UNIFORM COMMERCIAL CODE COMMITTEE

REPORT PREPARED FOR THE DECEMBER 3, 2011 COUNCIL MEETING

1. **2011-2012 Budget Request and Anticipated Use of Funds.**

I have requested $500.00 to be used for possible Committee meeting expenses.

2. **Use of Budgeted Funds During 2010-2011.**

No funds were used for the UCC Committee during 2010-2011.

3. **Next Scheduled Meeting of the Committee.**

Next scheduled meeting of the Committee: November 28, 2011 @ 4:00 p.m.

4. **Council Approval.**

No matters require Council approval.

5. **Membership.**

Since November 23, 2010, I have sent to all Committee members eight separate memoranda with attachments describing recent case law and statutory developments and enclosing copies of same. A copy of the most recent communication to all Committee members dated October 31, 2011 is attached to this Report. I have personally communicated with all new members of the Committee shortly after they have joined, advising them of the Committee's activities and urging them to become involved in the Committee's work.

6. **Accomplishments Toward Committee Objectives.**

I have kept the Committee members apprised of recent local and national developments in UCC law during this past year.

7. **Meetings and Programs.**

As noted above, the UCC Committee will meet on November 28, 2011 to discuss, among other things, the proposed legislation recently introduced in the Michigan legislature to adopt revised Articles 1, 7, and 9 of the UCC. If this legislation is adopted in Michigan, the Committee would be interested in presenting the major changes in the context of a state-wide seminar for attorneys and other interested persons.

8. Publications.

Please see response to Question 5 above. I am aware of no articles on UCC topics that have been recently submitted for publication to the Business Law Journal.

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

I have been monitoring the proposed legislation described in Paragraph 7 above.

10. Miscellaneous.

Noting to report.

Respectfully submitted,

Patrick E. Mears, Chairperson

BARNES & THORNBURG LLP

MEMORANDUM

TO: All Members of the UCC Committee

FROM: Patrick E. Mears

DATE: October 31, 2011

To All: Here is the 2011 Annual Survey of Article 9 developments authored by Steve Weise and published in the August 2011 issue of *The Business Lawyer*.

Patrick E. Mears

Personal Property Secured Transactions

*By Steven O. Weise**

I. Scope of Article 9 and Existence of a Secured Transaction

A. Introduction

The first thing that a potential secured party should do is figure out if Article 9 applies to the transaction. If it does, then the secured party will know to comply with the various requirements of Article 9. If the secured party misses that Article 9 applies to the transaction, then the secured party may find itself without an enforceable, perfected, or prior security interest due to the failure to comply with Article 9's requirements.

B. General

Article 9 disregards the form and looks to the substance of a transaction to determine whether the transaction creates a "security interest"—an interest in personal property that secures an obligation or arises in favor of the buyer of most kinds of payment rights.[1] In *In re C & S Electric, Inc.*,[2] a general contractor agreed to pay a subcontractor and its supplier jointly. This, the court held, did not create a security interest in property of the subcontractor to secure the subcontractor's obligations to the supplier.[3] Instead, it was a payment mechanism that specified how the general contractor would perform its own obligation to ensure that all parties were paid.[4] However, a secured party with a security interest in the subcontractor's accounts took its interest subject to the joint check agreement and therefore its interest did not attach to the amounts the general contractor owed to the supplier.[5]

* Steve Weise is a partner in the Los Angeles office of Proskauer Rose LLP.

1. *See* U.C.C. §§ 9-109(a)(1), 1-201(b)(35) (2008).
2. 433 B.R. 782 (Bankr. D. Haw. 2010).
3. *Id.* at 789.
4. *Id.* at 787–90; *see also In re* Stephens, No. 10-12704, 2010 WL 4286186, at *3–4 (E.D. Mich. Oct. 26, 2010) (attorney's fee agreement purporting to give the attorney "an attorney's lien on any asset owed or due to the Client" did not give the attorney a security interest on the client's rental income because the rental income was not earned as a result of the attorney's services).
5. *C & S Electric*, 433 B.R. at 790–91 (citing U.C.C. §§ 9-403, 9-404); *cf.* Randle v. AmeriCash Loans, LLC, 932 N.E.2d 1200, 1206–07 (Ill. App. Ct. 2010) (when taking out a loan, borrower signed an EFT authorization authorizing the lender to debit borrower's checking account upon a default; this arrangement created a security interest in the borrower's checking account).

C. Consignments

Non-lawyers often believe that because a consignor still owns the consigned goods, the consignor bears no risk of losing the goods to the creditors, secured and unsecured, of the consignee. The consignor often learns to its distress that Article 9 requires the consignor to take action to protect itself. The first question is whether the transaction constitutes a "consignment" under Article 9.[6] Unless some exception applies, a "consignment" exists under Article 9 if goods are delivered "for the purpose of sale" by the consignee.[7] This issue arose in *In re WFG, LLC*,[8] where the court denied summary judgment because there was a factual question as to whether goods were delivered to the debtor for the purpose of sale, which would be a consignment governed by Article 9 and would make the goods property of the debtor's bankruptcy estate, or as a bailment for display.[9]

Once a consignor determines that the transaction is a "consignment," the consignor needs to take additional steps to have priority over the secured creditors and lien creditors of the consignee. In *Rayfield Investment Co. v. Kreps*,[10] the owner of a painting consigned the painting to an art dealer. The owner/consignor did not file a financing statement to perfect its security interest as provided by U.C.C. section 9-310. As a result, the dealer's lender with a security interest in the dealer's inventory had priority because it was the only secured party with a perfected security interest.[11] Although the inventory secured party knew that some of the dealer's inventory was consigned, the consignor presented no evidence that the dealer was generally known by its creditors to be substantially engaged in selling the goods of others, which would have allowed the consignor to avoid the Article 9 rules.[12]

D. Real Property

Article 9 generally does not apply to an interest in real property.[13] To apply this exception, one must occasionally address the preliminary question of what is "real property." In *In re Arcadia Enterprises, Inc.*,[14] the court held that a developer's permits to develop a housing project ran with the land and were "real property."[15] Because the developer's lender had perfected its lien under real estate law, the lender did not have to file a financing statement to perfect its security interest in the permits.[16]

6. *See* U.C.C. § 9-102(a)(20) (2008).
7. *Id.*
8. No. 09-11265, 2010 WL 4607614 (Bankr. E.D. Tenn. Nov. 3, 2010).
9. *Id.* at *3.
10. 35 So. 3d 63 (Fla. Dist. Ct. App. 2010).
11. *Id.* at 65–67; *see* U.C.C. § 9-322(a)(2) (2008).
12. *Rayfield Inv. Co.*, 35 So. 3d at 66–67; *see* U.C.C. § 9-102(a)(20)(A)(iii) (2008).
13. U.C.C. § 9-109(d)(11) (2008).
14. 440 B.R. 1 (Bankr. D. Mass. 2010).
15. *Id.* at 10–11.
16. *Id.* at 11–12.

