# Personal Property Secured Transactions

*By Steve Weise and Stephen L. Sepinuck*

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I. SCOPE OF ARTICLE 9 AND EXISTENCE OF A SECURED TRANSACTION

A. GENERAL

A person entering into a financing transaction should first determine whether Article 9 applies to the transaction. An incorrect conclusion—in either direction—can lead to a disastrous result, such as not perfecting a security interest that should be perfected or perfecting a security interest under the “wrong” law.

For example, Article 9 does not apply to a security interest in a judgment as original collateral. In In re Kuranda, a debtor had granted to its lender a security interest “in the proceeds of [a specified] lawsuit” that had already been reduced to judgment. The court held that the debtor had in fact granted a security interest in the judgment itself, not only in the monies later collected on the judgment by the debtor’s bankruptcy trustee. Thus, Article 9 did not apply to the security interest.

The lender in Gardner v. Montgomery County Teachers Federal Credit Union also could not bring itself within Article 9. There a credit union argued that it did not violate the Truth in Lending Act by using depositors’ accounts to set off their credit card obligations. This argument required that the credit union prove the existence of a security agreement creating a security interest in the deposit account. The credit union’s submission of an unsigned application form, purporting to grant the credit union a security interest in the depositor’s account, did not satisfy this requirement.

B. CONSIGNMENTS

Sellers of goods sometimes have too much faith in their retention of title in consignment transactions, failing to recognize that Article 9 applies to most consignment transactions and thereby makes the consigned goods available to the...
consignee’s creditors.\(^8\) In *In re Wolverine Fire Apparatus Co. of Sherwood Michigan*,\(^9\) a truck dealer entered into a sales agreement with a buyer, and then abandoned the agreement. Despite this fact, the seller allowed the buyer to take possession of the truck. The seller retained title, never placed the manufacturer’s warranty in effect for a new buyer, continued to expose the truck to potential buyers through its inventory listings and commercial trader database, kept its inventory lender informed of the truck’s location, never sent a bill showing the amount that was due, and never listed the sales agreement for the truck as an accounts receivable. Therefore, the court held that the seller remained the owner of the truck. However, the transfer of possession was neither a “pure” bailment nor a “true” consignment, as the truck remained for sale in the hands of the buyer,\(^10\) and became available to the buyer’s creditors as property of the buyer’s bankruptcy estate.

C. LEASING

The U.C.C. has extensive rules on when a transaction denominated as a “lease” is in fact a sale with a retained security interest.\(^11\) When a lessor overlooks this possibility, it may find that it has not perfected what turns out to be a “security interest.” The lessor in *Midwest Media Group, Inc. v. Fusion Entertainment, Inc.*\(^12\) entered into a thirty-month lease of equipment. The lease included an option for the lessee to buy the equipment for the amount remaining due on the lease, and an option to terminate the agreement at any time upon payment of 30 percent of the amount remaining due. The court ruled that this right to terminate the agreement prevented the lease from fitting within the “safe harbor” test that treats a lease as creating a “security interest” if the lessee has the right to buy the goods for “nominal” consideration.\(^13\) The lessee did not argue that the economic realities effectively precluded it from terminating the agreement early.

D. SALES

Sometimes a transaction structured as a “sale” is really a loan secured by the asset sold, and vice versa. Generally, the analysis depends on which party has the benefits and burdens of ownership. In *Calloway v. Commissioner of Internal Revenue*,\(^14\) a transaction was structured as a three-year, nonrecourse loan of stock during which the putative lender of the stock had no right to the return of the stock, and the putative borrower was entitled to dividends, the right to

\(^8\) See id. § 9-102(b)(35) (defining “security interest” to include a consignment); id. § 9-317(a)(2) (an unperfected security interest is generally subject to the claims of the debtor’s creditors).


\(^10\) Id. at 819.


\(^12\) No. 12-0189, 2012 WL 5541613 (Iowa Ct. App. 2012).

\(^13\) Id. at *3 (citing U.C.C. § 1-203(b)(4)).

\(^14\) 691 F.3d 1315 (11th Cir. 2012).
II. SECURITY AGREEMENT AND ATTACHMENT OF SECURITY INTEREST

In general, there are three requirements for a security interest to attach; that is, to come into existence: (i) the debtor must authenticate a security agreement that describes the collateral; (ii) value must be given; and (iii) the debtor must have rights in the collateral.16

A. SECURITY AGREEMENT

The requirement of an authenticated security agreement is fairly easy to satisfy. The agreement must create or provide for a security interest,17 that is, it must include language indicating that the debtor has given a secured party an interest in personal property to secure payment or performance of an obligation (or in connection with a sale covered by Article 9),18 and it must describe the collateral.19 If no single document satisfies these requirements, multiple writings may do so collectively, under what is known as the “composite document rule.”20 Despite the rather minimal nature of these requirements, they nevertheless managed to trip up several creditors last year.

In In re Irvine-Hedrick,21 the debtor’s parents, who provided funds for the purchase of a vehicle, were listed as co-owners on the certificate of title. Eleven days before the debtor filed bankruptcy, the parents were added as lienholders on the certificate. However, the court ruled that the parents did not have a security interest because the written agreement, in which the debtor promised to repay them and which described the vehicle, did not expressly grant a security interest or include any language suggesting the debtor intended to do so.22 Similarly, in In re Buttke,23 the court ruled that notations referring to a security interest on the application for the certificate of title, which was authenticated by the debtor, and also on the certificate itself did not “create or provide for [one].”24

In contrast, in In re Westermeyer,25 the court ruled that an application for a certificate of title signed by the debtor and which identified the debtor’s parents...
as the holders of a lien on the debtor’s mobile home did qualify as a security agreement. Noting that the two purposes of requiring an authenticated security agreement are (1) to eliminate disputes as to the precise collateral being pledged and (2) as a statute of frauds, to preclude the enforcement of oral claims, the court concluded that both of these purposes would be served by treating the title application as a security agreement.26

In In re Bucala,27 a promissory note signed in connection with the sale of a manufactured home, provided that: (i) the lender could file a motor vehicle lien against the home; (ii) interest would be added to the debt “and secured by the DMV lien”; (iii) the lender was to discharge the lien when the note was fully paid; and, most important, (iv) if the borrower defaulted, the home could be repossessed. The court held that these terms were sufficient to create a security interest.28 It did not matter, the court concluded, that the note misidentified the model year of the manufactured home, especially given that the sales contract properly identified the model year, and the documents are to be read together.29

The court in Shales v. Pipe-Liners, Ltd.30 issued a somewhat troubling ruling regarding a secured party’s alleged security interest in a borrower’s accounts. The secured party’s agreement with the debtor provided that the secured party would have the rights of a secured party “[i]f an Event of Default occurs.” Ten weeks after a creditor obtained a judgment against the debtor and sought to garnish the debtor’s accounts receivable and deposit accounts, the secured party demanded payment from the debtor and intervened claiming priority. The judgment creditor acknowledged that the secured party had a perfected security interest but claimed that the secured party’s inaction caused it to forfeit its rights.31 The court agreed. Looking to the language of the secured party’s security agreement—as well as some earlier opinions construing identical language as not giving the lender a security interest until default occurred32—the court concluded that the secured party “did not do enough to preserve its rights.”33 It is not entirely clear whether the court ruled that the secured party’s security interest had never attached or attached but had been forfeited. Either way, the decision is suspect. The security agreement did not state that the secured party would be entitled to a security interest upon default; it provided that the secured party could exercise the rights of a secured party on default. Nothing in that language should have prevented the secured party’s security interest from attaching prior to default. As for forfeiting its rights, it is hard to see why a delay of a few

26. Id. at *4.
28. Id. at 631–32.
29. Id. at 630–31.
31. See id. at *2.
weeks in claiming priority should result in forfeiture, especially since there was no suggestion that the secured party’s inaction caused the judgment creditor any loss.

