

Personal Property Secured Transactions

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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. Reaching an incorrect conclusion on this issue can lead to a disastrous result. For example, if a person is unaware that Article 9 applies, the person might fail to perfect a security interest and end up losing all interest in the collateral to some other claimant.

In *In re Jones*,¹ the debtors purchased automobiles pursuant to bills of sale which provided that “this agreement will not remain binding if a third party finance source does not agree to purchase the installment sale contract based on this agreement”² and required the buyer to return the vehicle in such a situation upon the seller’s demand therefor. After the financing fell through, the debtors filed for bankruptcy protection and the court had to determine if the seller remained the owner of the vehicles, so that the vehicles did not become property of the estate, or if the seller retained only a security interest. The court concluded that the language of the agreements created a condition subsequent, not a condition precedent, to the transaction,³ and that as a result the seller retained only a security interest.⁴

In *In re Strata Title, LLC*,⁵ the debtor and another entity each owned a one-half interest in a limited liability company (“LLC”). The LLC operating agreement provided that the other entity would become the 100 percent owner if its capital contribution was not repaid by a specified date. Shortly before that date, the debtor filed for bankruptcy protection. The court ruled that, despite the fact that the operating agreement made the ownership change “self-operative,” it created a security interest, not an outright assignment, and thus the debtor’s ownership interest became property of the bankruptcy estate.⁶ However, the court also ruled that, after the specified date passed, the ownership change occurred and the property ceased to be property of the estate.⁷ The

1. No. 12-14608, 2013 WL 1092099 (Bankr. E.D. Tenn. Jan. 17, 2013).

2. *Id.* at *1.

3. *Id.* at *6–7.

4. *Id.* at *7; *cf.* *Cappo Mgmt. V, Inc. v. Britt*, 711 S.E.2d 209, 211–12 (Va. 2011) (automobile seller that repossessed the car subject to a conditional sale contract when the financing fell through was required to give the buyer notification of a resale because, even though the Supplement to Purchase Contract declared that the car remained property of the dealer pending approval of the lender, other contract documents treated the vehicle as belonging to the buyer and the ambiguity had to be construed against the dealer). *But cf.* *Drewry v. Starr Motors, Inc.*, No. 3:07CV624, 2008 WL 2035607, at *3–5 (E.D. Va. May 12, 2008) (automobile seller to whom buyer had returned car subject to a conditional sale when the buyer’s financing fell through was not required to give the buyer notification of a resale because the buyer, who had made no monthly payments and had stopped payment on the down payment check, had no interest in the car); *Bertin v. Grant Auto., Inc.*, No. 06-3002, 2007 WL 1257183, at *9–10 (C.D. Ill. Apr. 30, 2007) (automobile seller that repossessed the car subject to a conditional sale when the buyer’s financing fell through was not required to give the buyer notification of a resale because the seller resold the car pursuant to its ownership interest, not its security interest).

5. No. 12-24242, 2013 WL 2456399 (Bankr. D. Ariz. June 6, 2013).

6. *Id.* at *2–3.

7. *Id.* at *4–5.

court offered no explanation of why, if the operating agreement created a security interest, the normal enforcement rules of U.C.C. Article 9 did not apply.

B. LEASING

Distinguishing a lease of goods—which is governed by Article 2A of the U.C.C.—from a sale with a retained security interest—governed by Articles 2 and 9—is often difficult. The issue is a heavily factual one,⁸ although the U.C.C. contains some detailed rules that give a definitive answer in some situations in which the lease is not terminable by the lessee. Among those situations are when the lease extends beyond the economic life of the goods or the lessee has an option to buy the goods for nominal consideration.⁹ When a lessor overlooks the possibility that its transaction is a sale, the lessor may find that it has not perfected what turns out to be a “security interest.”

Such was the situation in *In re Purdy*,¹⁰ which involved fifty-month leases of dairy cows. The court ruled that the transactions were really sales with a retained security interest because the lessee had no right to terminate, and fifty months exceeded the economic life of dairy cows, thirty percent of which needed to be culled each year.¹¹ As a result, a lender with a prior perfected security interest in the lessee’s existing and after-acquired livestock had priority over the lessor.¹²

Similarly, *In re Rodriguez*¹³ involved a 30-month lease of two tractors with an option to purchase at the end of the lease term for \$6,600. The court ruled that the option price was nominal in reference to the projected fair market value of \$12,000–\$13,000, and thus the transaction was a sale with a retained security interest.¹⁴

II. SECURITY AGREEMENT AND ATTACHMENT OF SECURITY INTEREST

In general, there are three requirements for a security interest to attach, that is, effectively to come into existence: (i) the debtor must authenticate a security agreement that describes the collateral; (ii) value must be given; and (iii) the debtor must have rights in the collateral or the power to transfer rights in the collateral.¹⁵

8. See U.C.C. § 1-203(a) (2011).

9. See *id.* § 1-203(b).

10. 490 B.R. 530 (Bankr. W.D. Ky. 2013).