E. Leasing

Every year brings decisions addressing whether a transaction labeled as a "lease" is really a "lease" or is rather a sale with a retention of title that creates a "security interest."[17] To make this determination courts apply an economic realities test that inquires whether the "lessor" retained a meaningful economic interest in the goods.[18] If so, the lease form will be respected. If not, the transaction will be re-characterized as a sale and security interest. For example, *In re UNI Imaging Holdings, LLC*[19] involved a 66-month lease of equipment with a $175,000 purchase option at the end. The court did not re-characterize the lease as a sale with a retained security interest because the option price was more than 50 percent of the expected fair market value of the equipment at the end of the lease term and the cost of removing and shipping the machine back to the lessor was not more than $26,000.[20] In contrast, the "lease" in *In re Williamson*[21] was a 57-month car lease that included an option to buy the car at the end of the lease term for $386. The court had no difficulty in concluding that the transaction was a "sale" with a security interest because the lease was not terminable by the lessee and the option price was nominal.[22]

F. Sales

Sometimes a transaction structured as a "sale" is really a secured transaction if the "seller" retains too many rights with respect to the "sold" property. In *In re Belak*,[23] a tenant in default under a lease entered into a "Collateral Agreement" with the landlord. The agreement provided that the tenant transferred to the landlord the tenant's right to sell items of the tenant's personal property, required the landlord to give the tenant an accounting of the property sold, and provided the tenant with a right to redeem the property. The court held that the transaction was a "sale," and did not create a security device because the tenant had no right to remove the property during the term of the agreement and the tenant understood that he was transferring title to the property.[24] The court's reasoning seems questionable because the tenant retained the economic interest in the "sold" goods.

G. Intellectual Property

A secured party with a security interest in intellectual property must often contend with the possible application of federal intellectual property law, which

17. *See* U.C.C. § 2-401(1) (2002).
18. *See* U.C.C. § 1-203 (2008).
19. 423 B.R. 406 (Bankr. N.D.N.Y. 2010).
20. *Id.* at 418–20.
21. No. BK09-41019-TLS, 2010 WL 3369384 (Bankr. D. Neb. Aug. 23, 2010).
22. *Id.* at *2.
23. No. 09-51697 (AHWS), 2010 WL 1839350 (Bankr. D. Conn. May 6, 2010).
24. *Id.* at *2–3.

might preempt Article 9.[25] In *Brown Bark II, L.P. v. Dixie Mills, LLC*,[26] a seller of trademarks retained a security interest in the trademarks and associated goodwill. The seller later obtained a judgment against the buyer that gave the seller "full rights" to one of the trademarks. The court held that the seller was not liable to a subsequent secured party that purported to purchase the trademarks at a public sale after default.[27] The debtor's business had ceased prior to the public sale and there was no goodwill—of which trademarks are a part—left for the secured party to acquire at the public sale.[28]

II. Security Agreement and Attachment of Security Interest

A. Security Agreement

Having determined that Article 9 applies to a transaction, the putative secured party needs to have the debtor enter into an authenticated security agreement that provides for a security interest and describes the collateral.[29] Sometimes the secured party forgets to satisfy these elementary requirements. For example, in *In re Kaminsky*,[30] a creditor did not obtain an enforceable security interest based on an unsigned copy of a brokerage agreement that did not identify the debtor by name.[31] In contrast, the secured party in *In re Giaimo*[32] was lucky. Both an application for a certificate of title signed by the debtor and the certificate itself together indicated the secured party's security interest in the vehicle. The court ruled that these were sufficient to satisfy the requirement of a written security agreement because "[u]nlike simple financing statements, which are often filed in anticipation of a *possible* loan . . . , an application for a certificate of title is not completed unless there is an actual purchase or transfer of a motor vehicle."[33]

A security interest must secure the payment or performance of an obligation.[34] The court held that the security interest in *Roswell Capital Partners LLC v. Alternative Construction Technologies*[35] did neither. A secured party converted the debtor's notes to equity and as a result extinguished the debtor's obligation to the secured party and the court correctly held that the security interest was also extinguished.[36]

25. U.C.C. § 9-109(c)(1) (2008).
26. 732 F. Supp. 2d 1353 (N.D. Ga. 2010).
27. *Id.* at 1358.
28. *Id.*
29. U.C.C. § 9-203(b)(3)(A) (2008). It is possible to have an attached security interest created by an oral security agreement if the oral agreement is accompanied by possession, delivery, or control of the collateral. *Id.* § 9-203(b)(3)(B)–(D).
30. No. 1-09-47942-JBR, 2010 WL 4026378 (Bankr. E.D.N.Y. Oct. 13, 2010).
31. *Id.* at *2.
32. 440 B.R. 761 (B.A.P. 6th Cir. 2010).
33. *Id.* at 771; *cf. In re* Burival, No. BK07-42271-TLS, 2010 WL 2774830, at *2 (Bankr. D. Neb. July 14, 2010) (creditor's unilateral act of filing a financing statement did not create a security interest).
34. U.C.C. § 1-201(b)(35) (2008).
35. No. 08 Civ. 10647(DLC), 2010 WL 3452378 (S.D.N.Y. Sept. 1, 2010).
36. *See id.* at *6.

However, the court went astray in holding that the security interest did not come back to life when the secured party exercised its contractual right to re-convert the equity back to debt.[37]

Two decisions considered the effect of a depositary bank's security interest and set-off rights on each other. In *Fifth Third Bank v. Peoples National Bank*,[38] a depositary bank had a perfected security interest in a customer's deposit account. The court held that the bank did not waive that security interest by claiming that it held no deposit account when it answered interrogatories in connection with a writ of garnishment.[39] Nor did the depositary bank waive its security interest by failing properly to effect set-off upon service of the writ because the depositary bank's security interest had priority over the garnishment lien and the secured debt exceeded the balance in the deposit account.[40] In contrast, in *In re Lehman Brothers Holdings, Inc.*,[41] the court held that the language of an agreement creating a security interest in a customer's deposit account waived the bank's set-off rights. The customer had opened and funded a $500 million deposit account to provide collateral for intra-day credit that it owed to the depositary bank, of which there was none. The bank set the deposits off against the customer's unrelated obligations arising from derivatives transactions. The court ruled that the language of the security agreement made it clear that the security interest secured only intra-day credit and the restricted nature of the deposit account made it a special deposit against which the bank did not have common-law set-off rights.[42] The decision in *Lehman* on this point seems incorrect. The security agreement reserved the secured party's other rights, which would have included its set-off rights.[43]

B. Rights in the Collateral

To grant a security interest in property, the debtor must either have rights in the property or the power to convey rights in it.[44] Further, a person acting on behalf of another entity that owns the collateral must have authority to act for that entity under non-U.C.C. law. LLCs seem to confuse people. In *Assets Resolution Corp. v.*

37. *See id.* This portion of the court's decision is criticized in Stephen L. Sepinuck & Kristen Adams, *UCC Spotlight*, Joint Newsl. of the ABA Sec. of Bus. L. Comms. on Com. Fin. & U.C.C. (ABA Sec. of Bus. L., Chicago, IL), Fall 2010, at 23, 25, *available at* http://apps.americanbar.org/buslaw/committees/CL190000pub/newsletter/201011/201011.pdf. Other aspects of *Roswell* are discussed below. *See infra* text accompanying notes 144–46.

38. 929 N.E.2d 210 (Ind. Ct. App. 2010).

39. *Id.* at 216–17.

40. *Id.* at 215–17.

41. 439 B.R. 811 (Bankr. S.D.N.Y. 2010).

42. *Id.* at 823–33.

43. *See also* AEP Energy Servs. Gas Holding Co. v. Bank of Am., N.A., 626 F.3d 699 (2d Cir. 2010) (creditor with a security interest in stored natural gas did not waive or subordinate its security interest by agreeing to allow the lessee of the storage facility to use the gas during the term of the lease, provided the debtor was not in default).

44. U.C.C. § 9-203(b)(2) (2008); *see* TYCO Ventures, L.L.C. v. Wiggins, 32 So. 3d 1168 (La. Ct. App. 2010) (because the debtor paid off secured loan and then sold the collateral before purporting to grant another security interest to the original secured party, the debtor had no rights in the collateral at the time of the grant of the second security interest and the security interest did not attach).