In *In re Ciprian Ltd.*, the court ruled that a liquor license was personal property under Pennsylvania law and determined that the security agreement’s description of the collateral as “general intangibles” was sufficient to cover the license.

**B. Obligation Secured**

Article 9 expressly permits a security agreement to secure future indebtedness as well as existing debt. Moreover, a comment rejects the holdings of some cases decided under former Article 9, which required the future indebtedness be of the same type as, or otherwise related to, the original debt. In spite of this, in two cases the secured party lost its bid to have the collateral secure some other obligations of the debtor.

In *In re Duckworth*, a security agreement described the secured obligation as a note executed on December 13, 2008. In fact, the only note between the parties was actually executed and dated December 15, 2008. The court held that the security interest secured the note. However, it also ruled that the absence of a future-advances clause in the security agreement prevented the collateral from also securing a second loan, made in 2010, even though the second note expressly provided that “this Note is secured by Security Agreement dated December 13, 2008.” This second conclusion is questionable. A “security agreement” is “an agreement that creates or provides for a security interest.” An “agreement” is the bargain of the parties in fact, as found in their language or inferred from other circumstances. There is no reason why a security agreement that lacks a future-advances clause cannot be amended later to include one, and no reason why such an amendment cannot consist of a simple declaration in the note or loan documents relating to a subsequent advance.

In *Union Bank Co. v. Heban*, the debtor authenticated four security agreements, each of which contained a cross-collateralization clause making the collateral secure all of the debtor’s obligations to the secured party. Although ac-
knowledging that such clauses might operate so as to secure an otherwise unsecured obligation under certain circumstances, the court ruled that the clauses were insufficient to overcome the fact that the promissory note for one loan, which was entered into after the first secured transaction and before the remaining three, expressly stated that the loan was unsecured. The court did not discuss why the three later security agreements could not have amended the earlier promissory note.

C. RIGHTS IN THE COLLATERAL

In order to grant a security interest in personal property, the debtor must either have rights in the property, or the power to convey rights in it. It is not always easy to determine which, among several related entities, owns the property that is intended to serve as collateral. If the actual owner does not authenticate the security agreement, the putative secured party may find itself lacking a security interest in some or all of the collateral. This problem surfaced in two cases last year.

In *Jorday, Inc. v. Burggraff*, the trustees of a trust purchased on credit the equipment of an amusement park. They gave the seller a security interest in the equipment but, at least initially, the seller failed to perfect that security interest. Thereafter, the trustees formed a corporation to own the equipment. There was no bill of sale formally transferring the equipment to the corporation, but the trustees' income tax returns referenced a transfer to the corporation, and the corporation depreciated the equipment on its own tax returns. A secured party, relying on these tax returns and on the trustees' representations that the corporation had acquired the equipment, made a $460,000 loan to the trustees, who signed a security agreement on behalf of the corporation. The secured party conducted a U.C.C. search but, because the seller had not yet filed a financing statement, the search revealed no competing interest. When the trustees defaulted, the seller—who had perfected by then—sought to recover the equipment. The secured party claimed priority and the trial court ruled in favor of the secured party. The court of appeals reversed, concluding that the secured party did not in fact acquire a security interest in the equipment because, as a matter of law, the evidence of the corporation's ownership was insufficient.

The court noted that a secured party "was in the best position to protect its interest by requiring proof of ownership." A somewhat contrary result was reached in *In re WL Homes, LLC*. In that case, WL Homes capitalized an insurance subsidiary by depositing $10 million into the subsidiary's deposit account. WL Homes later entered into a loan agree-

44. Id. at *5.
45. See id.; see also U.C.C. § 9-203(b)(2) (2009).
47. Id. at *4.
48. Id.
ment with Wachovia Bank, pursuant to which WL Homes purported to grant Wachovia a security interest in the subsidiary’s deposit account. After WL Homes filed for bankruptcy protection, Wachovia sought a declaration indicating that it had a security interest in the deposit account. The bankruptcy court ruled that WL Homes had rights in the deposit account and, even if it did not, the subsidiary had implicitly consented to the use of the deposit account as collateral. The district court affirmed but only on the latter ground. The court concluded that the fact that WL Homes funded the deposit account, had access to it (five of the seven authorized signatories were officers of the debtor and the other two were officers of both the debtor and the subsidiary), and controlled access to the funds through its own controller, demonstrated possession, not ownership. However, the district court agreed with the bankruptcy court that the subsidiary had consented to the use of the deposit account as collateral because the person who signed the security agreement on behalf of the parent was also the president of the subsidiary.

Even if the debtor at one time had rights in the property intended to serve as collateral, if the debtor has transferred those rights away before authenticating the security agreement, no security interest will attach. This basic principle tripped up the putative secured party in Dragt v. Dragt/DeTray, LLC, in which a law firm representing defendants involved in civil litigation purported to take a security interest in funds that the defendants had previously deposited into the court registry. The court ruled that the law firm had no security interest because the funds were held in custodia legis, making them subject to further direction of the court, and state law made them immune from garnishment or a security interest. According to the court, the defendants had at most a contingent interest in the funds, and thus the security interest could have attached to the funds only if the trial court awarded the funds to the defendants.

D. Restrictions on Transfer

Even if the debtor owns the property offered as collateral, the debtor may lack the ability to create a security interest in that property if some law or contract prevents the debtor from granting a security interest. In recent years, one controversial issue has been whether the owner of an FCC broadcast license can, prior to entering into a contract to sell the license, grant a security interest in the proceeds of the license.
The issue arises from the interaction of U.C.C. Article 9, the Federal Communications Act of 1934, and section 552 of the Bankruptcy Code. The Federal Communications Act provides that “[n]o . . . station license, or any rights thereunder, shall be transferred, assigned, or disposed of in any manner,” without the advance approval of the FCC. The FCC had long interpreted this language as prohibiting the creation of a security interest in a broadcast license. However, in 1994 the FCC issued a clarifying order concluding that a creditor could take a security interest in the proceeds of a broadcast license because this would not interfere with the policy underlying the prohibition.

Relying on this order, some lenders have taken a security interest in the future proceeds of a borrower’s FCC licenses, rather than in the licenses themselves. The problem with this approach is that section 552 of the Bankruptcy Code prevents an after-acquired property clause from operating postpetition unless the pospetition property is proceeds of prepetition collateral. Thus, the argument goes, because the license itself is not and cannot be collateral, any receivable generated by a postpetition contract to sell the license cannot be proceeds of prepetition collateral. It is at best after-acquired property, to which no prepetition security interest can attach postpetition.

In In re Tracy Broadcasting Corp., the Tenth Circuit rejected this argument. The debtor in the case operated a radio station in Wyoming under a license issued by the FCC. Before filing a Chapter 11 bankruptcy petition, the debtor executed a security agreement granting a lender a security interest in the debtor’s general intangibles and their proceeds. At issue was whether proceeds of a postpetition sale of the FCC license were encumbered by the security interest. The court held the security interest attached to the “economic value” of the license, that this included the debtor’s right to receive proceeds of a future sale of the license, and that this right attached upon acquisition of the license. Because the acquisition of the license occurred prepetition, section 552 of the Bankruptcy Code did not interfere even though, as of the petition date, there was no agreement to sell the license. The court expressly relied in part on the language and policy of U.C.C. section 9-408, which overrides many legal restrictions on the creation of a security interest.