11. *Id.* at 536. This conclusion was further supported by other evidence indicating that the lessee retained the proceeds of cows sold, that some of the cows were selected and purchased by the lessee only to be later reimbursed by the lessor, and that some of the cows were not branded with the lessor’s brand until after delivery to the lessee. *Id.* at 537. The second and third additional factors are not persuasive.

12. *Id.* at 537–40.

13. No. 12-50321, 2013 WL 1385665 (Bankr. S.D. Tex. Apr. 3, 2013).

14. *Id.* at *2.

15. See U.C.C. § 9-203(a)–(b) (2013).

A. EXISTENCE OF SECURITY AGREEMENT

The requirement of an authenticated security agreement is fairly easy to satisfy. The agreement must create or provide for a security interest,¹⁶ 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),¹⁷ and it must describe the collateral.¹⁸ If no single document satisfies these requirements, multiple writings may do so collectively, under what is known as the “composite document rule.”¹⁹

In *Crozier v. Wint*,²⁰ a married couple signed a promissory note that stated it was “secured by a filed UCC Financing Statement.”²¹ The husband initialed a financing statement that listed a trailer home, furnishings, a pickup truck, and equipment for a business as the collateral. After citing authority indicating that Missouri does not allow a security interest to be inferred from multiple documents unless express language in them, when taken together, creates a security interest,²² the court ruled that the note and financing statement could be sufficient to create a security interest if the husband was the sole owner of the collateral described in the financing statement or acted as an agent of the wife when he initialed the financing statement.²³

B. 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.²⁴ 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 *In re WL Homes, LLC*,²⁵ a parent corporation authenticated a security agreement purporting to grant a security interest in a deposit account of one of its wholly owned subsidiaries. The court ruled that, while the parent may not have had sufficient rights to grant a security interest in the deposit account, the subsidiary consented to the use of the deposit account as collateral because

16. See *id.* § 9-102(a)(73).

17. See U.C.C. § 1-201(b)(35) (2011).

18. See U.C.C. § 9-203(b)(3)(A).

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

20. 736 F.3d 1134 (8th Cir. 2013).

21. *Id.* at 1136.

22. *Id.* at 1137 (discussing the “Composite Document Rule”).

23. *Id.*

24. See *id.*; see also U.C.C. § 9-203(b)(2) (2013).

25. 534 F. App'x 165 (3d Cir. 2013).

the CFO of the parent, who signed the security agreement on behalf of the parent, was also the president of the subsidiary and thus knowledge of, and consent to, the transaction were properly imputed to the subsidiary.²⁶

In *In re Terrabon, Inc.*,²⁷ a subsidiary, in whose name a certificate of deposit ("CD") was issued after its parent company deposited the funds for that purpose, authenticated a security agreement purporting to pledge the CD. The court ruled that the security interest attached because, even if the parent company owned the CD, either it consented to the subsidiary's use of the CD as collateral given that the same individual served as CEO of both entities and executed the documents, and thus acted under the apparent authority of the parent,²⁸ or the parent was estopped from denying the creation of the security interest due to the fact that it allowed the subsidiary to appear as the owner.²⁹

C. 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 a security interest can attach to the debtor's interest in an LLC if the LLC operating agreement prohibits members from transferring their interest without previously obtaining consent from the other members.³⁰ That issue arose again this year.

In *In re McKenzie*,³¹ an appeal of a decision reported on last year,³² the appellate court ruled that a creditor did not have a security interest in the debtor's LLC membership interest because the LLC operating agreement expressly provided that no member could transfer its interest without the prior written consent of the board and that any attempted transfer without consent was void. The court further concluded that the creditor's evidence of *subsequent* consent did not prove that the requisite *prior* consent was given.³³

26. *Id.* at 168–71. For a discussion of the lower court opinions in this case, see Steve Weise & Stephen L. Sepinuck, *Personal Property Secured Transactions*, 68 BUS. LAW. 1255, 1261–62 (2013) [hereinafter 2012 Survey]. It should be noted that the subsidiary's consent to the use of its deposit account to secure the parent's debt would likely amount to a guaranty. See William H. Coquillette, *Guaranty of and Security for the Debt of a Parent Corporation by a Subsidiary Corporation*, 30 CASE W. RES. L. REV. 433, 434 (1980).

27. No. 12-36805, 2013 WL 6157980 (Bankr. S.D. Tex. Nov. 22, 2013).

28. *Id.* at *6–10 (relying, in part, on a lower court opinion in the *WL Homes* case).

29. *Id.* at *10.

30. See Steven O. Weise & Stephen L. Sepinuck, *Personal Property Secured Transactions*, 67 BUS. LAW. 1311, 1321–22 (2012) (also discussing why U.C.C. section 9-408 does not override restrictions on transfer in an LLC operating agreement).

31. 737 F.3d 1034 (6th Cir. 2013).