CHE LLC,[45] an individual member of an LLC signed a note and security agreement on behalf of the LLC. Because the member lacked authority under the LLC operating agreement to enter into the transaction, the member was personally liable, but did not bind the LLC.[46]

Development Specialists, Inc. v. R.E. Loans, LLC[47] presented a different kind of signature problem involving LLCs. In that case, an individual signed a security agreement on behalf of three separate entities. Because it was unclear whether all three entities were granting a security interest in their assets, the court looked to extrinsic evidence and concluded that two of the entities signed only as members of the first entity.[48] Specifically, all the secured party's invoices identified only the first entity as the debtor and the subsequent security agreement did not mention the latter two parties in its text. As a result, the security agreement was not signed by the other entities and those entities did not grant a security interest in their assets.[49]

C. Restrictions on Transfer

Even if the debtor does own the property, it may lack the ability to create a security interest in that property because of contractual restrictions relating to the collateral or as a result of other laws.[50] In an important decision, the court in *In re Tracy Broadcasting Corp.*[51] dealt with a security interest in the proceeds of an FCC broadcast license. The court observed that a secured party could not obtain a security interest in the debtor's rights in an FCC license itself because federal law provides that no broadcast license be "transferred, assigned or disposed of in any manner," without approval of the FCC.[52] As to the proceeds of a sale of the license, the court acknowledged that it may be possible to grant a security interest in the right to future proceeds from an approved sale of a license.[53] However, if, on

45. No. 09-05042, 2010 WL 1345284 (W.D. Ark. Mar. 31, 2010).
46. *Id.* at *2–3.
47. No. C 10-0635 MEJ, 2010 WL 4055570 (N.D. Cal. Oct. 14, 2010).
48. *Id.* at *2–4.
49. *Id.* at *3–4; *see also* Miko Enters., Inc. v. Allegan Nursing Home, LLC, No. 1:09-CV-988, 2010 WL 148659 (W.D. Mich. Jan. 12, 2010) (a secured creditor of a nursing home facility that was operated by a related entity did not have a security interest in the accounts of the operator because the operator was not a party to the security agreement and the owner of the facility did not own the accounts).
50. *See* U.C.C. § 9-401(a) (2008). There have been several decisions in recent years concluding that a security interest could not be created in a liquor license because the law applicable to those licenses did not permit transfers. *See, e.g., In re* S & A Rest. Corp., No. 08-41898, 2010 WL 3619779, at *7 (Bankr. E.D. Tex. Sept. 10, 2010). Similarly, some states prohibit the transfer of a claim for legal malpractice. *See, e.g.*, InLiner Ams., Inc. v. Macomb Funding Grp., L.L.C., No. 14-08-00350-CV, 2010 WL 2853886, at *5 (Tex. App. July 22, 2010) (debtor cannot create a security interest in a legal malpractice claim because public policy prohibits the assignment of legal malpractice claims).
51. 438 B.R. 323 (Bankr. D. Colo. 2010).
52. *Id.* at 327–38 (discussing 47 U.S.C. § 310(d)). The court noted that while U.C.C. section 9-408(c) overrides state-law restrictions on transfer that would prevent a security interest from attaching, it does not override similar federal laws. *Id.* at 329 n.4; *see also* U.C.C. § 9-408 cmt. 9 (2008).
53. *Tracy Broad. Corp.*, 438 B.R. at 328–31.

the petition date, the "proceeds" do not yet exist because there is no contract for sale approved by the FCC, Bankruptcy Code section 552(a) prevents the security interest from reaching any post-petition sale proceeds.[54]

Although much has been written about whether restrictions on transfer in LLC governing documents can prevent the creation of a security interest in an LLC interest, there can be other restrictions that get in the way of a secured party exercising its rights. For example, in *In re Lake County Grapevine Nursery Operations*,[55] a security agreement purported to give the secured party the right to vote the pledged LLC membership interest. However, the court ruled that under the California LLC statute, the grant of a security interest in the membership rights was not sufficient to divest the member of the right to vote.[56]

III. Description or Indication of the Collateral and the Secured Debt—Security Agreements and Financing Statements

A security agreement must contain a reasonable description of the collateral,[57] and a financing statement must indicate the collateral it covers.[58] However, neither document needs to identify the collateral with particularity; in general, a description that indicates the collateral's Article 9 type is sufficient.[59]

In *In re CHA Hawaii, LLC*,[60] a security agreement described the collateral as "all personal property . . . , excluding Accounts . . . , including . . . [a]ll 'Contracts' . . . , [a]ll 'Deposit Accounts,' . . . [and] [a]ll 'General Intangibles.'"[61] Some rights could fall within both the exclusion of "Accounts" and the inclusion of "Contracts." The court held that the reference to "Contracts" did not limit the exclusion of "Accounts," and thus anything that was an "Account" was excluded even if it otherwise qualified as a "Contract."[62] The court in *In re Las Vegas Monorail Co.*[63] also considered the meaning of "contract rights." There the debtor granted a security interest in "contract rights,"[64] which included the franchise agreement under which the debtor obtained government permission to operate a monorail. The court interpreted the clause narrowly, holding that monies derived from the debtor's operation of a monorail were not "proceeds"[65] of the debtor's "contract rights" to operate the monorail franchise.[66]

54. *Id.*
55. 441 B.R. 653 (Bankr. N.D. Cal. 2010).
56. *Id.* at 655.
57. U.C.C. §§ 9-203(b)(3)(A), 9-108(a) (2008).
58. *Id.* §§ 9-502(a)(3), 9-504.
59. *See id.* § 9-108(b)(3).
60. 426 B.R. 828 (Bankr. D. Haw. 2010).
61. *Id.* at 832 (first, second, and fourth alterations in original).
62. *Id.* at 833–34.
63. 429 B.R. 317 (Bankr. D. Nev. 2010).
64. The term "contract rights" was a defined term in Article 9 until the 1972 amendments, when it was folded into the definition of "accounts."
65. *See* U.C.C. § 9-102(a)(64) (2008).
66. *Las Vegas Monorail Co.*, 429 B.R. at 333–36. The court also narrowly interpreted the scope of a security interest in the debtor's "net revenue." *Id.* at 337–38.

U.C.C. section 9-108(d) provides that a description of a securities entitlement is sufficient if it describes the collateral by that term, as investment property, or describes the underlying financial asset.[67] The court in *Monticello Banking Co. v. Flener*[68] misread this rule. The security agreement in that case described the collateral as "all Debtor's . . . [deposit] accounts maintained at . . . [any] financial institution . . . including, but not limited to, those deposit accounts styled and numbered as follows: . . . Certificate of Deposit #-9536 at Monticello Banking Company . . . [;] . . . Certificate of Deposit #-2581 at CDARS."[69] The court held that this was insufficient to describe the debtor's interest in deposits managed through the Certificate of Deposit Account Registry Service because the debtor's rights were a security entitlement and the language did not mention "security entitlements," "investment property," or describe the "underlying financial asset."[70] The court interpreted U.C.C. section 9-108(d) as requiring the use of one of those "magic words," but that subsection provides a safe harbor for how to describe that kind of collateral, and it does not mandate the use of those words.[71]