Another recurring issue is whether a security interest can attach to the debtor’s interest in a limited liability company if the LLC operating agreement prohibits members from transferring their interest without previously obtaining consent from the other members. In In re McKenzie, the court ruled that a creditor did not have a security interest in the debtor’s LLC membership interest. The

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59. 696 F.3d 1051, 1064 (10th Cir. 2012).
60. Id. at 1065.
62. 696 F.3d at 1061–65.
court explained that the Tennessee Limited Liability Company Act allows parties to impose restrictions on the transfer of a member’s interest, and the parties’ LLC operating agreement did just that by providing that no member could transfer its interest without the prior written consent of the LLC board, and that any attempted transfer without consent was void. Moreover, the court rejected the part of the creditor’s evidence that showed consent was provided after the transfer, noticing that it did not prove that the required prior consent had been given.

Article 9 overrides many contractual and legal restrictions on transfer. In *Forman v. Carver Federal Savings Bank*, the court ruled that even if a New Jersey statute required the consent of the state Board of Public Utilities in order for a sanitation company to grant a security interest in its sanitation collection vehicles—which it did not—that requirement was overridden by U.C.C. section 9-406(f)(1), and thus each of the three secured parties did acquire a security interest in the vehicles.

III. DESCRIPTION OR INDICATION OF COLLATERAL IN SECURITY AGREEMENTS AND FINANCING STATEMENTS

A security agreement’s description of collateral generally need not be specific; it must reasonably identify the collateral and, for most types of property, may refer to the collateral by its Article 9 type. Several cases dealt with this requirement last year.

In *In re Brown*, a security agreement referred to the collateral as “investment property,” “securities,” and “7,000 shares of preferred stock in Kansas Medical Center, LLC.” The court ruled that this description was sufficient even though the debtor’s interest in the LLC was a general intangible, not investment property, securities, or stock, because the property covered was objectively determinable from the description.

In *In re Delta-T Corp.*, the issue boiled down to what qualifies as an “account.” A judgment creditor had sought to garnish the funds in the debtor’s deposit account, which consisted of proceeds from the debtor’s sale of excess steel inventory. The debtor’s bankruptcy trustee, who had succeeded to the security interest of another creditor, claimed that the funds were the proceeds of “accounts,” which were encumbered by the security agreement. The garnishor argued that the funds had been generated from cash sales of the steel, thus no accounts were ever created and, therefore, the funds could not be considered proceeds of accounts. The court analyzed the issue under both Articles 2

65. Id. at *6.
66. Id. at *7.
71. Id. at 117.
72. Id. at 120–21.
The steel sold was identified to the sales agreements when the debtor accepted the purchase orders, and it was to be delivered to the buyers without movement or delivery of a document of title. Thus, title to the steel passed at the time of contracting. The court concluded that for this reason the sales generated accounts, which are defined to include a right to payment for property sold, when title of that property passed, even though the buyer paid shortly after taking possession of the steel. In other words, “the ‘right to payment’ was created by the passage of title.”

The court’s conclusion was correct, but its analysis was somewhat flawed. The issue is not whether title passed before payment but whether the purchase agreement was created before payment. A true cash sale—such as when a customer purchases groceries at a supermarket—does not generate an account because the supermarket has no right to payment before payment is made. However, if an agreement to buy and sell precedes payment, then an account is created, regardless of when title passes or when the goods are delivered.

In In re Madawaska Hardscape Products, Inc., a security agreement described the collateral to include the debtor’s existing and after-acquired personal property (listed by the various collateral types) “wherever the same may be located,” but it also contained the debtor’s warranty that, at the time the agreement was authenticated, all of the debtor’s personal property was located in Maine. The following year, the debtor established a business location in South Carolina. The court correctly ruled that the debtor’s property in South Carolina was encumbered by the security interest.

Secured parties did not fare so well in a few other cases. In In re SOL, LLC, the security agreement described the collateral to include “real estate listings and listing agreements and . . . the proceeds and products therefrom.” The court ruled that because the debtor’s “listings and listing agreements” referred only to transactions when the debtor represented the seller in a transaction, the security agreement did not cover the debtor’s contracts, receivables, and rights to commissions arising from sales in which the debtor represented the buyer.

74. Id. at 510, 520–26.
75. See id. at 522–23 (discussing U.C.C. § 2-401).
77. Id. at 522.
78. Id. at 523.
80. Because an account is a right to payment “whether or not earned by performance,” an account can arise even though the debtor has not yet performed and the right to payment is contingent on future events. See U.C.C. § 9-102(a)(2) (2009).
82. Id. at 209–12. But cf. In re Se. Materials, Inc., 452 B.R. 170 (Bankr. M.D.N.C. 2011) (describing collateral as “all of the Debtor’s . . . equipment, wherever located,” but which also stated that “the address where the Debtor keeps and maintains the equipment is . . . Columbus County,” created a factual issue as to whether the parties intended to encumber equipment located in a different county).
84. Id. at *5, *12.
In *In re Dwek*[^85], the security agreement described the collateral as “shares of stock or other securities or certificates as listed on Schedule A.” Unfortunately, there was no document labeled as “Schedule A.” The only contender was a one-page printout containing an account number, the names of specific stocks, and the quantity held, which was attached to a letter from the secured party to the debtor’s broker, dated five months after the security agreement was authenticated. Because it was unclear whether this document was Schedule A, the court denied summary judgment on the validity of the security interest.[^86]

In *In re TMST, Inc.*[^87], the security agreement executed by a debtor-loan servicer covered only the debtor’s rights as “owner” under various servicing agreements, but not the debtor’s rights as “servicer.” When all the debtor’s rights—as both owner and servicer—were sold in bankruptcy, the issue became what portion of the sale proceeds were subject to the security interest. Because the owner had the right to terminate and replace the servicer without cause, the court concluded that the debtor’s rights as owner were substantially more valuable than the debtor’s rights as servicer. Therefore, it allocated 95 percent to the rights as owner and 5 percent to rights as servicer, with the former therefore qualifying as proceeds of the collateral.[^88]

A financing statement must indicate the collateral to which it applies,[^89] and satisfaction of the rules regarding the reasonableness of the collateral description suffices. However, a phrase such as “all assets” or “all personal property” is sufficient in a financing statement even though it would not be in a security agreement.[^90] In *In re Baker*,[^91] a financing statement that identified collateralized cows by name and ear tag number was effective even though the tag numbers were incorrect. The reason provided by the court was that the names were referenced in a certificate of registration for each cow, each certificate included a sketch of the cow’s distinctive markings, and those markings were used to identify the cows.[^92] The court noted that fragility of the ear tag method of identifying cows is well known in the dairy industry, and thus is relevant to the searcher’s duty in reviewing a financing statement.[^93]

**IV. PERFECTION**

**A. CERTIFICATES OF TITLE**

A security interest in a vessel documented with the National Vessel Documentation Center (“NVDC”) cannot be perfected by filing a financing statement;

[^86]: Id. at *3.
[^88]: Id. at *9–11.
[^90]: Id. § 9-504.
[^92]: Id. at 365.
[^93]: Id. at 363, 365.
the only way to perfect the security interest is to comply with the Commercial Instruments and Maritime Liens Act. In *In re Sherman*, the preferred ship mortgage recorded with the NVDC identified the secured party—Commerce Bank—by its similarly named predecessor—Commerce Bank/Shore. The court held that the recorded mortgage, although mistaken, substantially complied with the Act and was therefore sufficient to perfect the bank’s security interest.