32. See 2012 Survey, *supra* note 26, at 1263–64 (discussing *In re McKenzie*, No. 1:11-cv-192, 2012 WL 4742708 (E.D. Tenn. Oct. 2, 2012)).

33. *McKenzie*, 737 F.3d at 1040–41; see also *McDonald v. Yarchenko*, No. 03:12-cv-00656-HZ, 2013 WL 3809512, at *2–4 (D. Or. July 23, 2013) (lender did not comply with term in LLC operating agreement requiring prior written consent of a majority of the five non-transferring members to debtor's encumbering his membership interest because a fax purporting to express consent of two members was signed by at most one of them and a letter that stated consent was given by another

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 need only reasonably identify the collateral and, for most types of property, may refer to the collateral by its Article 9 type.³⁴ Several cases raised unresolved factual issues about this requirement last year.

For example, in *In re Dwek*,³⁵ the security agreement described the collateral as "shares of stock or other securities or certificates as listed on Schedule A."³⁶ The bankruptcy court ruled that the sufficiency of the description remained an open question not resolvable by summary judgment because it was unclear whether the one page printout—containing an account number, the names of specific stocks, and the quantity held—attached to a letter dated five months after the security agreement was executed was the "Schedule A" referred to. The district court affirmed.³⁷

Similarly, in *Collins v. Angell*,³⁸ a summary judgment in favor of the secured party was reversed after the district court concluded that a factual question remained about whether a security agreement and financing statement that identified collateralized cattle by name and ear tag number were effective with respect to cattle whose ear tag had either fallen off or did not match one of the listed numbers. While the bankruptcy court had relied on evidence that the names of the cattle were referenced in a certificate of registration for each cow, each certificate included a sketch of the cow's distinctive markings, and those markings could be used to identify the cows, the district court noted that the only evidence of industry custom to identify cattle in this manner was an affidavit not stated to be based on the affiant's personal knowledge.³⁹

A slightly different result was reached in *In re Residential Capital, LLC*,⁴⁰ in which the creditors' committee in the debtors' bankruptcy case initially raised a cognizable claim that certain assets initially identified as "Excluded Assets," and therefore unencumbered by the security agreement, remained unencumbered when the assets ceased to qualify as Excluded Assets.⁴¹ In reaching this conclusion, the court noted that the exclusion was placed at the end of the collateral description, thereby presumably modifying all of it, and the security agreement lacked a traditional savings clause through which previously excluded property

member at the time the lender made the loan was signed six years later; however, the debtor waived the right to challenge the validity of the transfer by signing the agreement to encumber his interest).

34. See U.C.C. § 9-108 (2013).

35. No. 07-11757 (KCF), 2013 WL 6199259 (D.N.J. Nov. 27, 2012).

36. *Id.* at *1.

37. *Id.* at *10. The fact that the financing statement referred to an investment account with a company different from the one mentioned in the printout was, the court concluded, immaterial because that went to perfection, not to attachment, and the only issue raised on the motion for summary judgment was attachment. *Id.*

38. No. 3:12-CV-0589 (LEK), 2013 WL 3243559 (N.D.N.Y. June 26, 2013).

39. *Id.* at *2-3.

40. 495 B.R. 250 (Bankr. S.D.N.Y. 2013), *upon hearing*, 501 B.R. 549 (Bankr. S.D.N.Y.).

41. *Id.* at 261-62.

automatically becomes subject to the security interest once the reason for the exclusion is removed.⁴² However, at a hearing on the issue, the court received testimony about the parties' intent from four people, including the debtors' senior director of asset disposition, and the debtors' former treasurer, all of whom agreed that, once assets fell out of the Excluded Assets category, they were to be covered by the security interest. Based on this, and with no countervailing testimony, the court ruled that the assets were covered by the security agreement.⁴³

A super-generic description of collateral, such as "all the debtor's assets" or "all the debtor's personal property," is not a sufficient description of collateral in a security agreement.⁴⁴ This rule causes a problem for some creditors that attempted to obtain a security interest in personal property that the debtor might later leave on real property.

In *In re Gene Express, Inc.*,⁴⁵ the court considered whether a commercial real estate lease created a security interest by providing that "any personal property belonging to Tenant and left on the Premises"⁴⁶ was available to the landlord as an offset for rent and other expenses unpaid by the tenant. The court ruled that this language did not adequately describe the collateral because "any personal property" is not a permissible description.⁴⁷ In fact, the court indicated that the description was "less descriptive" than a normal super-generic description because it referred to property that may be abandoned in the future rather than property presently identifiable.⁴⁸ In short, the court treated the limiting language "left on the Premises" as making the description worse, rather than better.⁴⁹

In contrast, the court in *In re Estate of Wheeler*⁵⁰ ruled that a commercial lease which provided that rental obligations were secured by "all property now owned or hereafter acquired by [the tenant] which shall come in or be placed upon the Premises"⁵¹ was a sufficient description. The court reasoned that, while a super-generic description is insufficient, the description in this case was limited by location, which made it more narrow and sufficient.⁵² It noted that its ruling would facilitate commercial transactions, one of the express goals of the U.C.C.⁵³

While a description of collateral by its Article 9 type is normally sufficient, section 9-108(e)(2) makes inadequate a description of consumer goods only by type

42. *Id.* at 262.