A super-generic description, such as "all personal property," will not suffice in a security agreement.[72] In *Mac Naughton v. Harmelech*,[73] the security agreement described the collateral as "all of [the debtor's] right, title and interest in any and all real or personal property wherever located."[74] The description was ineffective because the language did not reasonably describe the collateral.[75] However, courts sometimes allow the use of imprecise language. In *In re U.S. Insurance Group, LLC*,[76] a financing statement described the collateral as accounts and "all records of any kind relating to" the accounts.[77] The court held that this language sufficiently indicated the debtor's records, also known as its book of business, which were general intangibles.[78] Similarly, in *In re Heilman*,[79] a security agreement described the collateral as "[a]ll . . . personal property of every kind and nature whatsoever located on or about" the debtor's farm, along with all products and proceeds thereof.[80] The court held, in a questionable decision, that the description was sufficient to cover the debtor's cows.[81] As a result, the security interest also covered the debtor's post-petition milk because the milk was a product of the cows.[82]

67. U.C.C. § 9-108(d) (2008).
68. No. 1:10-CV-121-R, 2010 WL 5158989 (W.D. Ky. Dec. 14, 2010).
69. *Id.* at *2.
70. *Id.* at *3–4.
71. *See* Howard Darmstadter, *Investment Securities*, 66 Bus. Law. 1153,1159–1160 & nn.35–46 (2011).
72. U.C.C. § 9-108(c) (2008). If, however, the super-generic description is followed by a more specific listing—such as expressly covered collateral types—the more specific listing will be sufficient. *See In re* Lifestyle Home Furnishings, LLC, No. 08-00629-TLM, 2009 WL 1270317, at *3–5 (Bankr. D. Idaho May 7, 2009).
73. No. 09-5450 (PGS), 2010 WL 3810846 (D.N.J. Sept. 22, 2010).
74. *Id.* at *2.
75. *Id.* at *4–5.
76. 429 B.R. 903 (E.D. Tenn. 2010).
77. *Id.* at 908.
78. *Id.* at 911–16.
79. No. 10-10107, 2010 WL 3909167 (Bankr. D.S.D. Sept. 29, 2010).
80. *Id.* at *1–2.
81. *See id.* at *2.
82. *Id.*

Because a security agreement is an "agreement," the description does not have to appear solely in the document labeled as the "security agreement."[83] In *LOL Finance Co. v. Paul Johnson & Sons Cattle Co.*,[84] a security agreement described the collateral as cattle "placed . . . with" a cattle management company.[85] The description was sufficient to cover cattle that the management company was in fact managing at an independent feedlot.[86] Similarly, in *FSL Acquisition Corp. v. Freeland Systems, LLC*,[87] a security agreement described the collateral as "(i) all Purchased Assets identified on the Bill of Sale, [and] (ii) all renewals, substitutions, replacements, accessions, proceeds, and products of the Purchased Assets."[88] The description was sufficient to cover software and customer lists because the bill of sale identified those items.[89]

IV. Perfection

A. Certificates of Title

Several years ago, the court in *In re Clark Contracting Services, Inc.* held that even though a security interest was perfected by notation of the security interest on a certificate of title,[90] a buyer of the secured obligation was not perfected unless the buyer had the notation changed to show the buyer as the secured party.[91] The decision was widely criticized and ultimately the result was changed by an amendment to the relevant state statute.[92] Recently, the decision was also reversed on appeal[93] and the result was rejected by other courts.[94]

83. *See* U.C.C. §§ 1-201(b)(3), 9-102(a)(73) (2008) (defining "agreement" as the "bargain of the parties in fact" and "security agreement" as "an agreement that creates or provides for a security interest").

84. 758 F. Supp. 2d 871 (D. Neb. 2010).

85. *Id.* at 880.

86. *Id.* at 891–92.

87. 686 F. Supp. 2d 921 (D. Minn. 2010).

88. *Id.* at 928.

89. *Id.* at 926–30. However, the court also ruled that the collateral description did not cover software and customer lists developed or acquired after the closing. *Id.* at 930. Such things were not "products" even though the debtor could not have developed the customers without the software purchased; they were not replacements because even though old software and customer lists may have been superseded, they were not displaced; and parol evidence indicated that proposed language covering "additions" to the purchased assets and "present and future general intangibles" was discussed but rejected. *Id.* at 930–33.

90. It is not enough that the secured party submits the paperwork necessary to have the security interest noted on the certificate of title; the security interest must actually be noted on an issued certificate of title. *See, e.g.*, Johnson v. Branch Banking & Trust Co., 313 S.W.3d 557, 561 (Ky. 2010) (the perfection of a security interest in a motor vehicle occurs only when the lien is noted on the certificate of title; the submission of the required paperwork and fee to the department of motor vehicles does not perfect the security interest); *In re* Shepard, No. 09-50064, 2010 WL 1257672, at *3 (Bankr. D.S.D. 2010) (a security interest in motor vehicles was perfected when the certificates were issued with the lien notation, not when the application for the certificates was filed).

91. 399 B.R. 789, 798–801 (Bankr. W.D. Tex. 2008).

92. *See* 2009 Tex. Sess. Law Serv. ch. 814 (West) (S.B. 1592) (amending Tex. Transp. Code Ann. § 501.114 (Vernon 2007)).

93. *In re* Clark Contracting Servs., Inc., 438 B.R. 913 (W.D. Tex. 2010).

94. *See In re* Scott, 427 B.R. 123 (Bankr. S.D. Ind. 2010) (a security interest noted on a certificate of title for a vehicle subject to a security interest remained perfected after the secured party assigned the security interest to a securitization trust); *In re* Johnson, 407 B.R. 364 (Bankr. E.D. Ark. 2009), *order reinstated by* 422 B.R. 183 (Bankr. E.D. Ark. 2010); *see also* U.C.C. § 9-310(c) (2008).

Certificates of title have created other issues for secured parties. In *In re Moye*,[95] a secured party's security interest in motor vehicles held as inventory was not perfected by possession of unmarked certificates of title for the vehicles. Because the vehicles were held as inventory, the secured party had to file a financing statement to perfect its security interest.[96]

B. Control

Although a security interest in investment property can be perfected by the filing of a financing statement,[97] a secured party will often perfect by obtaining control because that will often give the secured party a higher priority.[98] Obtaining control requires careful drafting[99] and the secured party in *National Consumer Cooperative Bank v. Morgan Stanley & Co.*[100] needed some careful analysis from the court to achieve that goal. In the control agreement, the securities intermediary agreed that it would "comply with all written instructions originated by Lender concerning the Collateral without further consent by the Owner."[101] The court correctly concluded that this agreement gave the secured party "control" of the securities account, even though the agreement did not expressly refer to an "entitlement order."[102] Drafting was also an issue in *Brown v. National City Bank*.[103] There a secured party with a security interest in uncertificated CDs[104] was perfected by control because the debtor had signed a document assigning to the secured party all of the debtor's "right, title and interest" in all deposits, making the secured party a customer of the issuer.[105]

C. Possession and Automatic Perfection

Sometimes a secured party will perfect its security interest the old-fashioned way—by possession of the collateral.[106] The U.C.C. does not define "posses-

95. No. H-09-2747, 2010 WL 3259386 (S.D. Tex. Aug. 17, 2010).

96. *Id.* at *10–11 (relying on U.C.C. § 9-311(d)). The court also noted that even if perfection could be obtained by complying with the Certificate of Title Act, that Act requires that the security interest be recorded on the certificate; possession of unmarked certificates would not suffice. *Id.* at *12.

97. U.C.C. § 9-312(a) (2008).

98. *Id.* § 9-328(1).

99. The control agreement must be in an "authenticated record." *Id.* § 9-104(a)(2). The secured party almost missed that basic point in *Wiley v. Hicks*, No. 08-03056, 2010 WL 4115146, at *6 (W.D. Ark. Sept. 29, 2010), where the secured party entered into an undated control agreement with the debtor, which the bank acknowledged and agreed to in a separate writing, which the court correctly held was sufficient to meet the authenticated record requirement.

