitting utility any "person filing a financing statement under this article and under the authority of sections 336B.01 to 336B.03, 507.327, and 507.328"), MONT. CODE ANN. § 30-9A-102(1)(bbbb) (1999) (minor variation to clause (B) of the model code), NEV. REV. STAT. § 104.9102(1)(bbbb) (1999) (including as a transmitting utility a person "providing sewerage" as opposed to one that transmits "goods by pipeline or sewer"), OR. REV. STAT. § 79.0102(1)(aaaa) (2001) (substituting an "organization" for a "person" in the lead-in of the definition).

[21] U.C.C. § 9-102(a)(80) (2001).

[22] *Id.* § 9-501(b).

[23] *See id.* § 9-301(3)(a).

[24] *Id.* § 9-515(f) (2001); *but see* GA. CODE ANN. § 11-9-515 (2001) (omitting the model code provision allowing transmitting utility filings to remain effective until terminated).

[25] U.C.C. § 9-334(c) (2001).

[26] *Id.* § 9-334 cmt. 6.

[27] *Id.* § 9-334(e)(1).

[28] *Id.* § 9-334(d).

[29] *Id.* § 9-334(h).

[30] *Id.*

[31] *Id.*

[32] 4 White & Summers, supra note 4, §33-5, at 345.

[33] U.C.C. § 9-334(e)(2) (2001).

[34] *Id.* § 9-334 cmt. 8.

[35] *Id.* § 9-334(e)(3); *see also id.* § 9-334 cmt. 9.

[36] *Id.* § 9-334 cmt. 9.

[37] U.C.C. § 9-334(e)(4) (2001); *see also* 4 White & Summers, supra note 3, §33-5, at 345 (discussing the interpretive issues likely to arise in defining the boundaries of "manufactured home").

[38] U.C.C. § 9-334(f) (2001).

[39] The fixture creditor should also be mindful that the first to file and purchase-money priority rules require that the debtor have an interest of record in the related real property or be in possession of it. If the debtor leases the property, the creditor should consider requiring that the lease or a memorandum thereof is recorded to prevent issues that may arise if the tenant vacates the property.

[40] *Id.* § 9-334 cmt. 3.

[41] *See generally id.* § 9-301(1) and § 9-307(b).

[42] Gary G. Neustadter, *Perfection as to Fixtures*, http://law.scu.edu/FacWebPage/Neustadter/sdbook/main/ commentary/16.html (last visited Dec. 6, 2011).

The Revised Article 9 Filing System: Did It Meet Its Objectives?

*Darrell W. Pierce**

Table of Contents

Introduction

This article assumes the reader will appreciate the importance of the Uniform Commercial Code ("UCC")[1] filing system, as the filing of a UCC financing statement is by far the predominant means of "perfecting" a security interest to establish and preserve its priority. The primary priority rule can be characterized as "first to file or (otherwise) perfect"[2] and, while there are many exceptions, a secured party with "first to file" priority is in a very advantageous position.

In 1998, I wrote an article for this Journal entitled "Revised Article 9 Of The Uniform Commercial Code: Filing System Improvements And Their Rationale" (the "1998 Article").[3] Now that a decade has passed since the uniform effective date of Revised Article 9, it seems appropriate to ask whether the revisions accomplished their intended purpose. Indeed, certain issues related to the filing system were significant in prompting the sponsors of the Code, the Uniform Law Commissioners and the American Law Institute, to propose uniform changes to Article 9 (the "2010 Amendments") that are in the process of being enacted by the states.[4] Some of the proposed changes related to the filing system remain the subject of debate, with at least one member of the review committee still questioning the need for change[5] and final proposed changes that include alternative solutions because the drafters could not agree on a consensus approach. This article will examine the current UCC filing system, existing case law under Revised Article 9 relating to filing issues, the proposed revisions and the degree to which the filing system has met the objectives of the 1998 revisions.

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[1]References to current Article 9's Official Text will be cited as "UCC § 9-____" while references to the 2010 amendments will be cited as "Rev. UCC § 9-____".

[2]See, U.C.C. § 9-322.

[3]Darrell S. Peirce, Revised Article 9 of the Uniform Commercial Code: Filing System Improvements and Their Rationale, 31 UCC L.J. 16 (1998).

[4]See, Edwin E. Smith, *A Summary of the 2010 Amendments to Article 9 of the Uniform Commercial Code,* 42 UCC L.J. 345 (2010).

[5]Harry S. Sigman, *Improvements (?) to the UCC Article 9 Filing System,* 46 Gonz. L. Rev. 457 (2010/11).

The Objectives of Reform

To quote my original article, "[a]s explained in the Reporters(Prefatory Comment for Part 5 of revised Article 9 in the May, 1997 draft, '[t]he filing system is the heart of Article 9. [New] Part 5, which governs the filing system, has been revised substantially, with a view toward reducing the costs of filing and searching the public records and reducing the burdens upon the filing office that Article 9 now imposes. Efforts have also been made to promote uniformity in the policies and practices of filing offices.'

Revised Article 9 will simplify the filing process by enabling a filer to file against a debtor at a single filing office for all Article 9 collateral (other than fixtures and other real estate-related collateral) using a uniform national form with improved name formats that promote filer accuracy and simplify indexing and searching for the filing office.

Filing system improvements will seek to promote the use of current and emerging technologies to reduce transaction costs for both filers and searchers. Filing offices will be freed from paper-based systems and unnecessary procedures in order to improve the speed and accuracy of the system, to assure filers that filings will be promptly accepted and expeditiously indexed and to assure searchers that search results will be accurate and current. To do so, filing officers will perform as professional *information system managers*, leaving the responsibility for the legal sufficiency of filings to filers and the responsibility to determine the ramifications of search results to searchers.

Improvements are also intended to re-balance the role of filers and searchers. Case law that has served to protect filers at the expense of searchers by giving effect to filings that are not readily retrievable by a search will be overturned by Revised Article 9. The new statute places a premium on getting the debtor's name right and, in doing so, obviates the need for complicated search logic and multiple name searches.

. . . Revised Article 9 recognizes the importance of drawing a clear distinction between the rules that govern the operation of the filing system in its intake, indexing, data storage and retrieval functions, and the rules that govern the legal effectiveness of filings. Filing officers cannot be the ultimate arbiters of legal effectiveness of filings as they cannot obtain all of the relevant information in all cases to make

the requisite decisions. Instead, revised Article 9 properly reallocates that role to filers, searchers and the judicial system."[6]

The objectives can be summarized as follows:

(1) to reduce transaction costs by reducing the cost of filing and searching, by
   (a) reducing the number of offices in which filings or searches need to be made,
   (b) reducing the scope of names that need to be searched or found for a searcher to be confident that all relevant legally effective financing statements are found in the search process, and
   (c) promoting electronic filing and other new cost-saving technology;
(2) to reduce the burden on filing offices, by
   (a) simplifying the indexing and searching process, and
   (b) relieving filing officers from having to be responsible for determinations of legal sufficiency of financing statements; and
(3) to promote uniformity in filing office practices and policies, including the use of a uniform national form with improved name formats.

The 1998 revisions also established special rules for the name to use for the debtor name on a financing statement when an estate, trust or trustee is the debtor.