43. 501 B.R. at 613–14.

44. U.C.C. § 9-108(c) (2013).

45. No. 10-08432-8-JRL, 2013 WL 1787971 (Bankr. E.D.N.C. Apr. 26, 2013).

46. *Id.* at *1.

47. *Id.* at *5.

48. *Id.*

49. *Id.* at *5–7; *see also* Johnson v. Binkley, No. 2 CA-CV 2012-0167, 2013 WL 5593287, at *2–3 (Ariz. Ct. App. Oct. 9, 2013) (deed of trust purporting to grant a security interest in "Personal Property," defined as "all equipment, fixtures, and other articles of personal property . . . attached to the Real Property," was limited to fixtures and did not encumber non-fixtures; even if it had covered non-fixtures, the description as "personal property" would have been inadequate).

50. No. 12CA1786, 2013 WL 3440953 (Colo. App. June 20, 2013).

51. *Id.* at *1.

52. *Id.* at *3–4.

53. *Id.* at *3.

of collateral in a consumer transaction.⁵⁴ This rule presents a bit of a problem for those that provide revolving secured credit to consumers because there is no way to know at the time the debtor authenticates the agreement what items of consumer goods the debtor will purchase on credit months or years later.

In *re Cunningham*,⁵⁵ the debtors used a store-branded credit card, issued by a bank, to purchase consumer electronics in twelve separate transactions. The cardholder application, authenticated by the debtors, provided that “you grant the Bank a purchase money security interest in the goods purchased on your Account.”⁵⁶ After filing bankruptcy, the debtors sought a declaration that the bank did not have a security interest in the items purchased with the card. The court ruled for the debtors. It concluded that the description in the cardholder agreement was insufficient under section 9-108(e)(2).⁵⁷ It then refused to read the signed sales receipts for each transaction with the cardholder agreement because nothing in the sale receipts referenced the cardholder agreement.⁵⁸ Moreover, the receipts were not sufficient by themselves because they lacked language purporting to grant a security interest.⁵⁹

The court’s ruling is questionable. The statutory text applicable to consumer transactions does not invalidate a description of consumer goods collateral “by type.” Rather, it invalidates a description “only by type,”⁶⁰ a critical distinction emphasized in the official comments.⁶¹ However, the description in the case did not say only “goods” or “consumer goods.” It said, “the goods *purchased on your Account*.”⁶² The court ignored the import of those additional words in the collateral description, and in the process failed to consider the effect of the word “only” in the statute.

The policy underlying the heightened description requirement for consumer goods in consumer transactions is not to make sure the collateral is identifiable. After all, there is no reason to think “all consumer goods” is any more difficult to interpret or apply than “all inventory” or “all equipment.” Instead, the concern is with overreaching: taking a security interest in items that the debtor did not expect.⁶³ “Goods purchased with your card” does not result in such overreaching.

In part for these reasons, within a few months of the *Cunningham* decision, two contrary rulings were issued, including one by another judge on the same court dealing with the same creditor and the same contractual language.⁶⁴

54. See U.C.C. § 9-108(b), (e)(2) (2013).

55. 489 B.R. 602 (Bankr. D. Kan. 2013).

56. *Id.* at 604.

57. *Id.* at 606–08.

58. *Id.* at 608.

59. *Id.*

60. U.C.C. § 9-108(e)(2) (2013) (emphasis added).

61. See *id.* § 9-108 cmt. 5.

62. *Cunningham*, 489 B.R. at 604 (emphasis added).

63. See U.C.C. § 9-108 cmt. 5 (“Subsection (e) requires greater specificity . . . to prevent debtors from inadvertently encumbering certain property.”).

64. See *In re Murphy*, No. 12-20434, 2013 WL 1856337, at *1–4 (Bankr. D. Kan. May 2, 2013) (interpreting same language from Best Buy credit application for card issued by Capital One); *In re Thrun*, 495 B.R. 861, 862–66 (Bankr. W.D. Wis. 2013) (customer’s signed Consumer Lending

A somewhat analogous issue arose in *In re LDB Media, LLC*,⁶⁵ in which a lender acquired a security interest in the debtor's news trucks. The lender also claimed a security interest in the equipment in the trucks, but the court rejected that argument because the security agreement identified only the trucks, not the equipment located in them.⁶⁶