100. No. 3:10cv434, 2010 WL 3975847 (M.D. Pa. Oct. 8, 2010).

101. *Id.* at *5.

102. *See id.*

103. No. H-10-009, 2010 WL 4683706 (Ohio Ct. App. Nov. 19, 2010).

104. An uncertificated certificate of deposit is a "deposit account." U.C.C. § 9-102(a)(29) (2008); *see In re* Perez, 440 B.R. 634, 638–40 (Bankr. D.N.J. 2010) (a certificate of deposit issued by credit union and conspicuously labeled "Non-Negotiable + Non-Transferable" was a "deposit account," not an "instrument").

105. *Brown*, 2010 WL 4683706, at *5. A secured party can perfect a security interest in a deposit account by becoming the bank's customer. *See* U.C.C. § 9-104(a)(3) (2008).

106. *See* U.C.C. § 9-313 (2008).

sion,"[107] instead leaving this as a matter of common law which supplements the Code.[108] The court in *In re Rose*[109] did a good job of analyzing when the secured party had "possession." The collateral, which consisted of coins, was in a safe deposit box and the secured party had all the keys to the safe deposit box. The court correctly concluded that the secured party had possession of the coins and thus a perfected security interest in the coins.[110]

The court in *In re Cedar Funding, Inc.*[111] did less well. There the owner of notes secured by mortgages transferred fractional interests in the notes. The court held that the transfer did not occur for preference purposes under Bankruptcy Code section 547[112] until the transfers were perfected.[113] While that is correct, the court was not correct to hold that because the notes were secured by real estate interests, the transfers involved an interest in real estate, and that the transfer was not perfected until there was a recording of the assignment in the real estate records.[114] The fact that the notes were secured by mortgages did not change their character as personal property.[115] Further, the transfer of the interests in the notes was automatically perfected upon the sale of the interests,[116] the creation of a security interest automatically carried with it the interest in the mortgages that secured the notes,[117] and the perfection of the interest in the notes also perfected the security interest in the rights in the mortgages.[118]

D. Financing Statements: Debtor and Secured Party Name

Although properly completing a financing statement should not be that hard, every year brings decisions involving a secured party's mistake in filling out a financing statement. A mistake can occur by giving too much or too little information. The secured party in *In re EDM Corp.*[119] listed the debtor on the financing statement as "EDM Corporation d/b/a EDM Equipment" instead of its registered name, "EDM Corporation." The court ruled that the financing statement was ineffective because a search under the registered name using the filing office's standard search engine did not reveal the filing.[120] A financing statement may list the

107. *Id.* § 9-313 cmt. 3.
108. *See id.* § 1-103(b); Cissell v. First Nat'l Bank of Cincinnati, 476 F. Supp. 474, 491 (S.D. Ohio 1979).
109. No. BK05-83572-TJM, 2010 WL 1740635 (Bankr. D. Neb. Apr. 29, 2010).
110. *Id.* at *4.
111. No. 08-52709-MM, 2010 WL 1346365, 2010 WL 1346402 (Bankr. N.D. Cal. Apr. 5, 2010).
112. 11 U.S.C. § 547 (2006).
113. *Cedar Funding*, 2010 WL 1346365, at *4, 2010 WL 1346402, at *5.
114. *Cedar Funding*, 2010 WL 1346365, at *5, 2010 WL 1346402, at *6.
115. U.C.C. § 9-109(b) (2008).
116. *Id.* § 9-309(3), (4).
117. *Id.* § 9-203(g).
118. *Id.* § 9-308(e). The Permanent Editorial Board for the Uniform Commercial Code is considering issuing a report that would address this and some related issues.
119. 431 B.R. 459 (B.A.P. 8th Cir. 2010).
120. *Id.* at 467 (relying on U.C.C. § 9-506(c)).

debtor's trade name as an *additional* name, but should not include it as *part of* the debtor's name.[121]

Secured parties also need to resist using nicknames for individual debtors, especially a debtor whose first name is "Michael."[122] In *In re Larsen*,[123] the financing statement identified the debtor as "Mike D. Larsen." The debtor's actual name was "Michael D. Larsen." The court held that the financing statement was ineffective to perfect the security interest because it did not use the debtor's legal name and a search under the legal name would not yield the filing.[124]

Because financing statements are indexed and searched for under the debtor's name, the Code is more forgiving of errors in the secured party's name on the financing statement.[125] Accordingly, the financing statement in *In re American Consolidated Transportation Cos.*,[126] which identified the secured party by its trade name, was still effective.[127]

A financing statement can name a representative of the secured party as the "secured party" on the financing statement,[128] and need not specify that the named entity is a representative.[129] However, the person named does in fact need to be a "representative." In *In re QuVIS, Inc.*,[130] a financing statement filed on behalf of several noteholders lapsed. Some noteholders re-perfected their own security interests by filing a new financing statement naming those noteholders. The court ruled that those filings did not re-perfect the security interests of the other noteholders.[131] The unperfected noteholders argued that the re-perfected ones were the representatives of the unperfected ones. However, there was no agreement authorizing one secured party to act as an agent or representative of all of the noteholders, despite language in the loan agreement providing that "Borrower authorizes each Lender to perform every act which such Lender considers necessary

121. The inclusion of the debtor's trade name adds nothing to the effectiveness of the financing statement. U.C.C. § 9-503(b), (c) (2008).

122. Curiously, at least three decisions concerning the correct name of an individual involved a debtor with the name of "Michael." *See* Nazar v. Bucklin Nat'l Bank (*In re* Erwin), 50 U.C.C. Rep. Serv. 2d (West) 933 (Bankr. D. Kan. 2003) (debtor's name was "Michael Erwin" and secured party completed financing statement by using the name "Mike Erwin"); Parks v. Berry (*In re* Berry), 61 U.C.C. Rep. Serv. 2d (West) 95 (Bankr. D. Kan. 2006) (debtor's actual name was "Michael R. Berry, Jr." and secured party completed financing statement with "Mike Berry, Jr."); Genoa Nat'l Bank v. Sw. Implement, Inc. (*In re* Borden), 353 B.R. 886 (Bankr. D. Neb. 2006) (debtor's name was "Michael R. Borden" and secured party filed financing statement using the name "Mike Borden").

123. No. 09-00219-lmj7, 2010 WL 909138 (Bankr. S.D. Iowa Mar. 10, 2010).

124. *Id.* at *2–3 (relying on U.C.C. § 9-506(c)).

125. *See* U.C.C. § 9-506 cmt. 2 (2008).

126. 433 B.R. 242 (Bankr. N.D. Ill. 2010).

127. *Id.* at 258–59; *see also In re* McGee, No. 09-11860, 2010 Bankr. LEXIS 3251 (Bankr. N.D. Ind. 2010) (although initial secured party was unperfected by financing statement that identified a different entity as the secured party, the security interest became perfected when, five months after closing, the security interest was assigned to the named secured party).

128. U.C.C. § 9-511(a) (2008).

129. *Id.* § 9-503(d).

130. No. 09-10706, 2010 WL 2228246 (Bankr. D. Kan. June 1, 2010).

131. *Id.* at *4–8.

to protect and preserve the Collateral and Lenders' interest therein."[132] While each noteholder had the debtor's authorization to file a financing statement, none had authorization to file for the others.