This article will evaluate the degree to which these objectives have been achieved with the implementation of the 1998 revisions as reflected in the case law, commentary and the 2010 Amendments.[7] This article will also discuss some of the case law regarding UCC financing statements. In addition to the debtor name issues addressed in the 2010 Amend-

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[6]Darrell W. Peirce, Revised Article 9 of the Uniform Commercial Code: Filing System Improvements and Their Rationale, 31 UCC L.J. 16, 17 (1998).

[7]This article focuses on state-level filing offices. Counties play a limited role in the Article 9 filing system, they have limited resources and many have never fully implemented a separate UCC index as contemplated in the statute. Article 9 has alternative language, adopted in many states, to require additional information on county filings so the counties can properly identify and index them in a grantor/grantee index. The counties should not be ignored but addressing the additional issues unique to counties is beyond the scope of this article.

ments, interesting issues have been addressed regarding secured party names, collateral descriptions, authority to file and the effectiveness of initial financing statements and amendments.

Reduction of Transaction Costs

Filing and Searching Only in the Debtor Location State

Revised Article 9 envisioned "one-stop shopping" for filers and searchers. With the exception of real-estate-related collateral like timber to be cut, "as extracted collateral" (oil, gas and other minerals upon extraction and certain wellhead and minehead sale receivables, U.C.C. § 9-102(a)(6)) and fixtures, all filing and searching would be done at the central filing office of the debtor location state.[8] Debtors have a single location state that is generally the debtor's state of organization, the state where the debtor's chief executive office is located, or the state where the debtor has his or her principal residence, depending in the nature of the debtor.[9]

Timber to be cut and as-extracted collateral transactions are relatively rare, and where fixtures are involved, it is often the case that either the secured party will be also taking a mortgage on the relevant real estate (and getting a title commitment or opinion), or a third party will enjoy priority under real estate law as a mortgagee or landlord (leaving little collateral value for the fixtures). As a result, the need for separate UCC fixture filings and searches is limited.

The debtor location state rule replaced the requirement under old Article 9 that a secured party search and file in every state where either the debtor's chief executive office (or principal residence) or any collateral was located. Limiting UCC searching and filing for most collateral to a single filing office in a single debtor location state, rather than requiring searching and filing in each state in which collateral is located, has clearly saved money in multi-state

[8] U.C.C. § 9-301(1).

[9] U.C.C. §§ 9-302 to 9-307. There are special rules for national banks and foreign debtors but every debtor has a single location for Article 9 purposes. Sometimes the location may not be certain (e.g. an individual with houses in Illinois and Florida) but in such cases it is unlikely there will be more than two viable candidates.

transactions. Money has also undoubtedly been saved by the elimination of dual filing requirements (where UCC financing statements had to be filed at both the state and county level to be effective) in those states that had them prior to 2001.

However, as noted in the 1998 Article, "because most debtors are organized or have their chief executive office in the state where they conduct business and have most of their assets" the debtor location state rule did not "radically diminish the number of filings in any state."[10] Obviously, for a transaction where the debtor has assets only in the state in which it is organized or resides, the rule has no impact on the initial searching and filing process. Nevertheless, even in "local" deals, the rule has saved secured parties from monitoring collateral location changes (which used to required timely filing in a new collateral location state) as they now need only monitor the debtor's state of organization, chief executive office or principal residence, which do not normally change very often. If the debtor is a registered organization, its debtor location state can be confirmed by verifying its ongoing "good standing" with the relevant state filing office, in many cases on-line and certainly without a site visit.

The "debtor location state" rule has had a positive impact without any apparent negative effect. For a debtor with collateral in 40 or more states, the positive impact is significant and obvious. Unfortunately, the positive impact has its limitations. First, where real-estate-related collateral is involved, the secured party will have to search and record in the county real estate records. Second, state statutory liens (including state tax liens), because they are necessarily limited to the jurisdiction of the relevant state, are typically filed (if at all) in the collateral location state. Third, depending on the debtor, a federal tax lien might be effectively filed in a state other than the Article 9 debtor location state. A federal tax lien is filed in the state where the debtor resides, which under federal law is where an organization has its "principal executive office."[11] In most states, the Uniform Federal Lien Registration Act is in effect and federal tax

[10]Darrell W. Peirce, Revised Article 9 of the Uniform Commercial Code: Filing System Improvements and Their Rationale, 31 UCC L.J. 16, 28.

[11]26 U.S.C.A. § 6323(f)(2).

liens are filed against organizations in the central UCC filing office. If the organization is a "registered organization" under Article 9,[12] one might need to search in the "principal executive office" state for a federal tax lien in addition to searching the state of organization for UCC financing statements.

Reducing the Number of Debtor Names to be Searched

Revised Article 9 has been successful in limiting the need to search multiple debtor names where the debtor is an organization. It has not been so successful in simplifying the search process for individual debtors and individual debtor name issues have been a primary focus of the 2010 amendments.

As documented in 1998 Article, judicial decisions under old Article 9 found financing statements with debtor name

[12]"[A]n organization organized under the laws of a single State or the United States and as to which the State or the United States must maintain a public record showing the organization to have been organized." U.C.C. § 9-102(a)(70). The 2010 Amendments clarify that the term does not apply to an organization merely because a State maintains a record that the organization was organized (such as a tax record or an assumed name record). The creation of the public record must be an essential element in the formation of the organization. The 2010 Amendments also clarify the status of certain business trusts (such as a Massachusetts business trust). In the 2010 Amendments, a registered organization is "an organization formed or organized solely under the law of a single State or the United States by the filing of a public organic record with, the issuance of a public organic record by, or the enactment of legislation by the State or United States. The term includes a business trust that is formed or organized under the law of a single State if a statute of the State governing business trusts requires that the business trust's organic record be filed with the State." Rev U.C.C. § 9-102(a)(71). "Public organic record" is defined in the 2010 Amendments as "a record that is available to the public for inspection and that is: (A) a record consisting of the record initially filed with or issued by a State or the United States to form or organize an organization and any record filed with or issued by the State or the United States which amends or restates the initial record; (B) an organic record of a business trust consisting of the record initially filed with a State and any record filed with the State which amends or restates the initial record, if a statute of the State governing business trusts requires that the record be filed with the State; or (C) a record consisting of legislation enacted by the legislature of a State or the Congress of the United States which forms or organizes an organization, any record amending the legislation, and any record filed with or issued by the State or the United States which amends or restates the name of the organization." Rev U.C.C. § 9-102(a)(68).

inaccuracies to be nevertheless legally effective. To be certain, a searcher might have been required to search trade names, alternative spellings, or even to have conducted computer-assisted database searches that duplicated a manual search of a physical index.[13] Note that many of these judicial decision arose out of circumstances where a search under the debtor's actual name would not find the financing statement later determined to be legally effective. Multiple searches, presumably including "key word" searches, were required, with the attendant cost for each search. Given the limited search logic of the time, duplicating a manual search and finding alternative spellings would have required each name variation to be searched. Even if all the searches were conducted, there was the additional cost of reviewing the results and getting comfort that the potentially legally effective financing statements found with similar but not identical debtor names do not in fact relate to the debtor being searched.