IV. PERFECTION

A. PROPERLY IDENTIFYING THE DEBTOR IN A FINANCING STATEMENT

A financing statement that contains an error in the debtor's name will be ineffective unless a search under the debtor's correct name using the filing office's standard search logic discloses the filing.⁶⁷ Properly indicating the debtor's name on a financing statement continues to be a problem for some secured parties. For example, in *In re C. W. Mining Co.*,⁶⁸ financing statements identified the debtor as "CW Mining Company," rather than as "C. W. Mining Company," its registered name. The court ruled that the financing statements were ineffective to perfect because, under the filing office's search logic, an exact match is required and a search under the debtor's correct name would not have disclosed the filings that lacked the periods and space.⁶⁹

B. TERMINATION OF FINANCING STATEMENT AND RELEASES OF COLLATERAL

A termination statement filed in the appropriate office by or with the authorization of the secured party of record terminates the effectiveness of a previously filed financing statement.⁷⁰ In a number of recent cases, a termination statement was filed by a person other than the secured party of record. The effect of such a filing usually rests on whether the filing was made by an agent of the secured party acting within the scope of the agent's authority.⁷¹

Plan with credit union providing that credit union would have a security interest in "all goods, property, or other items purchased under this Plan . . . either now or in the future" was sufficient to cover motor vehicle purchased with an advance under the plan even without considering the unsigned advance receipt referencing the plan and describing the vehicle); *see also In re Cikar*, No. 12-14328, 2013 WL 4041341, at *1 (Bankr. W.D. Wis. June 11, 2013) (involving the same issue and decided the same day by attaching and incorporating the opinion in *Thrun*); *In re Dalebout*, 454 B.R. 158, 159-65 (Bankr. D. Kan. 2011) (language in cardholder agreement providing for a security interest in "the merchandise purchased on your account" together with language on the charge slip providing for a security interest in "any goods[]" described in this charge slip" was sufficient).

65. 497 B.R. 332 (Bankr. M.D. Fla. 2013).

66. *Id.* at 337-40.

67. *See* U.C.C. § 9-506(a)-(c) (2013).

68. 488 B.R. 715 (D. Utah 2013).

69. *Id.* at 721-22, 726-28.

70. *See* U.C.C. §§ 9-102(a)(80), 9-509(d), 9-510(a), 9-513(d) (2013).

71. *See* U.C.C. § 1-103(b) (2011); U.C.C. § 9-509(d)(1); *see also In re Negus-Sons, Inc.*, 460 B.R. 754, 758 (B.A.P. 8th Cir. 2011); *Int'l Home Prods., Inc. v. First Bank of Puerto Rico, Inc.*, 495 B.R. 152, 161-62 (D.P.R. 2013); Official Comm. of Unsecured Creditors v. City Nat'l Bank, No. C09-03817 MMC, 2011 WL 1832963, at *5 (N.D. Cal. May 13, 2011); *Roswell Capital Partners LLC v. Alt. Constr. Techs.*, No. 08 Civ. 10647 (DLC), 2010 WL 3452378, at *7-8 (S.D.N.Y.

In *In re Motors Liquidation Co.*,⁷² the debtor's counsel on a transaction prepared and filed several termination statements in connection with the payoff of a particular loan. One of the termination statements referenced the financing statement for an unrelated loan. The creditors' committee for the debtor argued that the secured party on the unrelated loan had approved the termination statements, even though it was unaware that one of them involved the unrelated term loan. The court concluded that the issue was what constitutes "authorization" for the filing of a termination statement when someone other than the secured party files the termination statement, arguably on the secured party's behalf.⁷³ To resolve this question, the court looked to the common law of agency. The court concluded that the agent must reasonably believe that the secured party on the unrelated loan intended to terminate the initial financing statement for that particular financing.⁷⁴ Because neither the agent nor the term loan lenders knew that the termination statement related to the term loan, and none of the debtor, the agent, or the lenders intended to affect the term loan in any way, the court ruled that termination was unauthorized and ineffective.⁷⁵

In contrast, in *In re Residential Capital, LLC*,⁷⁶ the collateral agent for junior secured noteholders—not the debtor—executed releases of collateral and filed amendments identifying various categories of released collateral. After the debtor filed for bankruptcy protection, the junior noteholders claimed that the releases and amendments were not authorized. The court disagreed. It ruled that, because the collateral agent was the secured party, the releases and amendments were authorized even if the collateral agent acted outside the scope of the authority granted by the noteholders.⁷⁷ The court distinguished *In re Motors Liquidation Co.* and other cases about releases and termination statements filed by unauthorized parties, concluding that they were simply not relevant.⁷⁸

One final case on this general subject deserves mention. In *Monroe Bank & Trust v. Chie Contractors, Inc.*,⁷⁹ a bank filed an amended financing statement that purported both to delete a specific item of its collateral and to terminate its previously filed all-assets financing statement. In other words, the bank checked the "Termination" box *and* the "Amendment (Collateral Change)" box. After the debtor defaulted, the secured party brought an action to recover

Sept. 1, 2010), *aff'd*, 436 F. App'x 34 (2d Cir. 2011); *In re RAG E., LP*, No. 12-22328-CMB, 2013 WL 796616, at *11–12 (Bankr. W.D. Pa. Mar. 4, 2013); *In re Hickory Printing Grp., Inc.*, 479 B.R. 388, 396–97 (Bankr. W.D.N.C. 2012); *AEG Liquidation Trust v. Toobro N.Y. LLC*, No. 650680/10, 2011 WL 2535035, at *8–9 (N.Y. Sup. Ct. June 24, 2011).