E. Filing of Financing Statement—Manner and Location

Courts sometimes get confused about how to perfect a security interest in fixtures. In *Southwest Bank of St. Louis v. Poulokefalos*,[133] a secured party with a security interest in fixtures filed a financing statement in the state where the debtor was located. It did not record a fixture filing in the state where the fixtures were located. The court held that the secured party was subordinate to a landlord's lien under the common law because the security interest was unperfected and the landlord's lien was first in time.[134] The court missed the fact that a filing with the secretary of state in the location of the debtor is sufficient to perfect a security interest in fixtures. A local fixture filing at the location of the fixtures is important, however, for establishing priority vis-à-vis competing liens in the real property.[135]

F. Termination and Lapse of Financing Statement; Post-Closing Events

Even if the secured party does everything exactly right through the closing of the loan, things can happen afterwards that undermine perfection of the security interest. One such thing is that the debtor might change its name. In *In re Lifestyle Home Furnishings, LLC*,[136] the debtor changed its name from "Factory Direct, LLC" to "Lifestyle Home Furnishings, LLC," thereby rendering a filed financing statement seriously misleading.[137] As a result, the secured party was not perfected as to collateral acquired more than four months after the name change.[138] Another thing that might cause a loss of perfection is that the debtor moves to a different jurisdiction or transfers the collateral to someone located in a different jurisdiction.[139] In *In re Reid*,[140] the secured party perfected its security interest by filing a financing statement. The debtor later sold the assets to a buyer who subsequently filed for bankruptcy protection. The court ruled that because the buyer was located in the same state as the original debtor, the security interest remained perfected.[141] The court's ruling was correct. A security interest perfected by a filed financing statement does not become unperfected, as the bankruptcy trustee argued, four months after an

132. *Id.* at *4.
133. 931 N.E.2d 285 (Ill. App. Ct. 2010).
134. *Id.* at 292.
135. U.C.C. § 9-334(e)(1)(A) (2008).
136. No. 08-00629-TLM, 2010 WL 148644 (Bankr. D. Idaho Jan. 14, 2010).
137. *Id.* at *4.
138. *Id.* (relying on U.C.C. § 9-507).
139. *See* U.C.C. § 9-316(a)(2), (3) (2008).
140. 435 B.R. 810 (Bankr. D. Mass. 2010).
141. *Id.* at 813 (relying in part on U.C.C. § 9-507).

intrastate transfer of the collateral. If the transferee had been "located" in another state, the secured party would have had one year to file in the other state.[142]

Although the debtor's authorization is needed to file a financing statement, the authorization of the secured party of record is needed to file an amendment terminating a filed financing statement (subject to one narrow exception).[143] The decision in *Roswell Capital Partners LLC v. Alternative Construction Technologies*[144] badly misapplied these rules. The court stated that an unauthorized termination statement filed by the debtor with respect to the secured party's financing statement was effective.[145] The court's conclusion—which was dicta—improperly equates an authorized but mistaken filing with an unauthorized filing. Perhaps the most troubling part of the court's decision was its assertion that secured parties should be responsible for monitoring their outstanding financing statements and, when necessary, re-filing those which had been wrongfully terminated by the debtor (subject, of course, to a potential loss of priority and bankruptcy preference issues).[146]

V. Priority

A. Buyers

Even if a secured party has perfected its security interest, the secured party might not be at the head of the priority line. For example, a buyer in ordinary course of business acquires goods free of a security interest (even if perfected) created by the buyer's immediate seller.[147] In *In re Sunbelt Grain WKS, LLC*,[148] the court ruled that a prepaying buyer of inventory was not a buyer in the ordinary course of business that would have taken free of a perfected security interest in the inventory because the buyer did not have either possession of goods or the right to possession under Article 2.[149] To protect itself, a prepaying buyer ordinarily would need to enter into an intercreditor agreement with the existing secured party of the seller.

B. Equitable Claims

Courts sometimes bend (if not break) the Article 9 priority scheme by making exceptions for "equitable" reasons. The court declined to do that in *Kingsburg Apple Packers Inc. v. Ballantine Produce Co.*[150] The court correctly held that a se-

142. U.C.C. § 9-316(a)(3) (2008). The court erroneously cited U.C.C. section 9-316(a)(2), which deals with a debtor moving to a new jurisdiction, not a transfer of collateral to an entity located in a different jurisdiction. *See Reid*, 435 B.R. at 813.

143. *See* U.C.C. § 9-509(a), (d) (2008). Subsection (d) provides an exception that applies when the secured party breaches its duty to file a termination statement when the secured debt has been repaid and the secured party has no further commitment to make advances. *See id.* § 9-513.

144. No. 08 Civ. 10647(DLC), 2010 WL 3452378 (S.D.N.Y. Sept. 1, 2010).

145. *Id.* at *7–8.

146. *See id.* at *7. This portion of the court's decision is also criticized in Sepinuck & Adams, *supra* note 37, at 25.

147. U.C.C. § 9-320(a) (2008).

148. 427 B.R. 896 (D. Kan. 2010).

149. *Id.* at 902–07 (relying on U.C.C. §§ 9-320(a), 1-201(a)(9)).

150. No. 1:09-CV-901-AWI-JLT, 2010 WL 2719828 (E.D. Cal. July 6, 2010).

cured creditor that obtains the collateral through foreclosure is generally not subject to a restitution claim for the amount of the value of the collateral furnished to the debtor by an unsecured creditor.[151] Absent unusual circumstances, the equitable remedy of restitution must defer to the rights given a secured creditor by the U.C.C. The court came to a different result in *General Motors, L.L.C. v. Comerica Bank*.[152] In that case, a secured party had a security interest in a deposit account. The court ruled that the secured party had to return funds mistakenly transferred into the account by a third party.[153]

C. Priority—Competing Security Interests

The typical priority battle between two secured parties is governed by the rules of U.C.C. section 9-322(a).[154] In general, the first to file or perfect has priority.[155] This is generally true even if the debtor transfers the collateral to a buyer.[156] In *Merrill Lynch Business Financial Services, Inc. v. Kupperman*,[157] the court first correctly held that a secured party of a business debtor had priority over the secured party of the debtor's successor with respect to collateral the debtor had transferred to the successor.[158] However, the court went off base when it held that the secured party of the predecessor also had priority in newly acquired collateral by the successor.[159] The successor had never signed a security agreement in favor of the secured party of the predecessor and that secured party did not have a security interest in the assets of the successor, in the absence of the successor being a "new debtor," which the court did not address.[160]

Secured parties may adjust their priority by agreement.[161] In *American Bank of St. Paul v. Coating Specialties, Inc.*,[162] a secured party agreed to subordinate its security interest in the debtor's inventory, equipment, and accounts to the security interest of another lender. The subordination agreement referred to the debtor's $50,000 obligation to the lender, which was evidenced by two $25,000 promissory notes. The court ruled that even though the lender later rolled the two $25,000 notes into a $100,000 line of credit, the secured party remained subordinated to the extent of $50,000.[163] In doing so, the court relied in part on language in both security agreements that defined the notes to include "all renewals of, ex-

151. *Id.* at *5–6.
152. No. 291236, 2010 WL 5174515 (Mich. Ct. App. Dec. 21, 2010).
153. *Id.* at *5.
154. U.C.C. § 9-322(a) (2008).
155. *Id.*
156. *See id.* §§ 9-315(a)(1), 9-316(a)(3), 9-507(a). *But cf. id.* § 9-325.
157. No. 06-4802 (DMC)(MCA), 2010 WL 2179181 (D.N.J. May 28, 2010).
158. *See id.* at *23 (relying on U.C.C. § 9-322(a)(1)).
159. *See id.* at *20–22.
160. *See* U.C.C. §§ 9-102(a)(56), 9-203(e) (2008).
161. *See id.* § 9-339.
162. 787 N.W.2d 202 (Minn. Ct. App. 2010).
163. *Id.* at 205.

tensions of, modifications of, refinancings of, consolidations of, and substitutions for the note or credit agreement."[164]