The primary solution to these issues was to have Article 9 provide that a legally effective financing statement must correctly provide the debtor name or, if it does not, it must provide a name such that it is found in a search under the correct debtor name using the filing office's standard search logic.[14] This provides a nice solution for searchers who need only conduct a "standard" search under the debtor's correct name to find all potentially legally effective financing statements filed with the relevant filing office. Any financing statement not found in such a search is not legally effective as a matter of law. Issues remain, as discussed below, but the current statute substantially reduced the need for multiple searches in a single filing office.

At one point in the drafting of the 1998 revisions, while I was serving as the chair of the Article 9 Filing Project and meeting with filing officers and filing system users at a conference of the International Association of Commercial

[13]Darrell W. Peirce, Revised Article 9 of the Uniform Commercial Code: Filing System Improvements and Their Rationale, 31 UCC L.J. 16, 23.

[14]U.C.C. §§ 9-503 and 9-506.

Administrators ("IACA"),[15] a series of presentations were made in which the filing officers were informed of then-current and emerging search software capabilities. Even then, prior to Google, it was clear that comprehensive searches of a database using a variety of tools and "search logics" were possible so one could envision a single name search that would find matches, near-matches, matches to a limited set of characters (e.g. first three), alternative spellings, etc. The initial objection was the practical one of cost. At one point, a participant commented that things would be so much simpler if only the filing secured party could get the debtor name right. Not only did the comment ring true in terms of addressing the filing officers' cost and implementation concerns, it also addressed the issue of limiting "hits" in search results so that searchers would not have to spend time confirming that certain financing statements revealed by a search are in fact "false positives." From that point on, IACA and its Model Rules have promoted a "strict" search logic (closer to exact match with little "wiggle room" for debtor name errors) to limit the volume of search results.

The rule in § 9-506 that limits legally effective debtor names to those that are actually found in a "standard" search and the adherence to strict search logic have been upheld. Secured parties have not been protected from typographical errors, including punctuation errors,[16] or even from circumstances where the filing office did not program its system to meet expectations.[17] There appears to be no duty to provide a minimum level of search logic to protect filers and there is a clear need for filers to get the debtor name right. Courts have also properly distinguished between "standard"

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[15]IACA promulgates the Model Administrative Rules for UCC Filing Offices, which are to be consulted by UCC filing offices when they adopt their own administrative rules. U.C.C. § 9-526. While there are local variations, the vast majority of states have rules that are substantially consistent with the Model Rules, See, http://www.iaca.org.

[16]Host America Corp. v. Coastline Financial, Inc., 60 U.C.C. Rep. Serv. 2d 120 (D. Utah 2006).

[17]In re Tyringham Holdings, Inc., 354 B.R. 363, 47 Bankr. Ct. Dec. (CRR) 207, 61 U.C.C. Rep. Serv. 2d 339 (Bankr. E.D. Va. 2006). In this case, the programming failed to disregard "Inc." as intended by Virginia's filing office rules but the court properly protected searchers by holding that the objective actual outcome of a standard search logic search under the correct debtor name determined legal sufficiency.

searches and other search techniques that can yield expanded search results.[18]

Unfortunately for Article 9 filers and searchers, the Article 9 solutions could not address a couple of significant issues that arise outside of Article 9 and limit the success of the reforms. The first issue is, what is the "correct" name of the debtor? The system ultimately depends on the idea that a debtor has only one "correct" name. For registered organization names, a clarification is found in the 2010 Amendments. But there has been a lot of litigation over individual names, where Article 9 does not specify any requirement or standard other than "the individual . . . name" in § 9-503 and the "correct name" in § 9-506. The second issue is the fact that federal tax liens (and possibly other statutory liens), even though typically filed against organizational debtors in the relevant state's central UCC filing office, do not have to meet Article 9 debtor name requirements to be legally effective.[19] While a search under the debtor's correct name will find all potentially legally effective financing statements, it may not find a legally effective federal tax lien filing that has an incorrect debtor name but is nevertheless adequate under federal law.

Organizational Debtor Name Issues

For organizations, the answer seems fairly clear.[20] One uses a public record name for a registered organization, and for other organizations one uses the "organizational name" or if the organizational debtor does not have one, "the names

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[18]In re PTM Technologies, Inc., 452 B.R. 165 (Bankr. M.D. N.C. 2011). The financing statement was filed without the "h" in the debtor's name, was not revealed by a "standard" search, and was properly held ineffective notwithstanding the fact that it was revealed by a "Non-Standard" search with a "sounds like" option offered at the filing office's web site. Some filing offices offer non-standard expanded search logic and private search companies offer expanded search logic in non-standard searches to assist searchers in finding federal tax liens as well as legally ineffective UCC financing statements in favor of competing creditors.

[19]In re Spearing Tool and Mfg. Co., 412 F.3d 653, Bankr. L. Rep. (CCH) P 80317, 56 U.C.C. Rep. Serv. 2d 807, 95 A.F.T.R.2d 2005–2890, 2005 FED App. 0271P (6th Cir. 2005).

[20]There are special debtor name rules for estates and common law trusts/trustees. The name of the decedent is used for an estate and for a trust, one uses the name of the trust specified in its organic documents, or if not, the name of the settler of the trust. U.C.C. § 9-503(a)(3).

of the partners, members, associates, or other persons comprising the debtor."[21] The case law on organization names involves erroneous names and there does not appear to be much controversy regarding the nature or character of the "correct" name. However, current § 9-503 provides that for a registered organization, one is supposed to use "the name of the debtor indicated on the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized . . .." Presumably, this would be the name shown on the organization's charter (e.g., certificate or articles of incorporation or organization) as amended. But states maintain other public records showing organizations to have been organized, the primary one in many states being a list compiled by the filing office of existing organizations. Such lists facilitate searches to determine if a particular name is already in use or a particular organization exists or is in good standing. They were traditionally created by keying organization names from charters and early on, data entry personnel encouraged to abbreviate and in some cases names were truncated due to field size limitations. As a result, the "database names" are not identical to the "charter names."

Filers and searchers should note that such "database names" are the source for names on good standing certificates, so one should always examine a certified copy of the charter to confirm a registered organization's name. However, the question has been raised whether a "database name" (which is maintained in a public record showing the organization to have been organized, of course) would qualify as a "correct" name for Article 9 purposes.

2010 Amendments Regarding Organization Debtor Names

While there is no case on point, the 2010 Amendments will make it clear that the "charter name," as set forth in what the 2010 Amendments define as the "public organic record" for the registered organization debtor, is the "correct" name. U.C.C § 9-503 will be amended to require, for a registered organization name, "the name that is stated to be the registered organization's name on the public organic record most recently filed with or issued or enacted by the

[21] U.C.C. § 9-503(a)(4).

registered organization's jurisdiction of organization which purports to state, amend or restate the registered organization's name. . . ." A public organic record is "a record that is available to the public for inspection and that is: (A) a record consisting of the record initially filed with or issued by a State or the United States to form or organize an organization and any record filed with or issued by the State or the United States which amends or restates the original record; (B) an organic record of a business trust consisting of the record initially filed with a State and any record filed with the State which amends or restates the original record, if a statute of the State governing business trusts requires that the record be filed with the State; or (C) a record consisting of legislation enacted by the legislature of a State or the Congress of the United States which forms or organizes an organization, any record amending the legislation, and any record filed with or issued by the State or United States which amends or restates the name of the organization."[22]

Individual Debtor Name Issues

A more significant problem exists with respect to individual names. There is no registry of individual names, individual names can change under changing social conventions, and individuals regularly use and go by nicknames rather than their "legal" names. This leads to doubt because the legal standard does not yield an objective result that is readily determined. At common law, one's name is what one is known by. And one can change it over time through use.[23] How does a secured party determine an individual's current

[22]Rev U.C.C. § 9-102(a)(68).