A security interest in a vehicle or vessel covered by a state certificate of title statute, and not held as inventory, can similarly be perfected only through compliance with the certificate of title statute. The court in *Brenner Financial, Inc. v. Cinemacar Leasing* ruled that the purpose of giving public notice of the rights of a secured party was satisfied even though the certificate of title for a limousine identified the owner—a putative lessor who in fact had a security interest—as a lessor.

However, once the secured party has its name removed from the certificate, perfection will end. In *In re Mouton*, a security interest of a secured party was properly noted on a certificate of title. The court held that the security interest became unperfected when, upon receiving payment that later failed to clear, the secured party signed the certificate to release its lien and sent the certificate to the debtor, even though the debtor never submitted the certificate to any state agency to have the vehicle re-titled.

Substantial compliance saved the secured party in *In re Klein*. In that case, a secured party’s lien was properly noted on an application for a corrected certificate of title. However, due to an error by the Michigan Secretary of State’s office, the lien was not noted on the certificate issued pursuant to the application. The court ruled that the security interest was perfected because the defects were technical and minor—being that the application was on an outdated form bearing the name of the previous Secretary of State, and it did not list the number of miles on the vehicle’s odometer (as required by the form)—and thus the application substantially complied with the law.

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96. Id. at *6.
97. See U.C.C. § 9-311(a)(2), (b), (d) (2009).
99. Id. at *5; see also *In re Stuewe*, 74 U.C.C. Rep. Serv. 2d 864 (Bankr. D. Kan. 2011) (ruling that a putative lessor of a vehicle who was listed as owner on the certificate of title held a perfected security interest when leases were re-characterized as secured transactions because they had substantially complied with the certificate of title law, and no creditor could be misled); *In re My Type, Inc.*, 407 B.R. 329 (Bankr. C.D. Ill. 2009) (same); *In re Drahm*, 405 B.R. 470 (Bankr. N.D. Iowa 2009) (same).
101. Id. at 62–63.
103. Id. at *17.
B. CONTROL

A security interest can, of course, be perfected by control. Decisions concerning control of investment property are discussed in this survey in the part concerning Article 8.

C. FINANCING STATEMENTS: DEBTOR AND SECURED PARTY NAME

There have been many decisions involving the name of an individual debtor on a financing statement. The new amendments to Article 9 seek to address this issue and bring more certainty to this area. The most discussed decision from last year was *In re Miller*.\(^{104}\) In that case, a financing statement identified the debtor as “Bennie A. Miller.” This was the name the debtor had used much of his life and which appeared on his driver’s license, social security card, tax returns, and the deed to his residence. The bankruptcy court ruled that the financing statement was ineffective because it lacked the debtor’s “legal name,” as evidenced by his birth certificate.\(^{105}\) The district court reversed and held that the financing statement was effective to perfect the security interest. In doing so, the court ruled that a financing statement must contain the debtor’s “name,” not “legal name,” and for this purpose the name on the debtor’s driver’s license, social security card, and tax returns is the debtor’s correct name.\(^{106}\) Unfortunately, the court did not give any guidance on how to determine the debtor’s “name” when the facts were less clear.

Not all courts agree; some continue to require that a financing statement identify the debtor’s legal name. In *In re Green*,\(^{107}\) the court ruled that even though the name on the debtor’s driver’s license was “Ron Green,” financing statements identifying the debtor by that name were ineffective because a search under the debtor’s legal name, “Ronnie J. Green,” did not reveal the filings.\(^{108}\)

It is easier to get the debtor’s name right when the debtor is a “registered organization.”\(^{109}\) In such a case, the financing statement must identify the debtor by the name indicated on the public record that shows the debtor to have been organized.\(^{110}\) In *Bank of Nova Scotia v. Four Winds Plaza Corp.*,\(^{111}\) a financing statement that identified the debtor by its registered corporate name, rather

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108. Id. at *3–4.
110. See id. § 9-503(a)(1).
111. 56 V.I. 45 (Super. Ct. 2012).
than its trade name, sufficiently provided the debtor’s name for purposes of perfecting the security interest.112

D. FILING OF FINANCING STATEMENT—MANNER AND LOCATION

The secured party’s job is not done once it gets the correct name for the debtor on the financing statement. It must still file the financing statement in the correct office. In In re Value Investment Properties, LLC,113 the court ruled that a security interest in manufactured homes owned and held for sale or lease by a manufactured home park could be perfected only by filing a financing statement with the Secretary of State’s office.114 As a result, a secured party that filed had a perfected security interest; however, another secured party that had recorded a deed of trust, both to perfect its interest in the real property and as a fixture filing, did not have a perfected security interest in the manufactured homes because they were not fixtures.115

E. FINANCING STATEMENT—RELATIONSHIP TO TRANSACTION

Many lenders routinely file a new financing statement each time they make a new loan to the debtor, even if the new financing statement does not add any additional collateral. In Union Bank Co. v. Heban,116 the court ruled that this is unnecessary. The debtor in that case had executed four promissory notes and security agreements relating to equipment over a period of two years. Contemporaneously with the second and third transaction, the secured party filed a financing statement. It also filed a financing statement three years before the first loan and one year before the last loan. Two of the financing statements covered all of the equipment, while the other two covered specific equipment. The trial court ruled that the middle two security interests were perfected by the contemporaneously filed financing statements, but that the first and last loan were unperfected because there was nothing to associate the first or fourth financing statement with those loans. The appellate court reversed. Relying on U.C.C. section 9-322 cmt. 4, the court correctly concluded that there is no requirement that a financing statement relate to a particular indebtedness.117

F. TERMINATION AND LAPSE OF FINANCING STATEMENT

There have been a number of instances of termination statements filed when that was not the secured party’s plan. The result often turns on whether the filing

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112. The recent amendments to Article 9 confirm that, for the purpose of identifying the debtor’s name on a financing statement, a registered organization’s name is the name stated to be its name on its public organic record. See U.C.C. § 9-503(a)(1) (2009).
117. Id. at *4.
was made by an agent of the secured party within the scope of the agent’s authority.\textsuperscript{118} In \textit{In re Hickory Printing Group, Inc.},\textsuperscript{119} the court ruled that a security interest became unperfected when the secured party mistakenly filed a termination statement and did not become re-perfected when the secured party filed a correction statement.\textsuperscript{120} While a subsequently filed new financing statement did re-perfect the security interest, the court held that it did so only as of the date it was filed, which allowed the security interest to be avoided as a preference.\textsuperscript{121}

In contrast, in \textit{In re International Home Products, Inc.},\textsuperscript{122} a secured party remained perfected despite the debtor’s filing of a termination statement because that filing was unauthorized. Thus, the secured party was entitled to the proceeds of accounts on which it had “foreclosed” prepetition by instructing the account debtors to make payment to the secured party.