A secured party that has entered into a subordination agreement does not have to make a filing in the U.C.C. filing system to let the world know about the subordination agreement. However, the absence of a public record worked to the disadvantage of one of the parties in *Mitec Partners, LLC v. U.S. Bank National Ass'n.*[165] In that case, individual stockholders who purchased a secured loan previously made to their corporation had no cause of action against the original secured party for not disclosing that it had entered into a subordination agreement with the Small Business Administration. The stockholders failed to identify any specific misrepresentation made by the secured party and could not have justifiably relied on any misrepresentation because the stockholders initiated the transaction, were sophisticated in business and financial matters, had access to the corporation's financial records which contained information about the subordination agreement, and the sale documents expressly disclaimed any representations by the bank and indicated that the stockholders had relied on their own investigation.[166]

D. Purchase-Money Security Interests

A purchase-money security interest ("PMSI") can leap to the front of the priority line if the purchase-money secured party jumps through the necessary hoops.[167] For a secured party with a PMSI in inventory to obtain priority, the secured party must give notice of the plan to obtain a PMSI to all existing inventory secured parties.[168] The purchase-money secured party in *In re Sports Publishing, Inc.*[169] failed to give the proper notice. The purchase-money secured party sent the prior secured party a copy of the security agreement, which contained a single sentence in the middle, without any heading, referencing a PMSI.[170]

PMSI status can be relevant for reasons other than priority. For example, a PMSI in consumer goods is automatically perfected.[171] In addition, PMSI status can be very relevant to the secured party's rights if the debtor seeks protection under Chapter 13 of the Bankruptcy Code.[172] Article 9 provides that PMSI status in non-consumer-goods transactions is not impaired by cross-collateralization or refinancing.[173] However, Article 9 is intentionally silent about whether such things affect PMSI in consumer-goods transactions, leaving the matter for courts to decide.[174]

164. *Id.*
165. 605 F.3d 617 (8th Cir. 2010).
166. *Id.* at 621–25.
167. U.C.C. § 9-324 (2008).
168. *Id.* § 9-324(b).
169. No. 09-CV-2132, 2010 WL 750008 (C.D. Ill. Mar. 3, 2010).
170. *Id.* at *4–7.
171. U.C.C. § 9-309(1) (2008).
172. *See* 11 U.S.C. § 1325(a)(5) (2006).
173. U.C.C. § 9-103(f) (2008).
174. *Id.* § 9-103(h).

In *In re Naumann*[175] a secured party renewed a PMSI consumer loan, increased the interest rate, extended its maturity, and, most importantly, added a co-debtor. The court concluded that this constituted a novation and destroyed the purchase-money nature of the transaction.[176] The court came to a contrary result in *In re Boston*.[177] There the secured party modified a PMSI consumer loan by altering the interest rate, the payment amount, the payment date, and number of payments, but the secured party did not loan additional funds and the debtor did not execute a new note or security agreement. The court held that this did not destroy the purchase-money nature of the transaction.[178]

A series of decisions have considered whether the negative equity in a trade-in vehicle financed as part of the purchase of a new car is part of the purchase-money obligation and therefore secured by a PMSI. Except for the Ninth Circuit, the federal appeals courts continue to answer that question with a "yes."[179]

VI. Default and Foreclosure

A. Default

Article 9 does not define when a debtor is in "default," yet the secured party's right to exercise remedies may depend on the debtor's "default."[180] The security agreement in *Grohman v. Kahlig*[181] provided that the debtor would not "sell, transfer, lease, or otherwise dispose of the Collateral."[182] The debtor converted two corporations, whose stock was pledged as collateral, into limited partnerships. The court held that this did not breach the security agreement because the security agreement defined the collateral to include "all replacements, additions and substitutions" for the stock.[183] The court in *In re Bolin & Co.*[184] enforced a "default" based on the breach of an agreement by the debtor not to create any encumbrance on the collateral.[185]

B. Repossession of Collateral

A secured party may repossess collateral without judicial assistance if the secured party can do so without a breach of the peace.[186] However, if a breach of

175. No. 09-32092, 2010 WL 2293477 (Bankr. S.D. Ill. June 8, 2010).
176. *Id.* at *4.
177. No. C/A 09-09099-JW, 2010 WL 5128960 (Bankr. D.S.C. Mar. 5, 2010).
178. *Id.* at *3.
179. *Compare, e.g., In re* Howard, 597 F.3d 852 (7th Cir. 2010), *and In re* Westfall, 599 F.3d 498 (6th Cir. 2010), *with In re* Penrod, 611 F.3d 1158 (9th Cir. 2010).
180. U.C.C. § 9-601(a) (2008).
181. 318 S.W.3d 882 (Tex. 2010).
182. *Id.* at 885.
183. *Id.* at 887–88.
184. 437 B.R. 731 (D. Conn. 2010).
185. *Id.* at 754–55. A secured party can enforce a security interest by going after the collateral even though the statute of limitations on the secured debt has run, as was the case in *Holman Street Baptist Church v. Jefferson*, 317 S.W.3d 540 (Tex. App. 2010).
186. U.C.C. § 9-609(b)(2) (2008).

the peace occurs, the repossession is unauthorized and may well be tortious. As a result, an improper repossession can create difficulties for the secured party outside of Article 9. Such was the case in *Williams v. Republic Recovery Services, Inc.*[187] The secured party did breach the peace, which eliminated the secured party's right to take possession.[188] That in turn made the repossession a violation of the Fair Debt Collection Practices Act, which prohibits "[t]aking or threatening to take any nonjudicial action to effect dispossession . . . if . . . there is no present right to possession of the property claimed."[189]

It is sometimes difficult to determine whether a "breach of the peace" has occurred. In *Ford Motor Credit Co. v. Ryan*,[190] the court ruled that a repossession agent did not breach the peace in repossessing three cars, even though they were located in the debtors' parking lot, driveway, and carport, because the secured party has a limited privilege to trespass on the debtor's property to repossess collateral and this privilege extends to the secured party's agents.[191] However, a breach of the peace may have occurred in a fourth repossession, during which the debtor went out to the carport and confronted the repossession agent hooking the car to a tow truck.[192] The debtor told the agent to stop, to unhook the car, and to leave the premises. The debtor then reached down to unhook the car, and the agent grabbed his hands, pushed him, and began screaming. The secured creditor was also liable for conversion of personal property in the cars when repossessed but not returned.[193]

Unlike the rules in some states relating to real property law, a secured party does not have to make an election between enforcing its security interest in personal property and proceeding personally against the debtor.[194] In *SFG Commercial Aircraft Leasing, Inc. v. N59CC, LLC*,[195] the court held that the secured party could proceed to enforce a secured obligation, even though the secured party had repossessed the collateral and not yet sold the collateral.[196]

The secured party has a non-waivable duty to take reasonable care to preserve collateral in its possession or control.[197] The court in *First United Bank & Trust Co. v. Penny*[198] correctly held that a secured party in control of stock in which the secured party had a security interest has a duty physically to preserve the stock, but not its value.[199] Therefore the secured party was not liable in negligence for

187. No. 09 C 6554, 2010 WL 2195519 (N.D. Ill. May 27, 2010).
188. *See id.* at *3–4.
189. *Id.* (citing 15 U.S.C. § 1692f(6)).
190. 939 N.E.2d 891 (Ohio Ct. App. 2010).
191. *Id.* at 908–10.
192. *Id.* at 911.
193. *Id.* at 913.
194. *See* U.C.C. § 9-601(a)–(c) & cmt. 5 (2008).
195. No. 3:09 CV 101 PPS, 2010 WL 883764 (N.D. Ind. Mar. 8, 2010).
196. *Id.* at *3–4.
197. *See* U.C.C. § 9-207(a) & cmt. 2 (2008).
198. 242 P.3d 593 (Okla. Civ. App. 2010).
199. *Id.* at 597–98.