[23]In Michigan, where the Secretary of State manages both the UCC filing office and the department of motor vehicles which issues driver's licenses, the Secretary of State's office manual discusses Michigan's common law rule for individual names, noting that "[a] person has the right to adopt any name they want to use provided it is not done for a fraudulent purpose. No legal proceeding is required. Upon marriage a woman has the right to adopt her husband's surname [sic]. The marriage itself gives her the common law right to change her name. The common law in force in 1963 [when Michigan's Constitution was adopted] does not recognize same sex marriages. Therefore, a person who marries a person of the same sex does not by virtue of that marriage have a common law right to adopt a new surname. The person may, however, choose to adopt the other person's name because they do have a common law right to use any name. Proof of having used the name consistently for at least six months without fraudu-

name or when it changes at common law? The guidance provided in Michigan and quoted in the preceding footnote is far from definitive.

With Article 9's focus on the "correct" name and the application of strict search logic, the cases were inevitable. Many of them dealt with a debtor who used a nickname. Early cases upholding financing statements[24] filed under the nickname were criticized. Article 9 was supposed to do away with searchers having to search name variations and enable a searcher who searched the "correct" name to confidently rely on the results. The cases then trended towards finding nicknames inadequate.[25] The courts seemed to be looking for a name that, like organization names, could be verified by reference to some record. As articulated by one court, what is required is the "individual debtor's 'correct legal name,' presumably the name indicated on a birth certificate or a name otherwise maintained in the public records (e.g., social security card, driver's license)."[26]

Then there are cases like the Fifth Circuit's 2007 decision in Peoples Bank v, Cornerstone Bank.[27] The court gave legal effect to a financing statement that named the debtor as "Louie Dickerson" when his (arguably) "legal" name was "Brooks L. Dickerson," essentially because everyone knew him as Louie and a searcher should have searched that name. Knowing that the old "reasonably diligent searcher" standard was supposed to have been replaced with a "you're

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lent intent must be presented to assume a name different from one's birth name. A common law name is generally not the same as a nickname. Nicknames are often descriptive (slim. Lefty, etc.) A common law name is a name used in the everyday conduct of personal business or legal activities." As quoted in an email from Joseph S Ross to the IACA listserve on December 6, 2010, and summarized with other listserve comments on the 2010 Amendments by Robert Lindsey on December 10, 2010. See, http://www.iaca.org.

[24]See, In re Erwin, 50 U.C.C. Rep. Serv. 2d 933 (Bankr. D. Kan. 2003).

[25]See, In re Kinderknecht, 308 B.R. 71, 52 Collier Bankr. Cas. 2d (MB) 46, 53 U.C.C. Rep. Serv. 2d 167, 28 A.L.R.6th 799 (B.A.P. 10th Cir. 2004); In re Borden, 353 B.R. 886, 61 U.C.C. Rep. Serv. 2d 223 (Bankr. D. Neb. 2006), judgment aff'd, appeal dismissed, 63 U.C.C. Rep. Serv. 2d 801 (D. Neb. 2007), and In re Berry, 2006 WL 3499682 (Bankr. D. Kan. 2006).

[26]In re Stewart, 2006 WL 3193374 (Bankr. D. Kan. 2006).

[27]Peoples Bank v. Bryan Bros. Cattle Co., 504 F.3d 549, 64 U.C.C. Rep. Serv. 2d 113 (5th Cir. 2007).

protected if you search the 'correct' name" standard, it is hard to reconcile this outcome with the statute unless one imagines that the Fifth Circuit was really reaching the conclusion that "Louie" was the "correct" name because at common law the fellow's name was "Louie" and not "Brooks L."

One line of cases reflects a desire to have a debtor name that is verifiable by reference to some public record while another reflect a desire to protect a filer who files under the name "everybody" knows is name the debtor goes by. As a result, filers and searchers have been left to ponder the need or desirability of name variation filing and searching. While some commentators advised a review of all name information for an individual (birth certificate, driver's license, passport, military identification, etc) and searching all name variations, many secured parties found this impractical. Particularly for smaller transactions, they wanted a more straightforward rule that would be easier to apply.

As a result, secured parties sought additional guidance and, ultimately, non-uniform amendments to address individual name issues. Texas successfully introduced a non-uniform amendment to its Article 9 creating a "safe harbor" for driver's license names. Efforts in other states also found support, but were deferred when the committee was formed to draft the 2010 Amendments in the expectation that the 2010 Amendment would provide a uniform solution.

The impetus to do something about individual names has been criticized[28] and there are problems with the use of driver's license names.[29] Without repeating the debate here, it seems clear that using driver's license (or other state-

[28]Harry S. Sigman, *Improvements (?) to the UCC Article 9 Filing System*, 46 Gonz. L. Rev. 457 (2010/11). "Most of the cases involved nicknames, or secured party spelling or typographical errors or secured party carelessness, and were not about uncertainty about which version of the debtor's name to provide. Indeed, not a single case involved a situation where the filer was uncertain about which of several possible names to provide and then was found to be unperfected because it had guessed wrong. . . . Nevertheless, certain interest generated an unwarranted (in the author's view) hysteria about individual debtor names . . .." Harry S. Sigman, Improvements (?) to the UCC Article 9 Filing System, 46 Gonz L. Rev. 457, 467 (2010/11).

[29]Among the issues noted by Mr. Sigman are the following: (1) characters acceptable to the DMV may not be acceptable in the UCC filing system (obviously it is very important that the UCC filing office be able to

issued picture identification) names is not always a perfect solution. However, the lending community is strongly in favor of a driver's license solution and they are presumably best-positioned to undertake the cost-benefit analysis. The lending community understands there are issues with individual debtor names with or without a driver's license solution, and is willing to embrace a rule that is simpler to apply even if it will not work well all the time.

2010 Amendments Regarding Individual Debtor Names

The Joint Review Committee determined to provide a response to the demand for change from the lending community but because of the potential problems it could not reach consensus and instead provided two Alternatives to the states for consideration. Under Alternative A, the so-called "only if" approach, a financing statement is effective only if it sets forth the driver's license name[30] for an individual debtor.[31] Filing under any other name, even if it is the debtor's common law name, will not be effective, so presumably filers and searchers would have to deal with one name only. Under Alternative B, the so-called "safe harbor" approach, filing under the driver's license name is legally sufficient but not required, leaving the possibility for searchers that another "correct" name needs to be searched.[32] Under both Alternatives, the standard is the driver's license name from the license most recently issued by the debtor's state of residence, and if the debtor does not have such a license, the secured party must use the debtor's surname and first

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take DMV characters if the driver's license name becomes the only effective name to use), (2) the formatting of the name on a driver's license may not match up to the UCC format, (3) DMV characters and formats may change without coordination with the UCC filing office, (4) the driver's license name will control, typos and all, even if it no longer the debtor's "real" name, and prior driver's license names will need to be searched, (5) federal tax liens may be filed under different name variations which will therefore need to be searched anyway, and (6) Alternative A is more complex so introduces more opportunity for non-uniform judicial decisions.