Financing statements are normally effective for only five years.\textsuperscript{123} If a financing statement lapses while the secured obligation remains outstanding, the secured party will find itself with an unperfected security interest.\textsuperscript{124} This can occur even after a bankruptcy petition is filed.\textsuperscript{125}

This is essentially what transpired in \textit{In re Miller Brothers Lumber Co., Inc.},\textsuperscript{126} where the court ruled that a secured party whose filing lapsed during the debtor’s bankruptcy case lost perfection. The court held that the debtor in possession, armed with the rights of a lien creditor as of the petition date, could avoid the security interest.\textsuperscript{127} While the court’s conclusion about perfection was correct, its ruling on avoidance was emphatically not.\textsuperscript{128} While a person that becomes a judicial lien creditor takes priority over a security interest that was unperfected \textit{when the judicial lien arose},\textsuperscript{129} a person that becomes a lien creditor when a security interest is perfected, and thus initially takes subject to that security interest, does not acquire priority if the security interest subsequently becomes unperfected.\textsuperscript{130}

\textsuperscript{118} See U.C.C. § 1-103(b) (2011); U.C.C. § 9-509(d)(1) (2009).
\textsuperscript{119} 479 B.R. 388, 397–404 (Bankr. W.D.N.C. 2012).
\textsuperscript{120} The recent amendments to Article 9 re-designated a “correction” statement as an “information” statement to avoid any misunderstanding as to its effect. See U.C.C. § 9-518 (2009).
\textsuperscript{121} \textit{Hickory Printing Grp.}, 479 B.R. at 404–05.
\textsuperscript{123} See U.C.C. § 9-515(a), (b) (2009).
\textsuperscript{124} Id. § 9-515(c).
\textsuperscript{127} Id. at *3.
\textsuperscript{130} When perfection lapses, a perfected security interest is deemed never to have been perfected as against “a purchaser of the collateral for value.” Id. § 9-515(c). A lien creditor is not a purchaser. See U.C.C. § 1-201(b)(29), (30) (2011). Thus, a person who becomes a lien creditor when a security interest is perfected takes subject to that security interest and remains subject to it even if perfection subsequently lapses. See U.C.C. § 9-515 cmt. 3, ex. 2 (2009).
V. PRIORITY

A. STATUTORY LIENS

The IRS need not play by the U.C.C. rules. In *United States v. Montesinos*, a notice of federal tax lien misspelled the taxpayer's first name as "Isreal" instead of "Israel." The court held that the lien was nevertheless valid against a later mortgagee because the lien was indexed in a real property system that permitted searching by last name, by last and partial first name, by partial last name and partial first name, or with a "sounds like" feature that captured names spelled differently but that sound similar to the name being searched, and thus, a reasonably diligent searcher would have discovered the notice. This decision perpetuates the unfortunate result in *In re Spearing Tool & Manufacturing Co.*, in which the Sixth Circuit held that a tax lien filing that did not provide the taxpayer's correct name was still sufficient if a reasonably diligent searcher would find it. Thus, a prospective secured party or other searcher looking for tax liens must search under all "reasonable" alternative spellings and configurations of the debtor's name to gain comfort that it has found all IRS tax lien filings.

In addition to its powerful tax lien rights, the government has other powers that can interfere with the rights of a secured party. Chief among these is its right to forfeiture of the instrumentalities or proceeds of criminal activity. In *Bode v. State*, a secured party's security interest in an airplane was forfeited to the state as a result of the debtor's criminal activity. The secured party was aware of the debtor's history of using the airplane to violate state gaming laws in ways that might lead to forfeiture. Thus, the secured party did not qualify for the innocent owner/creditor defense, even if the secured party did not have reason to believe that the debtor, her son, would again violate the statute.

In contrast, in *United States v. $463,497.72*, a pharmaceutical supplier had a security interest in the deposit accounts of its customer pharmacy. The pharmacy had diverted controlled substances for unlawful purposes. The supplier was

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132. Id. at *4.
133. 412 F.3d 653 (6th Cir. 2005); see also Trane Co. v. CGI Mech., Inc., No. 2:09-CV-01045-PMD, 2010 WL 2998516 (D.S.C. July 28, 2010) (ruling notice of federal tax lien listing the debtor by its former name, "Clontz-Garrison Mechanical Contractors, Inc.", instead of its current name, "CGI Mechanical, Inc.", was sufficient to give IRS tax lien priority over a subsequent judgment lien in part because the judgment creditor occasionally still used the debtor's former name and a reasonably diligent search by the judgment creditor would have revealed the tax lien notice); *In re Green Pastures Christian Ministries, Inc.*, 437 B.R. 465 (N.D. Ga. 2010) (ruling notices of federal tax lien that misspelled the debtor's name as "Green Pastures Chrestain Ministries, Inc." were effective in part because a computerized search in the filing office could be conducted under the name "Green Pastures" and such a search would reveal the notices). But cf. *In re Crystal Cascades Civil, LLC*, 415 B.R. 403 (B.A.P. 9th Cir. 2009) (holding notice of tax lien was ineffective because it identified the debtor as "Crystal Cascades, LLC, a corporation," rather than "Crystal Cascades Civil, LLC, a Nevada limited liability company," and while a professional searcher would have discovered the notice using a proprietary title plant, in this locality a reasonable non-professional searcher using the real estate records would not have).
entitled to the innocent owner defense to forfeiture because, even if the supplier was negligent in monitoring its customer, the supplier's employees had no knowledge of the illegal activity, had reported suspicious orders of controlled substances, and had credible explanations why the spike in the orders for some controlled substances did not provoke additional suspicious order reports or suspension of shipments. Thus, the supplier was not willfully blind to the illegal diversions.

The U.C.C. creates at least one statutory lien that can conflict with a security interest: U.C.C. section 7-209 provides a warehouse that has issued a warehouse receipt for goods with a lien on the bailed goods to secure the costs of storing and transporting them. In general, the warehouse lien takes priority over a subsequent security interest in the goods but is junior to a prior perfected security interest unless the secured party entrusted the goods to the warehouse.

In *M & I Marshall & Isley Bank v. Kinder Morgan Operating L.P.*, the court ruled that a perfected security interest in warehoused coal was junior to an earlier warehouse lien, even though some or all of the originally warehoused coal had been replaced with new coal after the security interest was perfected. However, the perfected security interest had priority over a subsequent warehouse lien. The fact that the secured party may have benefitted by the warehouseman's storage of the goods did not give the warehouseman priority and storage of the goods was not an entrustment.

**B. BUYERS AND OTHER TRANSFEREES**

A buyer in ordinary course of business takes free of a security interest created by its seller. For a buyer to qualify for this protection, the buyer must, among other things, act in good faith and take possession of the goods or have a right to possession under Article 2. In *Arthur Glick Truck Sales, Inc. v. Stephen East Corp.*, the court held that buyers of trucks qualified as buyers in ordinary course of business and took free of a security interest created by their seller. The fact that the supplier retained the certificates of title to the trucks was immaterial. The buyers did not lack good faith because of their failure to research title to the trucks because, even had they done so and discovered the supplier...