failing to monitor the price of the stock after the debtor's default or in ignoring the stock's decline in value.[200]

C. Notice of Foreclosure Sale

In general, a secured party must give notice of a planned foreclosure sale of collateral.[201] The requirements for the notice are not difficult,[202] but secured parties are sometimes careless. In *Colonial Pacific Leasing Corp. v. Elite S-W Mo., Inc.*,[203] a secured party sent a notice that stated that the collateral (vehicles) would be sold at a public auction on September 10, 2009, and identified the auction company. In fact, the vehicles were sold at private, dealer-only auctions on September 17, 2009, and October 15, 2009, conducted by that auction company. The court held that the notice was nevertheless sufficient in part because the debtor had bought and sold vehicles through the auction company and was aware that it conducts private, dealer-only auctions.[204] The court further ruled that the sale was commercially reasonable because the auction company was the largest in the country, regularly frequented by hundreds of dealers, the debtor had itself delivered the vehicles to the auction company for sale before the secured party took control, and the five-month delay before the sale was caused by the debtor's own obstructions.[205]

D. Commercial Reasonableness of Foreclosure Sale

"Every aspect" of a foreclosure sale must be commercially reasonable.[206] The court in *USA Financial Services, LLC v. Young's Funeral Home, Inc.*[207] held that the secured party in that case did not satisfy this requirement. The secured creditor's sale of a hearse approximately one year after repossessing it was not commercially reasonable, particularly because vehicles are depreciating assets and the factors contributing to the delay were within the creditor's control.[208] In addition, the notice of public sale provided by the creditor was deficient because it failed to provide the time or full address of the public sale, failed to inform the debtors that they were entitled to an accounting of the unpaid indebtedness, and did not accurately state the intended disposition because the vehicle was not immediately

200. *Id.* at 598.
201. U.C.C. § 9-611(b), (d) (2008).
202. *See id.* §§ 9-613, 9-614.
203. No. 6:09-CV-3154-RED, 2010 WL 3119448 (W.D. Mo. Aug. 4, 2010).
204. *Id.* at *4.
205. *Id.* at *5–6.
206. U.C.C. § 9-610(b) (2008).
207. No. U607-11-102, 2010 WL 3002063 (Del. Ct. Com. Pl. June 24, 2010).
208. *Id.* at *4. A delay in conducting the sale can often create problems for the secured party. *See* State *ex rel.* Cordray v. Estate of Roberts, 935 N.E.2d 450 (Ohio Ct. App. 2010) (secured party may have breached the terms of the security agreement by failing to dispose of the collateralized inventory of chemicals in a timely fashion after taking possession, thereby allowing the chemicals to turn into hazardous waste and making it responsible in part for the debtor's environmental cleanup liability).

taken to auction, but first was placed for private sale at a used car lot for nearly a year.[209]

Although most of the debtor's rights under Part 6 of Article 9 cannot be waived, the secured party and the debtor can agree on the standards used to measure compliance with the statutory requirements so long as the agreed standards are not manifestly unreasonable.[210] In *In re Walter B. Scott & Sons, Inc.*,[211] the security agreement provided that a disposition would be commercially reasonable if the secured party sent[212] notice to the debtor ten days in advance of the foreclosure and the secured party published notice in a newspaper of general circulation at least ten days before a public sale. The court held that these terms were manifestly unreasonable and therefore unenforceable because they dealt only with notification and advertisement, but not with the other aspects of the sale.[213]

VII. Collection

A secured party does not have to dispose of the collateral. If the collateral is a right to payment, the secured party may instead collect on the collateral by instructing the account debtors (or other obligors) to pay the secured party.[214] Once the secured party has notified account debtors to make payment to the secured party, the account debtors pay the debtor at their peril.[215] In *Platinum Funding Services, LLC v. Magellan Midstream Partners, LP*,[216] an account debtor that paid the debtor after being instructed by certified mail to pay the debtor's secured party had not discharged the account and still had to pay the secured party.[217] The account debtor was not entitled to set-off or mitigation for checks sent, which the debtor had endorsed over to the secured party, allegedly providing the secured party with notice that the account debtor was still paying the debtor.[218] The court came to a different conclusion in *Summit Financial Resources, L.P. v. Kathy's General Store, Inc.*[219] There a secured party with a security interest in accounts did not have a cause of action against a customer of the debtor who continued to *prepay* the debtor after receiving notice to pay the secured party directly because the transactions involved prepayment, and thus the customer never owed a monetary obligation, and no accounts were created.[220]

209. *Id.* at *3.
210. U.C.C. §§ 9-602, 9-603 (2008).
211. 436 B.R. 582 (Bankr. D. Idaho 2010).
212. The notice has to be "sent," but does not have to be received by the debtor. *See* U.C.C. §§ 1-201(b)(36), 9-611(b) (2008); *see also* Textron Fin. Corp. v. Metro Lincoln-Mercury, Inc., No. 2:09-cv-275, 2010 WL 4736262 (E.D. Tenn. Nov. 16, 2010) (notification of disposition sent by certified mail, return receipt requested, and returned "unclaimed" was effective because it was "sent").
213. *Walter B. Scott*, 436 B.R. at 595–97.
214. *See* U.C.C. § 9-607 (2008).
215. *See id.* § 9-404(a).
216. No. CV095029911, 2010 WL 2383786 (Conn. Super. Ct. Apr. 30, 2010).
217. *Id.* at *3.
218. *Id.* at *4.
219. No. 08-2145-CM, 2010 WL 1816685 (D. Kan. May 5, 2010).
220. *Id.* at *5.

VIII. Retention of Collateral

A secured party may accept the collateral in full or partial satisfaction of the secured debt if the secured party follows certain procedures.[221] Several decisions did not strictly enforce the relevant requirements. In *In re CBGB Holdings, LLC*,[222] a secured party conducted an effective strict foreclosure by entering into an agreement with the debtor, after default, providing that if the debtor did not pay the secured obligation within the next three months, the secured creditor could, without further notice, "possess and retain" the collateral pursuant to U.C.C. section 9-620. The court ruled that the debtor's further consent after the end of the three-month period was not necessary.[223] In *Corsair Special Situations Fund, L.P. v. Engineered Framing Systems, Inc.*,[224] a patent security agreement provided that the creditor's interest would "become an absolute assignment" after the debtor defaulted. The court erroneously ruled that the security interest became an absolute assignment of the patent upon default.[225]

The court was properly stricter in *R.S. Silver Enterprises Co. v. Pascarella*.[226] There the secured party did not obtain ownership of a participation interest in which the secured party had a security interest through a strict foreclosure because the secured party had not sent a proper proposal to do so.[227] The court found the communication sent was conditional because it referred to consequences *if* payment were not made.[228] It identified the debtor, a corporation, simply as "Bob," identified the collateral simply as "the Riversedge project," made no mention of cancelling or satisfying the $200,000 note, and was not authenticated.[229]

221. U.C.C. §§ 9-620, 9-621, 9-622 (2008).
222. 439 B.R. 551 (Bankr. S.D.N.Y. 2010).
223. *Id.* at 555–59.
224. 694 F. Supp. 2d 449 (D. Md. 2010).
225. *See id.* at 459.
226. No. FSTCV0650024995, 2010 WL 3259869 (Conn. Super. Ct. July 14, 2010).
227. *Id.* at *12–13.
228. *Id.* at *12.
229. *Id.*