72. 486 B.R. 596 (Bankr. S.D.N.Y. 2013). Steve Weise (one of the authors) is advising the secured party in this litigation.

73. *Id.* at 605.

74. *Id.*

75. *Id.* at 630. The court also concluded that the agent lacked apparent authority to authorize the filing of the termination statements, *id.* at 634–35, and that the lenders had not ratified the filing, *id.* at 635–37.

76. 497 B.R. 403 (Bankr. S.D.N.Y. 2013).

77. *Id.* at 416–17.

78. *Id.* at 417.

79. No. 310226, 2013 WL 1629300 (Mich. Ct. App. Apr. 16, 2013).

the collateral and another creditor intervened, claiming that its security interest had priority. The trial court ruled for the first secured party and the court of appeals affirmed.⁸⁰ The court concluded that the incongruous nature of the error should have put a searcher on notice “that further inquiry was required.”⁸¹ As a result, it ruled that the amendment was not seriously misleading and the first secured party remained perfected in the collateral that had not been released.⁸²

V. PRIORITY

A. BUYERS

A buyer in ordinary course of business of most goods takes free of a security interest created by its seller.⁸³ This rule does not apply to buyers of farm products from a person engaged in farming operations, however.⁸⁴ The protection for such buyers is left to the Food Security Act of 1985.⁸⁵ That act generally protects a buyer in ordinary course of farm products,⁸⁶ but allows for a security interest to survive the sale if the secured party sends, and the buyer receives, notification of its security interest.⁸⁷

In *State Bank of Cherry v. CGB Enterprises, Inc.*,⁸⁸ a secured party with a security interest in a farmer’s crops and the proceeds thereof sent a notification of its security interest to a crop buyer. However, the notification failed to identify the counties in which the farm products were grown or located and instead stated that it covered “farm products wherever located.”⁸⁹ The court ruled that strict compliance with the notification rules of the Food Security Act is required for a secured party to retain its security interest in farm products sold to the buyer,⁹⁰ and the failure to identify the counties in which the farm products were grown or located rendered the notification ineffective.⁹¹ As a result, the buyer took free of the secured party’s security interest and had no liability to the bank, even though the buyer failed to comply with the instructions in the notification by sending a check for the purchase price directly and solely to the debtor.⁹²

B. 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.⁹³

80. See *id.* at *3.

81. *Id.*

82. *Id.* at *4.

83. U.C.C. § 9-320(a) (2013).

84. *Id.*; *id.* § 9-320 cmt. 4.

85. Pub. L. No. 99-198, 99 Stat. 1354.

86. 7 U.S.C. § 1631(d) (2012); see also U.C.C. § 9-320 cmt. 4.

87. See 7 U.S.C. § 1631(e) (2012).

88. 984 N.E.2d 449 (Ill. 2013).

89. *Id.* at 453.

90. *Id.* at 456–67.

91. *Id.* at 468.

92. See *id.* at 452, 469.

93. U.C.C. § 9-322(a)(1) (2013).

In *In re HW Partners, LLC*,⁹⁴ a lender loaned funds for a real estate development and received notes and real estate mortgages from the borrowers. The lender's own lender acquired a security interest in the notes. It also received assignments of the mortgages but did not initially take possession of the notes or file a financing statement against the first lender. Subsequently, the first lender and the developers refinanced their loan. The original notes were consolidated into a single \$3.2 million note, the original mortgages were released, and a new mortgage was created to secure the consolidated note. The first lender then borrowed \$1 million from a third lender and granted it a security interest in the consolidated note. The note was placed in escrow and the third lender filed a financing statement. After the first lender defaulted, the second and third lenders each claimed priority in the note and in the proceeds of the developers' real estate.

The court ruled for the third lender.⁹⁵ It concluded that its security interest in the consolidated note was perfected by the filed financing statement and by possession through the escrow agent, whereas the second lender's security interest was not perfected until it filed a financing statement much later.⁹⁶ As to priority, the court correctly ruled that priority was governed by Article 9, not by real estate law.⁹⁷ Because the third lender was the first to file or perfect, its security interest had priority even if the consolidated note was proceeds of the original notes and thus collateral for the unperfected second lender.⁹⁸

Not all priority disputes are governed by Article 9. For example, if a creditor has a statutory lien, the basic priority rule of section 9-201(a)⁹⁹—the secured party beats other creditors—may have to yield to the policies or text of the other statute.¹⁰⁰ Unfortunately, courts do not always analyze the issues properly. That is what happened in *American Bank, FSB v. Cornerstone Community Bank*,¹⁰¹ which involved insurance premium financing.