[30]The 2010 Amendments refer to driver's license names but the comments make it clear that each state is invited to define the relevant terms to include other state-issued identification in the concept of "driver's license" for those who do not drive.

[31]Rev U.C.C. § 9-503 Alternative A.

[32]Rev U.C.C. § 9-503 Alternative B.

personal name (with or without other name elements). As of the end of August, 2011, 13 states had passed the 2010 Amendments with 11 opting for Alternative A and two opting for Alternative B.

Perhaps the most important point in the individual name debate, used by both proponents and opponents of a driver's license solution, as noted by Mr. Sigman, is "there does not appear to be a single case that held the name on a driver's license was not sufficient." (emphasis in original)[33] Regardless of the proper legal rule to be applied and regardless of the degree to which one wants to issue simplified "marching orders" to loan documentation teams, given the case law and the fact that by and large folks use their driver's license name as their formal, legal or correct name, it is hard to imagine anyone not filing and searching under the driver's license name. With that in mind, in my opinion there is no harm in adopting the Alternative B safe harbor approach as it will not increase transaction costs. For those who limit their filing to the driver's license name, their expectations of perfection under current law will be guaranteed, and searchers will be searching the driver's license name anyway.

Proponents of a driver's license name solution have preferred Alternative A because in their view, it will give more certainty to searchers (who presumably will need to search only the driver's license name) as well as filers. But there are always potential issues regarding residence, in many cases (where prior licenses are confiscated when a new license is issued) a secured party may not have any means to objectively verify prior driver's license names, and where the driver's license name is the only effective name to use, the previously noted issues regarding differences between DMV and UCC characters and name formats may prevent a searcher or a filer from presenting the driver's license name, as such, to the UCC filing office. These issues may rarely occur, but when they do, Alternative A may not provide the desired clarity, so a searcher will not get the desired benefit of a single name search and a filer will lose the ability to protect itself by filing under the common law name. Given the federal tax lien problem, I am not convinced that Alternative A accomplishes enough for searchers but I am

[33]Harry S. Sigman, Improvements (?) to the UCC Article 9 Filing System, 46 Gonz L. Rev. 457, 467 (2010/11).

also convinced that most of the situations in which Alternative A poses problems are situations ("foreign" characters, different name formats and social conventions) that also pose problems under current law and Alternative B. In my view, Alternative A does not present "new" problems though it simply falls short of providing the "one-stop shopping" for searchers that its proponents desire. But because Alternative B offers filers the additional possible protection of making and maintaining effective financing statements under a common law name, and searchers will likely have to search a common law name to find tax liens, I prefer Alternative B.

There is no doubt that driver's license names will remain the focal point of individual name filing and searching, even where Alternative A is not enacted. Secured parties will need to determine the extent to which they will want to monitor driver's license names and name changes. Representations and covenants will certainly address the issue as they do today, but it remains to be seen if secured parties will demand periodic copies of driver's licenses or impose other procedures to monitor a debtor's driver's license name in the future.

Federal Tax Liens

The Internal Revenue Code governs federal tax liens and largely pre-empts state law in determining the priority of a federal tax lien. It is federal law, 26 U.S.C.A. § 6323, that determines what must be filed where and the affect of a federal tax lien filing. Unfortunately, notwithstanding the fact that in most states under the Uniform Federal Lien Registration Act, federal tax lien filings are to be made against organizations in the relevant state's central UCC filing office. The relevant state will be the one where the debtor resides—the principal place of business for organizations under federal law, not necessarily the UCC debtor location state (the state of organization for registered organizations). This means additional offices may need to be searched to find federal tax liens. Worse yet, a searcher will likely have to search more than the correct name of the debtor for Article 9 purposes because, under the Spearing Tool decision, the IRS does not have to follow Article 9's strict debtor name

requirements to make an effective tax lien filing.[34] In Spearing Tool, modest errors and abbreviations in the debtor name on the federal tax lien filing resulting in it not being found in a "standard" search. The Sixth Circuit rejected the opportunity to hold the IRS to the same debtor name standards imposed on Article 9 filers and instead determined that a reasonably diligent searcher (at least under circumstances where there were indications that filings under the name variation existed in the filing office) should have searched the alternative names and found the federal tax lien filing.

The terrible impact of a filed federal tax lien on a secured party's priority (the secured party rapidly loses priority with respect to future advances and after-acquired property) suggests that all but the most trusting secured parties will want to conduct a meaningful (if not 100% comprehensive) federal tax lien search. Accordingly, they will need to conduct multiple Article 9 searches under name variations or they will need to conduct non-standard searches using expanded search logic. In neither case will they enjoy the degree of certainty afforded by Article 9 and the fact that they will have to conduct extra searches undercuts the ability of the Article 9 reforms to successfully reduce transaction costs. While certain searches have become unnecessary under Article 9, nothing is saved if they need to be conducted anyway to find potential federal tax liens.

The Florida Experience

Florida outsourced it UCC filing office and has never adopted administrative rules. To conduct a search in Florida, one goes to a web site and inputs the initial characters of the debtor name, and the search engine takes you to an "insertion point" in the database, from which the searcher can scroll backwards or forwards as far as they want. This is just like a human being looking up a name in a phone book and the entire database is "revealed" by the search and made available to the searcher. But how far should one scroll? The first Florida case to address the issue held that a searcher should have found a financing statement that was one page ahead of where it should have been in the index because of a

[34]Harry S. Sigman. Improvements (?) to the UCC Article 9 Filing System, 46 Gonz L. Rev. 457, 474 (2010/11).

debtor name error.[35] A subsequent case, where the debtor name error resulted in the financing statement being indexed 60 pages from where it should have been indexed, limited a searcher's duty to scroll to one page, plus or minus, from the insertion point.[36] We will see if the "one page" standard survives in Florida. Note that there is an argument that there is simply no standard search logic in Florida and therefore there is no safe harbor under U.C.C. § 9-506 for an erroneous debtor name to be saved because it is found in a "standard" search. If that argument were to be raised and prevail, secured parties would have no "wiggle room" for debtor names in Florida at all.

Promotion of Electronic Filing and New Cost-Saving Technology

When Article 9 was being revised in the 1990's, there were only a couple of filing offices that offered electronic filing and its users were limited to a small group who contracted with the filing office for special access. It seems so obvious today that electronic filing would become ubiquitous, but it was not so obvious then. Filing offices needed to build and upgrade systems and funding was a problem. While funding remains a problem for filing offices,[37] today at least 45 states offer some form of electronic filing.[38] Many states offer some form of electronic search capability as well. For example, Michigan allows a searcher to get electronic search summaries for free. Copies of financing statements revealed and a certified search, if desired, must be paid for, but basic information is readily available for little cost.

States also sell their data in bulk as required by Article

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[35]Harry S. Sigman. Improvements (?) to the UCC Article 9 Filing System, 46 Gonz L. Rev. 457, 474 (2010/11).