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136. *Id.* at 689.
137. *Id.* at 691. The government's rights can assert themselves in surprising ways. In *Sadowski v. Commissioner of Revenue*, No. 8299, 2012 WL 1414924 (Minn. Tax Ct. Apr. 18, 2012), a secured party foreclosed on stock in which the secured party had a security interest and became sole owner of corporation. The secured party was liable for the unpaid sales tax liability of the corporation because he had become the party responsible for filing the tax returns and paying the taxes. *Id.* at *2.
139. See *id.* § 7-209(c); U.C.C. § 9-333 (2009).
140. 368 S.W.3d 160 (Mo. Ct. App. 2012).
141. *Id.* at 167–69.
142. *Id.* at 169–71.
144. See U.C.C. § 1-201(b)(9) (2011).
possessed the certificates, that discovery would not have suggested that the seller lacked authority to sell the trucks validly.\textsuperscript{146}

A buyer did not fare as well in \textit{Hockensmith v. Fifth Third Bank}.\textsuperscript{147} In that case, the buyer of three vintage cars allowed the seller to retain possession pursuant to their unwritten agreement for the seller to restore the cars, market them, and split the profits with the buyer. When the seller defaulted on its floor plan financing, the buyer demanded that the seller re-title the cars in the buyer's name, which the seller did. However, the seller retained possession and there were no sales agreements or bills of sale. Because it was unclear whether the buyer had the right to possession, the court denied summary judgment on whether the buyer was a buyer in ordinary course.\textsuperscript{148} Further, because the buyer may have purchased the goods not from the dealer but from third parties with the dealer acting as the buyer's purchasing agent, the security interest may not have been created by the buyer's seller.\textsuperscript{149}

\section*{C. Subordination and Subrogation}

Article 9 expressly recognizes that a secured party may enter into a subordination agreement and that such an agreement can be effective.\textsuperscript{150} Of course, effectiveness is based on the assent of the secured party otherwise entitled to priority, and an agreement between two others cannot affect the priority of the secured party with priority.\textsuperscript{151} Application of this rule can be tricky, however, when the subordinating creditor later sells all or part of the secured loan.

This is precisely what happened in \textit{In re Brooke Capital Corp.}.\textsuperscript{152} Two secured parties agreed that the senior secured party would pay the proceeds of collateralized stock to the junior secured party. The court first ruled that this subordination agreement was enforceable even though the economic assumptions underlying the agreement proved not to be correct because those assumptions were not made conditions to the subordination.\textsuperscript{153} The court then dealt with whether the subordination was binding on four entities that acquired participation interests in the senior secured party's subordinated loan. As to three of those participants, the court concluded that, even though they had purported to buy a share of the loan, because the senior secured party retained the risk of loss, the

\textsuperscript{146} \textit{Id.} at *14. The buyers did not receive delivery until after the supplier that had consigned the trucks to the seller had perfected its security interest—and thus the buyers did not take free under U.C.C. section 9-317. \textit{Id.} at *11.


\textsuperscript{148} \textit{Hockensmith}, 2012 WL 5969654, at *8–9.

\textsuperscript{149} \textit{Id.} at *9; \textit{see also West v. Houchin}, No. 1:10CV936, 2012 WL 2810298 (M.D.N.C. July 12, 2012) (ruling that prepaying buyer of specially manufactured goods had no cause of action against the seller for conversion due to the seller’s sale and delivery of the goods to another buyer because, unless the sales agreement provides otherwise, title does not pass until delivery and thus the prepaying buyer lacked ownership or a superior possessory interest).

\textsuperscript{150} See U.C.C. \textsection 9-339 (2009).

\textsuperscript{151} \textit{Id.} \textsection 9-339 cmt. 2.


\textsuperscript{153} \textit{Id.} at *14.
participants had in fact made loans to the senior lienor. The court then con-
cluded that those participants could not rely on the senior lienor’s perfection
and, because those entities had taken no action to perfect their interests, their
interests were subordinate to the junior lienor’s rights. The fourth participant,
in contrast, was a true buyer of a portion of the senior lienor’s loan, and thus the
court ruled that its interest was perfected. The court then concluded that the
subordination agreement was not binding on the fourth participant even though
the senior lienor remained the servicer of the entire loan because the participa-
tion agreement required the participant’s consent to any substitution of collateral
outside the normal course of dealing with the borrower.

The priority rules of Article 9 can, on occasion, be affected by the principles of
subrogation that allow one party to stand in the shoes of the secured party oth-
erwise entitled to priority. In re Siskey Hauling Co., a debtor granted a se-
curity interest in its accounts to SP1, who filed the first financing statement. The
debtor then granted a security interest in its accounts to SP2, who filed the sec-
ond financing statement. Subsequently, the debtor granted a security interest in
and sold its accounts to SP3 in exchange for SP3 paying off the debtor’s obliga-
tion to SP1. In connection with this transaction, SP3 filed its own financing
statement and obtained a release and termination of SP1’s security interest. In
the resulting dispute, SP3 argued it should be prior to SP2 because it should
be equitably subrogated to SP1’s claim. The court rejected this assertion for
two related reasons: (i) the transaction was not an assignment from SP1 to SP3;
and (ii) SP3 knew of SP2’s interest and knew that something had to be done to
obtain priority over SP2, but failed to structure the transaction properly and thus
the equities were not in its favor.

D. EQUITABLE CLAIMS

In general, the U.C.C. does not give priority to the equitable claims of those
who allegedly provided benefit to the secured party through some benefit
to the collateral. In Granite Commercial Industries, LLC v. Landmark American

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154. Id. at *15–16.
155. Id. at *16. This aspect of the court’s decision is flawed. The fact that the participants did not
file against the secured party to whom they made a loan should have had no bearing on whether their
interest in the account debtor’s collateral was perfected. The court seems to have been confused by
the fact that the account debtor and the subordinating secured party were two different debtors.
156. Id.
157. Id. at *17–18. For a lengthier discussion of the decision and its implications, see John F.
Hilson & Stephen L. Sepinuck, The Perils of Participations (and Secrets to Successful Subordinations),
commercial-law/links-resources/.
158. See U.C.C. § 1-103(b) (2011); see also U.C.C. § 9-618(a)(3) (2009) (recognizing subrogation
in a specific context).
160. Id. at 604–05. SP3 also argued that its “purchase” of the receivables placed the receivables
outside the debtor’s estate and gave SP3 sole access to them. The court rejected this argument because
the “purchase” was a full-recourse factoring arrangement and, even if it were a “sale,” the purchased
assets would remain subject to SP2’s prior lien. Id. at 605–08.
Insurance Co., a secured party had a perfected security interest in the debtor’s equipment. The court ruled that the secured party had priority over the debtor’s attorney in the proceeds of the debtor’s insurance claim for damage to the equipment even though the attorney brought the action against the insurer and was entitled to a charging lien on the proceeds. The secured party’s security interest was first in time and the attorney had constructive and actual knowledge of that interest.

E. Priority—Competing Security Interests

The baseline priority rule for two or more security interests in the same collateral is section 9-322(a)(1), which grants priority to the first to file or perfect. However, this rule can be ephemeral because it requires that there be no period thereafter when there is neither filing nor perfection. Thus, if the secured party with priority allows its filing to lapse, and its security interest is not perfected by some other means, the secured party will find that it is not entitled to priority.

This should have been the result in In re Wilkinson, in which a secured party financing statement lapsed during the debtor’s bankruptcy proceeding. However, relying on cases dealing with how lapse affects the rights of a lien creditor, the court erroneously concluded that priority was fixed as of the petition date.