A secured party made a loan to a borrower for the borrower to acquire an insurance policy. The loan was to be secured by the unearned premiums and dividends payable under the policy. The lender wired the funds to the insurance broker's deposit account at a bank. The depository bank swept the deposit account to recover on a debt owed to it by the broker. Consequently, no insurance policy was ever acquired. The broker later repaid the first lender with other funds, but that payment was avoided as a preference in the broker's subsequent bankruptcy. The lender repaid the funds to the bankruptcy trustee, preserving its rights to pursue the depository bank for conversion.

An applicable state premium financing statute gives a premium financier a perfected security interest "in any premiums financed" if the borrower has signed

94. No. 11-03366-JAR11, 2013 WL 4874172 (Bankr. E.D. Wash. Sept. 12, 2013).

95. *Id.* at *12.

96. *Id.* at *8.

97. *Id.* at *6–11.

98. *Id.* at *11.

99. U.C.C. § 9-201(a) (2013).

100. *See id.* § 9-201(b)–(c).

101. 733 F.3d 609 (6th Cir. 2013).

a written security agreement.¹⁰² Based on this, the court ruled that the first lender had a perfected security interest in the broker's deposit account, which was superior to the rights of the depositary bank.¹⁰³ However, the court improperly conflated a security interest in the *unearned premiums* with a security interest in the *loan proceeds* that had been deposited at the depositary bank. Because the broker never acquired the policy, there never were any unearned premiums or dividends. Thus, it is far from clear that the statute applied at all.¹⁰⁴

The court made a second error, which flowed from its first. In ruling that the first lender had priority, the court made two alternative rulings. First, that the premium finance statute was more specific and thus controlled over the more general rules of Article 9.¹⁰⁵ Second, that Article 9 was inapplicable under section 9-109(d)(8) because the issue involved an interest in a policy of insurance.¹⁰⁶ The first ruling is questionable but defensible. The second ruling is not. The property at issue was a deposit account, not unearned premiums or insurance. Article 9 undoubtedly applies to a security interest in a deposit account.¹⁰⁷

Nevertheless, the court may have reached the correct result, albeit by a different path. Recall that the funds were transferred to the broker's deposit account to facilitate the broker's purchase of an insurance policy for the borrower. Under such circumstances, the broker arguably held the funds in trust for the borrower. As a result, the broker may not have had any right to the deposited funds and thus could not have granted a security interest in the deposited funds to the depositary bank.¹⁰⁸ Indeed, in its very first paragraph, the appellate court stated that the broker "held the money . . . in trust."¹⁰⁹ Thus, the court itself seemed to embrace this idea.

C. 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

102. *Id.* at 613 (citing TENN. CODE ANN. § 56-37-112 (subsequently re-designated as subsection (a))).

103. *Id.*

104. *Cf.* First Trinity Capital Corp. v. Catlin Specialty Ins., No. 3:13CV9TSL-JMR, 2013 WL 6230099, at *2–3 (S.D. Miss. Dec. 2, 2013) (insurance premium financier had no right to collect unearned insurance premiums from the insurer because, due to the broker's fraud, the insurer never received any funds and the policies were never issued).

105. *Am. Bank*, 733 F.3d at 614.

106. *Id.* (quoting U.C.C. § 9-109(d)(8) ("This article does not apply to . . . a transfer of an interest in or an assignment of a claim under a policy of insurance")).

107. *Cf.* U.C.C. § 9-108(d)(13) (2013) ("This article does not apply to . . . an assignment of a deposit account in a consumer transaction" (emphasis added)). The Tennessee legislature recently amended the Tennessee Premium Finance Company Act of 1980 to provide that Tennessee's Article 9 "shall govern the relative priorities of security interests in, and any right of set-off against, funds advanced pursuant to a premium finance agreement." TENN. CODE ANN. § 56-37-112(b) (Supp. 2013) (effective Apr. 12, 2013).

108. See Stephen L. Sepinuck, *Deconstructing the Constructive Trust*, 3 TRANSACTIONAL LAW., Aug. 2013, at 2, 2–4.

109. *Am. Bank*, 733 F.3d at 612.

that would normally have priority under the first-to-file-or-perfect rule.¹¹⁰ When the collateral is inventory, those procedures require that: (i) the PMSI lender perfects its security interest before the debtor receives the new inventory; and (ii) less than five years before the debtor receives the new inventory, any secured party who had filed a financing statement before the PMSI secured party filed receives written notification from the PMSI lender of the plan to obtain a PMSI.¹¹¹

In *T. Gluck & Co. v. Craig Drake Manufacturing, Inc.*,¹¹² a consignor with a PMSI in diamonds supplied to the debtor sent notification of its interest to the debtor's existing inventory lender. However, the consignor never renewed that notification even though it continued to supply diamonds for more than five years. Thus, the court ruled, the consignor lost PMSI priority as to post-five-year collateral after five years.¹¹³ The court's ruling underscores the need for PMSI inventory lenders to renew their PMSI notifications every five years, just as they must file a continuation statement every five years to remain perfected.¹¹⁴