[36]In re John's Bean Farm of Homestead, Inc., 378 B.R. 385, 49 Bankr. Ct. Dec. (CRR) 44, 64 U.C.C. Rep. Serv. 2d 454 (Bankr. S.D. Fla. 2007).

[37]See, Paul Hodnefield, *State Budget Woes Impact Filing* Offices, Commercial Law Newsletter, Summer 2011.

[38]IACA compiles annual reports from state-level UCC filing offices regarding activity and capabilities. While every office does not update their information every year, a review of recent reports shows that almost every state has or recently had an electronic filing capability. One assumes that states that reported an electronic capability have maintained it even if they have not updated their report. See, http://www.iaca.org and the 2010 IACA Reports found there.

9,[39] so private databases and searches are available. While results are "unofficial," information can be obtained by a searcher more quickly, and usually for less cost, than it might be obtained from the filing office. The ability to maintain and communicate information electronically has clearly reduced transaction expenses for filers, searchers and filing offices, and has enabled private companies to provide value-added products that the filing offices do not have the resources to develop.

Effect on Transaction Costs

The Article 9 filing system is significantly better than it was under old Article 9. Electronic filing and searching has saved costs and the system has worked well for organizations, especially registered organizations. The debtor name is objectively verifiable and even though the 2010 Amendments add further certainty, very few cases have arisen once filers came to understand the critical importance of getting the debtor name right. However, the inherent difficulty of determining an individual's name with the same degree of precision, and the unfortunate fact that federal tax lien searchers need to search name variations have impeded cost-effective searching. A UCC search for a multi-state registered organization debtor is very efficient compared to what would have been required under old Article 9. It is hoped that the 2010 Amendment will improve outcomes for individual debtor transactions. The 2010 Amendments do not offer a perfect solution, but I would expect that the emphasis on the driver's license name will cause all secured parties always to search and file under the driver's license name. While there will be unavoidable issues, the focus on the driver's license name should improve the odds that searchers will find prior filers. For UCC searches, the goal of "one-stop shopping" has been substantially achieved. But the "jurisdictional" limits of Article 9, particularly with respect to federal tax liens, still require searchers to search in additional filing offices and under various debtor name variations.

[39]U.C.C. § 9-523(f).

Reduce Burden on Filing Offices

Simplifying the Indexing and Searching Process

Name Formats

As noted in the 1998 Article, one of the objectives of Article 9 was to simplify, and therefore improve the efficiency and accuracy of, the process of indexing debtor names.[40] Because the search logic (and in many cases the database) is different for individual names and organizational names, the filing office needs to know if the debtor is an individual or an organization, and if the debtor is an individual the filing office needs to know which portion of the name is to be treated as the last name (John Elton or Elton John?). These improvements were fully implemented by providing in the statute that financing statements submitted for filing must be rejected if not submitted on an approved form,[41] if they do not indicate whether the debtor is an individual or an organization,[42] or if, for an individual debtor, they do not identify the debtor's last name (now clarified to be the surname in the 2010 Amendments[43]).[44] The filing office is no longer required to guess. The filer provides the information in the specified format and the filing office enters the information exactly as it appears.

Data Entry

Note that filing offices have provided in their rules that debtor name information is entered into their filing system

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[40]Darrell W. Peirce, Revised Article 9 of the Uniform Commercial Code: Filing System Improvements and Their Rationale, 31 UCC L.J. 16, 22.

[41]U.C.C. § 9-516(b)(1). In most states, the statute incorporates a "national" form that must be accepted by the filing office, whether or not the filing office accepts other forms. U.C.C. § 9-521. IACA also has promulgated a form that most filing offices will accept. The 2010 Amendments modernize the statutory form.

[42]U.C.C. § 9-516(b)(5)(B).

[43]Rev U.C.C. § 9-503(a)(4) under Alternative A or Rev U.C.C. § 9-503(a)(5) under Alternative B.

[44]U.C.C. § 9-516(b)(3)(C).

exactly as it is provided by the filer.[45] In a recent poll of IACA members in the IACA listserve, every state that responded confirmed that they enter debtor names exactly as presented.[46] Filing offices will not attempt to correct what appear to be typographical errors, understanding that their role is to index what the filer provides, not to pass on the legal sufficiency of a financing statement.[47] Filing offices no longer try to "fix" submitted names. A filer may get an informal notice to the effect that they may want to verify a name but only a handful of filing offices will do this, and all of them will enter the name exactly as it appears notwithstanding any apparent problem.

Data entry error was another problem Article 9 sought to address. The "original" system of physical file drawers containing paper copies of financing statements in alphabetical order had been replaced with databases of debtor names that are searched by computer. Filing offices were required to key information from paper financing statements to enter debtor names into the computer-searchable database and human errors are inevitable. Given the strict search logic employed in most filing offices, typographical errors are in the debtor name are almost certain to cause the erroneous name not to be found in a "standard" search. Because filing occurs upon tender of an appropriate financing statement and the requisite filing fee,[48] and an indexing error made by the filing office does not adversely affect the legal effectiveness of a financing statement,[49] the effect of a filing office indexing error is to create a legally effective hidden lien that

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[45]See, e.g., 14 Ill. Adm. Code 180.17(b).

[46]Summary compiled by Sheri L. De Marco, IACA Secured Transactions Section Chair, on June 17, 2011, and distributed on the IACA listserve. Eighteen states responded. Minnesota indicated that they did not enter all punctuation but it has no impact because the punctuation would have been ignored by the search logic anyway.

[47]"The duties and responsibilities of the Secretary with respect to the UCC are ministerial. In accepting for filing or refusing to file a UCC record, the Secretary does none of the following: 1) Determine the legal sufficiency or insufficiency of a record. 2) Determine that a security interest in collateral exists or does not exist. 3) Determine that information in a record is correct or incorrect, in whole or in part. 4) Create a presumption that information in a record is correct or incorrect, in whole or in part."

[48]U.C.C. § 9-516(a).

[49]U.C.C. § 9-517.

a searcher cannot find (unless they stumble into the same typographical error in submitting the debtor name to be searched). Accordingly, filing office error should be avoided whenever possible. Filer error has adverse consequences, but a filer may well be in a position to identify and correct an error before a search is made, and in any event appropriately bears responsibility for its own mistakes.

