SPOTLIGHT

Barring adverse reaction, this column will be a new, regular feature in the Newsletter. Its purpose is to identify some of the most flawed judicial decisions interpreting the Uniform Commercial Code to be published after the previous edition of the Newsletter. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is shine a spotlight on major errors of analysis, and thereby provide practitioners and judges with reason to disregard the opinion as precedent.

To merit attention in this column, a decision must not merely err on a matter of law. The error must be patent and fundamental to the analysis. One the other hand, the decision need not reach the wrong result. In fact, a good candidate may contain multiple errors that cancel each other out, so that in the end the right result is reached, albeit for wrong reasons. The two decisions discussed below are among the most misguided UCC opinions of the year. You be the judge: which is worse?

***Fodale v. Waste Management of Michigan, Inc.*, 718 N.W.2d 827 (Mich. Ct. App. 2006).**

This case concerned whether a secured party violated the debtor's rights while enforcing a security interest. In 1987, the debtor borrowed $250,000 from the secured party and in return gave the secured party an option, upon default, to buy the debtor's interest in a redemption agreement for $350,000 minus the amount of the debt then outstanding. In 1998, after a series of defaults, the secured party notified the debtor that it was exercising its option to purchase debtor's redemption rights and that this satisfied the debtor's secured obligation. Four years later, the debtor sued claiming this violated his rights under Part 6 of Article 9.

The court committed the first of its numerous errors by ruling that former Article 9 applied to the dispute because the transaction and the default both took place prior to the effective date of revised Article 9. In fact, revised Article 9 applies as long as the litigation was commenced after the July 1, 2001 effective date, which it did. *See* § 9-701(a), (c). Indeed, both parties thought revised Article 9 controlled, but the court ruled otherwise without even citing to the transition rules. 718 N.W.2d at 831-32.

The court's next error was more substantial. Although both parties regarded the debtor's rights under the redemption agreement as the relevant collateral, the court instead treated the secured party's option to purchase those rights as the collateral. Indeed, the court was quite specific on this point, italicizing its disagreement with the parties' position and then reiterating twice more that the option, not the redemption rights, were the pertinent collateral. *Id.* at 832-33. This is just plainly wrong. The option may well have been a security device – a point alluded to by the court – but it was not the collateral. Collateral is, after all, property in which the debtor has an interest. *See* § 9-102(a)(28) (defining "debtor"). The debtor had no rights in the option; the debtor *issued* the option.

From here, the court went on to discuss whether the option structure constituted an impermissible pre-default waiver of the debtor's right to: (i) notification of a disposition, (ii) a commercially reasonable disposition; (iii) redeem the collateral prior to the disposition; and (iv) payment of a surplus. *See* § 9-602. The court concluded that the secured party's exercise of the option could indeed be a disposition of the collateral (a conclusion arguably inconsistent with its treatment of the *option* as the pertinent collateral), and thus violate the duties to give reasonable advance notification of the disposition, to permit redemption prior to disposition, and to conduct a commercially reasonable sale. However, it concluded that the debtor was not entitled to any surplus. This conclusion was not explained. Instead, the court supported it merely by quoting former § 9-504(2), which provided that the debtor is not entitled to a surplus if the underlying transaction is a sale of accounts or chattel paper. Yet the underlying transaction was a $¼ million loan, not a sale of accounts or chattel paper, so this portion of the court's analysis was again wrong.

Despite all this, the court concluded that the secured party did not in fact dispose of the collateral, but instead had conducted a strict foreclosure by exercising the purchase option. 718 N.W.2d at 839-40. Because the debtor did not object within 21 days, the strict foreclosure was effective. Given that the secured party's notification that it was exercising the option was phrased not as a proposal to which the debtor could object, but as a *fait accompli*, this conclusion is questionable. Still, no express wording is required for a proposed strict foreclosure and there is no specific requirement that the proposal inform the debtor of the right to object. Thus, the court may have reached the correct result, at least if it had applied revised Article 9. However, former Article 9 – which the court had erroneously concluded was the applicable law – limited strict foreclosure to collateral in possession of the secured party, *see* former § 9-505(2). Here, both the option and the redemption rights to which it related were intangible, and thus incapable of possession. Thus, strict foreclosure was – at least arguably – not available at all.

***Madisonville State Bank v. Canterbury, Stuber, Elder, Gooch & Surratt, P.C.*, 2006 WL 3020404 (Tex. Ct. App. 2006).**

This case pitted a putative secured party against a transferee of fund from the debtor's deposit account. Madisonville State Bank ("MSB") had a security interest in the debtor's accounts, inventory, chattel paper, documents, and equipment. Sometime later, the debtor paid approximately $59,400 to its law firm for services rendered. The payment was made from a deposit account at First State Bank. MSB sued the law firm for conversion and, not surprisingly, the law firm moved for summary judgment on the basis of § 9-332(b). The trial court granted the motion and MSB appealed.

MSB argued that § 9-332 did not apply because MSB did not have a security interest in the deposit account, instead it had a security interest in certain proceeds, which were deposited into the deposit account. Although the decision of the court of appeals is a bit unclear, the court apparently accepted this argument and reversed the lower court. In other words, it seems to have concluded that § 9-332 applies only if the security interest in the deposit account is claimed as original collateral. This is, of course, nonsense. Article 9 expressly treats proceeds as collateral. *See* § 9-102(a)(12)(A) & comment 3(a). Indeed, the vernacular of Article 9 throughout clearly treats a security interest in proceeds as a security interest in whatever those proceeds happen to be. Indeed, it does this in particular with respect to deposit accounts, thus unambiguously indicating that a security interest in a deposit account can arise if proceeds of other collateral are deposited into a deposit account. *See, e.g.,* § 9-312(b).

The court then compounded this error by apparently also concluding that § 9-332(b) could not protect the law firm because it protects a transferee from a perfected security interest in a deposit account, and MSB had no control agreement with First State Bank, and thus was unperfected. If this is really what the court ruled, then the court erred in two ways. First, and less important, MSB may well have had a perfected interest in the deposit account. The court never bothered to mention whether MSB was perfected in the original collateral by filing, but if MSB was, then it was perfected in the identifiable proceeds deposited into the deposit account under § 9-315(d)(2). Second, and more important, § 9-332(b) makes no reference to perfection. Perfection is mentioned in the examples to comment 2, but merely as an illustration, not as a requirement for the provision to be applicable). The provision itself, though, allows a transferee to take free whether the security interest is perfected or unperfected.

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