A secured party that attempts to perfect in the incorrect jurisdiction can lose priority for that reason. In Dayka & Hackett, LLC v. Del Monte Fresh Produce N.A., the court held that, prior to amendments in 2009, Mexican law did not generally require a filing as a condition to a security interest obtaining priority over the rights of a lien creditor—something (the court held) to be assessed in general, not on a collateral-specific basis. Therefore, under U.C.C. section 9-307(c), a secured party that filed in the District of Columbia against Mexican debtors’ grape crop had priority over a secured party that recorded in Mexico. The junior secured party, which had sold the crop, was liable for conversion because the senior secured party was entitled to possession even if it did not demand possession, although such a demand was in fact made. The court held that it was irrelevant that the junior secured party also acted as the debtor’s

162. Id. at *3–4.
164. Id.
165. Id. § 9-515 cmt. 3, ex. 1.
167. Cf. discussion of In re Miller Brothers Lumber Co., supra notes 123–27 and accompanying text; see also Spotlight, supra note 128, at 20 (criticizing the decision in In re Wilkinson).
168. 269 P.3d 709 (Ariz. Ct. App. 2012). The authors of this survey assisted in this litigation on behalf of the secured party that the court held was junior.
169. Id. at 712–14.
170. Id. at 716.
distributor, and therefore had recoupment rights with the respect to the sale proceeds.171

F. PURCHASE-MONEY SECURITY INTERESTS

If a secured party with a purchase-money security interest (“PMSI”) follows the applicable procedures, it can establish priority over other secured parties that would normally have priority under the first-to-file-or-perfect rule.172 In *First Financial Bank v. GE Commercial Distribution Finance Corp.*,173 the court held that a secured party with a PMSI in inventory had priority over another secured party with an earlier filed financing statement because the other secured party received the PMSI secured party’s notification of the planned PMSI inventory financing. That notification, though unsigned, was authenticated because it was on the secured party’s letterhead.174 The notification sufficiently described the collateral as including “new and used boats.”175

G. PROCEEDS

A security interest in collateral automatically extends to identifiable proceeds of the collateral.176 A security interest can also encumber after-acquired property, if the security agreement so provides.177 However, section 552 of the Bankruptcy Code178 prevents an after-acquired property clause from operating postpetition unless the postpetition property is proceeds of prepetition collateral. Because “proceeds” is not a limitless concept,179 secured parties occasionally find themselves without an interest in some postpetition property. Such was the case last year in *In re Premier Golf Properties, LP.*180 The court ruled that a prepetition security interest in accounts and revenues generated by the debtor’s golf courses did not extend to postpetition membership initiation fees, green fees, and driving range fees because such receipts were neither rents nor proceeds of prepetition collateral.

The definition of “proceeds” is sometimes in dispute.181 In *1st Source Bank v. Wilson Bank & Trust,*182 a secured party obtained a security interest in two trucking companies’ accounts as well as their rigs. The financing statement was limited to the rigs and the proceeds thereof; it did not indicate that the accounts were part of the collateral. The court ruled that the secured party was not per-

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171. *Id.* at 716–17.
172. *See* U.C.C. § 9-324 (2009); *see also* id. § 9-103 (defining “purchase-money security interest”).
174. *Id.* at *4; *see also* U.C.C. § 1-201(b)(37) (2011) (definition of “signed”).
177. *See* id. § 9-204(a), (b).
fected in the debtors’ accounts because the accounts were neither included in the collateral indication in the financing statement nor were the accounts proceeds of the rigs because use of equipment does not generate proceeds.183

VI. DEFAULT AND FORECLOSURE

A. REPOSSESSION OF COLLATERAL

Article 9 gives secured parties the right to repossess collateral after default.184 This right, like most of the rights provided for in the U.C.C., can be varied by agreement.185 In Zorin Properties, LLC v. Denney,186 the secured party sent the debtor a notification of his intention to repossess the collateral—the equipment of a Dairy Queen restaurant—after February 18, 2008. Upon learning that the manager and assistant manager planned to leave their employment, and fearing that this would lead to a closure of the restaurant and difficulty repossessing, the secured party began removing the collateral on February 13. Noting that neither the security agreement nor the law required notification of repossession, and that the security agreement expressly provided that no notice to the debtor would entitle the debtor to further notice in the future, the court ruled that the secured party had not waived the right to repossess earlier than February 18.187 The notification was merely a courtesy and did not create a course of dealing that overrode the express terms of the security agreement.188

A secured party may repossess collateral without judicial process provided the secured party acts without breaching the peace.189 Article 9 does not define “breach of the peace,” and instead leaves it to courts to give meaning to that standard.190 Numerous courts have ruled that if a breach of the peace does occur, thus making the repossession wrongful, the secured party has necessarily taken property to which the secured party had no present right to possession, thus potentially triggering a violation of the Fair Debt Collection Practices Act.191

In Smith v. AFS Acceptance, LLC,192 the court ruled that the debtor stated a claim for breach of the peace and, therefore, also a claim for violation of the Fair Debt Collection Practices Act against the secured party by alleging that, after the debtor and the debtor’s daughter jumped into the car, the repossession

183. Id. at *3–4. The court did not indicate whether the debtor operated the rigs (i.e., had employees use the rigs to haul cargo), or whether the debtor leased the rigs to independent contractors. If the debtor leased the rigs, the rental payments would have been proceeds of the rigs. See U.C.C. § 9-102(a)(64)(A) (2009).
187. Id. at *5.
188. Id. at *6.
190. Id. § 9-609(b)(2) cmt. 3.
agent continued to hook the car up to the tow truck, raised the rear of the car, and towed the car from the driveway with the door open, all while the debtor’s family members and neighbors yelled at the agents to stop. The court also ruled that the alleged facts served as the basis for a claim for intentional infliction of emotional distress against the repossession agent.193

Somewhat similarly, in Thompson v. Gateway Financial Services, Inc.,194 the debtor claimed that, as she drove onto her driveway, repossession agents struck her car with a flashlight, repeatedly yelling, “Bitch, get out of the car!,” and then backed a tow truck in the driveway, blocking the car’s path onto the street. This frightened a diabetic passenger in the car, causing him to urinate on himself. The court ruled that the debtor stated a claim against both the secured party and the repossession agents for breach of the peace, as well for violation of the Fair Debt Collection Practices Act.195 However, the court also ruled that: (i) the debtor had no evidence to support her claim against the secured party and the repossession company for negligent hire and supervision of the individual repossession agents;196 (ii) the debtor’s children, who witnessed the repossession effort but who had no interest in the vehicle, had no claim for the breach of the peace but did have a claim under the Fair Debt Collection Practices Act;197 and (iii) the defendants were entitled to summary judgment on the plaintiffs’ claims for emotional distress because the only evidence was their own testimony, they offered no medical records because none of them consulted a physician, and while a severely degrading event may lead to an inference of emotional distress, the incident was not so degrading as to excuse the plaintiffs’ failure to explain their emotional distress with more specificity.198

Once repossession is completed, the secured party’s obligation not to breach the peace during repossession necessarily ends.199 In Marcum v. Eastman Credit Union,200 a towing company attached the debtor’s vehicle to a tow truck and towed the vehicle from its parking spot into the flow of traffic before the debtor exited the vehicle, made her presence known to the agent, and objected to the repossession. The court ruled that the repossession had been completed before the objection was made and, as a result, the repossession was not a breach of the peace and the debtor’s claim under the Fair Debt Collection Practices Act failed.201

One of the few certain things about the duty not to breach the peace is that this is a nondelegable duty: a secured party is liable for a breach of the peace that occurs during a repossession on its behalf, even if the persons seeking to

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193. Id. at *5.
195. Id. at *3.
196. Id.
197. Id. at *2–3.
198. Id. at *4.
201. Id. at *5–6.
repossess were independent contractors. Nevertheless, in *Wecker v. Crossland Group, Inc.*, the court ruled that a repossession company, which contracted with an independent contractor to effectuate a repossession commissioned by the secured party, was not responsible for torts committed by an independent contractor during repossession. Although the secured party’s duty not to breach the peace is nondelegable, the court noted that the repossession company was not the secured party and chose to follow the general rule that a principal is not liable for the acts of the independent contractor.