The primary solution to filing office keying errors is electronic filing where the debtor name does not need to be re-keyed and but is instead (as I put it in the 1998 Article in nontechnical terms) "automatically" transferred into the filing office's computer index. Once the system that transfers the debtor name is properly built and tested, all keying errors will be those of the filer and not of the filing office. In addition, having the debtor name in electronic form has allowed private search companies to offer products where a submitted debtor name is compared to the names of registered organizations in the relevant state (purchased from the state's "corporate" database) to confirm that there is an exact match to one of the listed names.[50]

Relieving the Filing Office From Legal Sufficiency Determinations

Filing offices used to verify the existence (if not the authenticity) of signatures on financing statements and they would also evaluate other aspects of a financing statement that go to legal sufficiency. As noted in the 1998 Article, this lead to many filing offices having inconsistent and nonuniform reasons to reject financing statements tendered for filing. Article 9 fixed that problem by making acceptance of a tendered filing mandatory unless there is a specific statutory reason to refuse the filing. The statutory reasons for refusal are limited and specific, and generally relate to the ability of the filing office to index the financing statement or amend-

[50]This tool is not perfect because some of the "corporate" database names were keyed into that database many years ago when storage costs were high and so names were abbreviated or truncated. The abbreviated or truncated names probably will not be legally effective as the name of the debtor under U.C.C. § 9-503 or as a name nevertheless found in a "standard" search under U.C.C. § 9-506. In many states, it is this flawed database that generates good standing results and certificates, so one should always confirm a registered organization name by reference to its "public organic record" and rely only on a good standing certificate.

ment, not to the other features of the proposed filing that are required for legal effectiveness.[51]

"Rogue" Amendments

This streamlining of the intake process was extended to amendments to financing statements. Article 9 provides that amendments are to be indexed "in a manner that associates" them with the initial financing statement they (purport) to amend.[52] The linkage is accomplished by using the file number of the initial financing statement being amended, and such file number must be provided on an amendment.[53] While certain amendments must provide certain data elements (e.g., an amendment adding a debtor must provide an address for the new debtor), in general amendments are accepted by a filing office if they provide an initial financing statement file number that matches the file number of an initial financing statement that has not yet lapsed.[54] The filing office does not and cannot verify that the file number provided is the correct one.[55] This is made the filing process much faster for filers and cheaper for filing offices to administer, but because typographical errors can occur easily in numbers, there are a number of instances where amendments get linked to the wrong (from what was intended—the filing office did its job properly) financing statement. Amendments not authorized by a proper party have no legal effect, but filers who have erred and secured parties who have found "rogue" amendments associated with their financing statements have felt some need to "do something". Article 9 allows debtors to file correction statements to indicate the debtor has an issue with a filed financing statement.[56] They have no legal effect, but they provide public notice, and filers other than debtors have been using them and filing offices have been taking them to accommodate them. The 2010 Amendments address this develop-

[51]U.C.C. § 9-516(b).

[52]U.C.C. § 9-519(c).

[53]U.C.C. §§ 9-512(a)(1) and 9-516(b)(3)(B)(i).

[54]U.C.C. § 9-516(b).

[55]U.C.C. § 9-520(a).

[56]U.C.C. § 9-518.

ment by permitting secured parties of record to file correction statements.[57]

In addition, where filing officers once had to manipulate a number of data inputs to reflect the legal impact of amendments to financing statements, Article 9 now provides for a system where all amendments are linked to an initial financing statement by file number, all amendments so linked are retrieved with the initial financing statement in a search, and all financing statements remain on the searchable index until at least one year after they lapse.[58] The filing office no longer needs to make changes based on apparent legal status—it just adds amendments to the financing statement—and reacts only to a date that is established by the filing office itself when the financing statement is first filed. This eliminates potential filing office errors. It does present searchers with search results for financing statements that are in fact no longer legally effective (e.g., because a filed termination is in fact legally effective), trading off some efficiency in the system, but it seeks to eliminate hidden liens created by filing office error, giving searchers information on all potentially legally effective financing statements and letting the searcher decide whether to conduct further diligence.

Authorization; Legal Effectiveness

Signatures of debtors used to be required on financing statements. However, signatures impeded electronic filing and because the filing office had no way to verify signatures, the signature requirement was not an effective barrier to fraud. Instead of signatures, Article 9 provides that for a financing statement to be legally effective, it must be authorized by the debtor.[59] Similarly, any amendment to a financing statement (other than one adding collateral, which

[57] Rev U.C.C. § 9-518(c).

[58] Financing statement generally are effective for five year periods and must be continued by an amendment every five years. U.C.C. § 9-515. Note that the filing office can independently determine the "lapse" date at the end of the five-year period and financing statements are removed from the searchable index only after the secured party fails to continue them, even if they have been the subject of an amendment that purports to terminate the financing statement or release all of the collateral covered by the financing statement.

[59] U.C.C. §§ 9-509 and 9-510. A security agreement constitutes authorization to file on the collateral described in the security agreement.

require debtor authorization) must be authorized by the secured party of record (the secured party or its assignee as shown as the secured party on the public record of the financing statement as amended).[60] Law other than Article 9 determines authority and one would expect normal principles of agency, including the doctrine of apparent authority, would apply. A couple of issues have arisen regarding authority to file. As indicated, one might have expected that when a secured party acts through an agent, the secured party would be bound by its agent's mistakes. But a couple of secured parties have tried to argue that their agent was not authorized to make the mistake they in fact made. In one case, a service company was authorized to amend a financing statement but not only checked the box and provided the information to effect the authorized amendment, it checked the "termination" box as well. The secured party was successful in persuading the court that the erroneous amendment was not effective to terminate, but the court took notice of the fact that a subsequent searcher would see the amendment and would recognize the inconsistency of amending a financing statement that is being terminated and, therefore, be put on notice that the check in the termination might well be in error.[61]

In my view, courts should not go too far in protecting secured parties from errors of their authorized agents. To the extent possible, searchers should be able to rely on the public record. Having said that, one needs to also recognize that the fact that an unauthorized financing statement or amendment has become a matter of public record does not cause the unauthorized filing to become legally effective. At least one court lost sight of that in stating that what appeared to be a "clean" termination statement apparently authorized by the secured party of record would be legally effective when in fact it was not authorized by the secured party of record.[62] The case has been criticized and was not followed in a subsequent case involving an unauthorized

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[60]U.C.C. § 9-511.

[61]In re A.F. Evans Co., Inc., 69 U.C.C. Rep. Serv. 2d 1115 (Bankr. N.D. Cal. 2009), aff'd, 2011 WL 1832963 (N.D. Cal. 2011).

[62]Roswell Capital Partners LLC v. Alternative Const. Technologies, 2010 WL 3452378 (S.D. N.Y. 2010), judgment aff'd, 2011 WL 3849613 (2d Cir. 2011).

termination filed by the debtor.[63] And of course that is the right outcome—a debtor simply cannot be empowered to make a fraudulent filing that will nevertheless be legally effective. Searchers need to understand that the mere fact of filing is not the equivalent of legal effectiveness, and courts will need to balance the desire to provide reliable search results to searchers with the need to protect existing filed secured parties from debtor fraud. The 2010 Amendments do not address this issue.

Overbroad Financing Statements

There is another issue lurking in Article 9 regarding authority to file, which arises out of a desire to protect secured parties from errors in collateral descriptions and the fact that "supergeneric" "all assets" descriptions are permitted and given legal effect when used on financing statements. There are Official Comments to Article 9 to the effect that if a secured party files a financing statement with an overbroad collateral description, the financing statement is effective with respect to the actual collateral and unauthorized with respect to the described property that is not in fact collateral.[64] This protects the secured party but "chills" the debtor's ability to use the non-collateral property described as collateral in another deal. There may be a cause of action for damages under Article 9, but tort remedies are likely supplanted by the Code and contract damages may be difficult to prove, even while the debtor's ability to obtain other credit is impaired.[65] While I generally approve of the idea that secured parties should not be punished for modest overbreadth, I have always harbored a concern that, in an egregious case (e.g., lessor of a single item of equipment files an "all assets" financing statement and refuses to amend it), a court might conclude that the entire financing statement is

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[63]AEG Liquidation Trust v. Toobro N.Y. LLC, 32 Misc. 3d 1202(A), 74 U.C.C. Rep. Serv. 2d 675 (N.Y. Sup 2011). See, Clarks' Secured Transactions Monthly, Vol. 27, No. 8 (August, 2011), and William H. Henning and Fred H. Miller, *Dangerous Dictum Rejected,* The Uniform Commercial Code Law Letter, Vol. 45, No. 8, October, 2011. "The [Roswell] dictum was wrong, and dangerous, and we're pleased to report it was thoroughly analyzed and rejected in [Toobro]."

[64]See, Official Comment 2 to U.C.C. § 9-510.

[65]Lissa Lamkin Broome, *Supergeneric Collateral Descriptions in Financing Statements and Notice Filing,* 46 Gonz. L. Rev. 435 (2010/11).

not authorized. I note that while a debtor has a statutory right to a termination once all secured obligations are paid and there is no further commitment to lend, which can be "enforced" by self-help (the debtor is authorized to file a legally effective termination if the secured party does not timely act), there is no similar right with respect to an overbroad financing statement. A debtor could file a correction statement (to be called an "information statement" under the 2010 Amendments) to create a public notice that the debtor claims the collateral is less than what is described, but a correction statement has no legal effect.[66] This lack of a meaningful remedy may influence a court to provide one by finding the entire financing statement unauthorized.

Other than reinforcing the Official Comments regarding overbroad collateral descriptions, the 2010 Amendments propose no change to the authority to file rules. This may well be an area where future litigation develops now that a couple of cases have addressed the issue and exposed it for further analysis. The agency issues surrounding authority to file are more complex than a determination of whether or not a signature is genuine and authentic. In addressing these agency issues, one hopes that courts will strike an appropriate balance to effect the Code's purpose of providing a meaningful information to searchers while protecting secured parties from fraud.

Promote Uniformity in Filing Office Practices and Policies

Use of National Form with Improved Name Formats

As noted above, Article 9 now provides that financing statements submitted for filing must be rejected if not submitted on an approved form,[67] if they do not indicate

[66]U.C.C. § 9-518. The 2010 Amendments would allow a secured party of record also to file information statements.

[67]U.C.C. § 9-516(b)(1). In most states, the statute incorporates a "national" form that must be accepted by the filing office, whether or not the filing office accepts other forms. U.C.C. § 9-521. IACA also has promulgated a form that most filing offices will accept. The 2010 Amendments modernize the statutory form.

whether the debtor is an individual or an organization,[68] or if, for an individual debtor, they do not identify the debtor's last name (now clarified to be the surname in the 2010 Amendments[69]).[70] Article incorporated a standard "national" form into the statute to ensure that at least one form would work in every filing office.[71] The 2010 Amendments make a couple of modest changes to the national form found in the statute, the primary one being to eliminate a box for tax identification numbers.[72] The name formats have relieved filing offices from guesswork, enabling them to simplify their indexing function to entering the debtor name exactly as it is provided in the financing statement. There is no data on how many names, if submitted in the old format (a single box for debtor name and address), would create problems for a filing office. The problem simply doesn't exist anymore.

Model Administrative Rules and IACA

Article 9 provides that filing offices must adopt administrative rules and, in doing so, they should "consult the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators . . ."[73] In addition, IACA regularly addresses various filing scenarios with its members, develops a preferred response and polls its membership to determine who varies from the preferred response and why. This information is compiled and updated annually (subject to the willingness and ability of individual filing offices to participate) and can be found on

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[68]U.C.C. § 9-516(b)(5)(B).

[69]Rev U.C.C. § 9-503(a)(4) under Alternative A or Rev U.C.C. § 9-503(a)(5) under Alternative B.

[70]U.C.C. § 9-516(b)(3)(C).

[71]U.C.C. § 9-521.

[72]Rev U.C.C. § 9-521. Filers tend to fill in boxes on forms and almost every state is now required to redact tax identification numbers because of privacy concerns.

[73]U.C.C. § 9-526(b)(2). Since 2001, IACA has changed its name to the International Association of Commercial Administrators. Some states have already reflected this name change in their enacted version of Article 9 and the 2010 Amendments do so as well. The current Rules can by found at http://www.iaca.org.

the IACA web site in a document commonly known as the "Filing Chart."[74]

Non-uniformity is out there but most state filing offices claim to follow the model rules and as one can see from the Filing Chart, there is substantial consensus on most issues and outcomes. Having been a primary liaison between the Drafting Committee and the filing officers in my role as Chair of the Article 9 Filing Project, I am absolutely certain that the great strides have been made to improve the common understanding and professionalism of the filing officers and IACA has been the catalyst. I am aware of criticism that non-uniformity remains, that the Model Rules have not been properly implemented even if adopted and that systems managers may be altering the search logic or otherwise damaging the database in managing their systems.

One has to assume that this criticism is correct to a point. But I know that IACA has raised the general level of awareness and promoted uniformity. I am not aware of a serious problem where search outcomes have been altered by filing office action. Indeed, I have observed IACA self-policing its members, its listserve is active with filing officers sharing best practices, and I know at least one state backed away from tweaking its search logic because of the potential change in search outcomes and the potential impact on legal effectiveness. In my opinion, IACA and the state-level filing officers as a whole are doing a fine job, but the next challenge is educating a new generation of filing officers who did not participate in the 1990's reform efforts and have not come to understand why the system is built as it is.

Conclusion

The revisions described in the 1998 Article have been implemented and have been substantially accomplished. To the extent Article 9 itself could provide solutions through a change in the statute (e.g., new name formats, limited reasons to refuse to accept filings), they have been achieved. To the extent solutions depended on the use of electronic communication and improved information management technology, they have been substantially achieved but success has been limited by limited budgets. To the extent a

[74] http://www.iaca.org/downloads/STS/Accepting_UCC_Record_Filing_Chart.pdf.

problem exists outside the scope of Article 9 (e.g. federal tax lien rules, common law rules regarding individual names), the problem remains. While the 2010 Amendments address the individual debtor name issues, the controversy surrounding the proposed changes and the adoption of alternative formulations for the statute demonstrate there is no perfect or consensus solution.

I believe that Article 9 and the 2010 Amendments have done substantially all of what can and should be done under Article 9 to improve the Article 9 filing system. Transaction costs are reduced because the number of jurisdictions to be searched and the number of "hits" revealed by searches have been limited. The Article 9 system is clean and efficient compared to other filing systems and should be kept that way.

As we move forward, the next phase of improvements will and should be left to electronic communication and the use of non-standard search logics to quickly find federal tax liens and other filings under name variations. Private search companies can provide this and a level of integration that no filing office can. For example, if one wants to search fully for pending litigation for a multi-state company, one might have to search to hundreds of counties. Even if those counties provide a electronic search option, it would be limited to that county so hundreds of searches would still be required. Private companies can automate and integrate that process in a variety of ways and that process can be market-driven. Private companies are already providing financing statement and debtor monitoring services where a secured party gets notice whenever an amendment is filed, gets reminded to continue every five years, and gets notice if an amendment to a debtor's public organic record is filed, so the secured party can act accordingly. The key to enabling these improvements is to promote secure electronic access to public records and database sales.