B. NOTICE OF FORECLOSURE SALE

In general, a secured party must reasonably send advance notification to the debtor of a planned disposition of collateral. The requirements applicable to a notification of disposition are fairly minimal and not difficult to satisfy. One of the few requirements is that the notification must state the method of disposition, including whether the disposition will be by private sale or public sale. For transactions other than consumer transactions, there is a safe harbor as to timing, which provides that notification ten days in advance is sufficient, as well as a safe harbor form, but a notification that fails to comply with either or both of these safe harbors might nevertheless be sufficient.

In *Bank of America v. Sea-Ya Enterprises, LLC*, a secured party notified the debtor and a guarantor that it planned to sell aircraft by private sale after a specified date. Although the security agreement provided that “Bank will advise Debtor in its Notice of Resale . . . what kind of repair, maintenance or make ready service it will perform prior to offering the Aircraft for resale,” no such work was done to the aircraft. Accordingly, the court concluded that there was nothing to notify the debtor of and, even if a statement to that effect were required, the secured party’s failure to make it was a harmless error. However, the court ruled, the guarantor’s spouse, who also guaranteed the secured obligation, was entitled to her own notification and the secured party’s failure to address the notification to the spouse freed her of personal liability even though she resided at the same address and likely had actual notice of the secured party’s disposition plans.

In *In re MarMc Transportation, Inc.*, the secured party sent on January 21 a notification indicating that the collateral would be sold no later than January 31.

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204. Id. at 483–84.
205. See U.C.C. § 9-611(b)–(d) (2009).
206. See id. § 9-613(1)(C).
207. See id. § 9-612(b).
208. See id. § 9-613(1).
209. See id. §§ 9-612(a) & cmt. 3, 9-613(2)–(4).
211. Id. at 364–65.
212. Id. at 365.
After observing that this gave only seven days notice of the pending sale, the court concluded that the notification was inadequate, particularly given that the buyer had previously paid for the aircraft and the creditor sought a deficiency of over $700,000. It did not matter, the court noted, that the secured party did not actually transfer title by providing a bill of sale until May 23.

In VFS Leasing v. Bric Constructors, LLC, the secured party’s disposition notification indicated that the collateral would be sold at a private sale after a specified date. In fact, the secured party sold the collateral via a public online auction, pursuant to its normal practices, following unsuccessful efforts to sell through a private online offering. The court ruled that this created a factual issue as to the reasonableness of the notification and denied the secured party’s motion for summary judgment.

In a consumer-goods transaction, the notification requirements are more stringent and failure to comply with any of them means that the notification was insufficient. Moreover, the ten-day safe harbor for non-consumer-goods transactions does not apply. In In re Boone, the secured party in a consumer-goods transaction sent notification on August 30 of a private sale to be held no earlier than September 9. The court ruled that this was sufficient even though the interval included a national holiday and the debtors claimed that they lacked the time to withdraw money from their retirement account to redeem the collateral.

In Limtiaco v. Auction Cars.com, LLC, the court ruled that the secured party failed to give proper notification of a disposition of collateral in a consumer-goods transaction because the notification failed to state that the debtor was entitled to an accounting of the unpaid indebtedness. The secured party was therefore liable for statutory damages equal to 10 percent of the principal amount of the obligation at the time of the notification.

C. COMMERCIAL REASONABILITY OF FORECLOSURE SALE

Every aspect of a foreclosure sale must be “commercially reasonable.” If a secured party’s compliance with this standard is challenged, the secured party has the burden of proof. Because commercial reasonableness is a fact-intensive question, this burden can occasionally be difficult to satisfy.
For example, in *M & T Bank v. Bolden*, the secured party sought to collect a deficiency after selling a ten-year-old Mercedes-Benz for $3,900 at a dealer’s-only auction. The auction was, in the court’s words, “one of the world’s largest sales facilities for automobiles.” Nevertheless, the court ruled that the secured party had failed to demonstrate that it had acted in a commercially reasonable manner because it offered no evidence about how the sale was advertised or conducted, how many bidders were present, how many bids were made, or whether the sale was done in accordance with the accepted practices of reputable finance companies for, or dealers of, automobiles. As a result, the debtor was presumptively entitled to statutory damages.

In contrast, the court in *Universal Truck & Equipment Co. v. Caterpillar, Inc.* held that the secured party, one of the leading sellers of construction equipment, was entitled to summary judgment on claims that it failed to conduct a sale of construction equipment in a commercially reasonable manner. The secured party had listed three of the four items on the secured party’s own website to generate a worldwide audience of potential buyers. Two items were sold at an auction, one to a private buyer, and one to a buyer on whose lot the item was held. All four items sold at prices comparable to that of other used equipment at the time, as well as the values assigned by the Green Book. The court concluded that a reasonable jury could not find that this was a commercially unreasonable manner in which to market the collateral.

**D. OTHER ENFORCEMENT ISSUES**

In *In re Crossover Financial I, LLC*, the secured party sought to avail itself of a clause in its security agreement providing that, upon default, the debtor’s voting rights as the sole member of a limited liability company would cease and that the secured party could vote any or all of the pledged interest. The court ruled that Colorado LLC law requires a secured party to enforce the security agreement and become admitted as a member before the secured party may exercise voting rights associated with a membership interest pledged as collateral. The court did not discuss why the secured party would not be entitled to vote either under the law of agency or under U.C.C. section 9-601(a), which allows the parties by agreement to expand the secured party’s rights upon default.

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228. Id. at *1.
229. Id. at *3.
230. Id. (citing U.C.C. § 9-625(c)).
232. Id. at *4.
234. Id. at 205–06.
235. Nevertheless, the decision does not stand alone. *See In re Lake Cnty. Grapevine Nursery Operations*, 441 B.R. 653 (Bankr. N.D. Cal. 2010) (ruling that despite language in pledge agreement to the contrary, under California LLC law neither the pledging of membership rights in an LLC, nor the declaration of a breach by the secured party, is sufficient to divest the pledging member of the right to vote). *Cf. Corsair Special Situations Fund, L.P. v. Engineered Framing Sys., Inc.*, 694 F. Supp. 2d 449
In *Jones v. West Plains Bank & Trust Co.*, a person claiming to be the owner of recording equipment and master recordings, which had been in the possession of the debtor, brought an action for conversion and copyright infringement against the secured party that repossessed and sold the equipment and recordings. The court ruled that the plaintiff had stated a cause of action and that the debtor was not a necessary party to either cause of action.237

In *Israel Discount Bank of New York v. First State Depository Co.*, the secured party made a $10 million loan secured by $17 million in numismatic coins and gold bullion. A professional bailee, which had entered into an agreement with the secured party to honor the secured party’s instructions, held the collateral. The secured party sued the bailee after the bailee refused instructions to release the collateral to the secured party and in fact released the collateral to the debtor. The bailee moved to dismiss on the basis of exculpatory clauses in its agreement with the debtor. The court denied the motion, concluding those clauses did not apply to intentional misconduct and, in any event, provided no defense to the secured party’s claims based on its own agreement with the bailee.239

(D. Md. 2010) (ruling that because patent security agreement provided that the creditor’s interest would “become an absolute assignment” after debtor defaulted, and debtor had defaulted, the security interest had become an absolute assignment of the patent).

237. *Id.* at *3–4*.
239. *Id.* at *11–13*. The court also ruled that the secured party was not subject to the arbitration clause in the debtor’s agreements with the bailee even though the secured party was a third-party beneficiary of those agreements because the secured party’s claim rested on breach of its direct agreement with the bailee, not on breach of the debtor’s agreements with the bailee. *Id.* at *6–10.*