In general, a PMSI does not lose its purchase-money status if the PMSI secured obligation is refinanced.¹¹⁵ The meaning and scope of this rule was limited in *Caterpillar Financial Services Corp. v. Peoples National Bank*,¹¹⁶ which involved three security interests in the same mining equipment. The first security interest in time was perfected by a financing statement filed in 2005. The second, in favor of another lender, was perfected in 2006. The third, perfected in 2008, was held by yet another lender. The second lender claimed that its interest was a PMSI with priority over the first lender because the second lender had refinanced the debtor's obligation to equipment lessors that did have PMSIs. The court disagreed, concluding that the only way the second lender could have a PMSI was if it had received an assignment of the lessors' interests, something the second lender had not done.¹¹⁷

110. See U.C.C. § 9-324 (2013); see also *id.* § 9-103 (defining "purchase-money security interest").

111. *Id.* § 9-324(b).

112. No. 603914/2009, 2013 N.Y. Misc. LEXIS 2384 (Sup. Ct. June 4, 2013).

113. *Id.* at *8.

114. See generally U.C.C. § 9-515(a) (2013) ("[A] filed finance statement is effective for a period of five years after the date of the filing."). The court failed to consider whether any of the diamonds at issue had been provided to the debtor within the five-year period covered by the notification. In other words, the effect of a failure to renew a PMSI notification is different from the effect of a failure to timely file a continuation statement. If a secured party fails to file a continuation statement, its entire security interest becomes unperfected (or at least that portion for which filing is necessary to perfect), and thus priority can be lost as to all of the collateral, whether acquired by the debtor before or after the financing statement lapses. See *id.* § 9-515(c) ("Upon lapse, a financing statement ceases to be effective and any security interest . . . that was perfected by the financing statement becomes unperfected . . ."). In contrast, if a PMSI inventory lender fails to renew its PMSI notification, the PMSI inventory lender will lose priority only in the inventory received by the debtor more than five years after the original notification; the lender retains priority in inventory acquired within that five-year period. See Stephen L. Sepinuck, *UCC Spotlight*, COM. L. NEWSL. (Am. Bar Ass'n Bus. L. Section), Nov. 8, 2013, at 20, available at http://apps.americanbar.org/buslaw/committees/CL190000pub/newsletter/201311/201311_commercial_law_newsletter.pdf.

115. See U.C.C. § 9-103(f)(3) (2013).

116. 710 F.3d 691 (7th Cir. 2013).

117. *Id.* at 695. The second lender nevertheless won the case because the third lender, which had entered into a subordination agreement with the first lender, never produced a security agreement

D. PROCEEDS

A security interest in collateral automatically extends to identifiable proceeds of the collateral.¹¹⁸ However, because “proceeds” is not a limitless concept,¹¹⁹ secured parties occasionally find themselves without a security interest in some property that the debtor uses the collateral to help generate.

For example, in *In re Gamma Center, Inc.*,¹²⁰ a lender had a perfected security interest in a medical provider’s nuclear stress test camera, and the proceeds and products thereof. However, the court ruled that the lender did not have a security interest in either the provider’s accounts or the collections thereon because, even if the accounts were generated solely through use of the camera, the accounts were not proceeds or products of the camera.¹²¹ The decision is in line with several others indicating that the debtor’s use of equipment is not a disposition that generates proceeds.¹²²

A similar result was reached in *1st Source Bank v. Wilson Bank & Trust*,¹²³ an appeal of a decision reported on last year.¹²⁴ The case involved a lender that obtained a security interest in the accounts and rigs of two trucking companies. However, the lender’s financing statement failed to include the accounts in its indication of the collateral. The court ruled that the lender was not perfected in the debtors’ accounts because accounts were neither mentioned in the financing statement nor proceeds of the rigs.¹²⁵ That is, use of equipment does not generate proceeds.¹²⁶ Unfortunately, the opinion goes much further and seems to suggest that accounts can never be proceeds:

A foundational rule of statutory construction is to give effect to the intent of the Legislature by giving words their “natural and ordinary” meaning. Where two statutory provisions potentially conflict, “a specific statutory provision controls over a more general statutory provision.”

Here, [Article] 9 provides a comprehensive definition of the term “proceeds[.]”

. . . .

between the debtor and the first lender. *Id.* at 696–97. Therefore, the court ruled that the second lender had the more senior of the two proven security interests and that the third lender was liable for conversion in refusing to pay the second lender the proceeds of the collateral. *Id.* at 697.

118. See U.C.C. § 9-315(a)(2) (2013).

119. See *id.* § 9-102(a)(64) (defining “proceeds” categorically).

120. 489 B.R. 688 (Bankr. N.D. Ohio 2013).

121. *Id.* at 695–98.

122. See, e.g., *In re Premier Golf Props., LP*, 477 B.R. 767, 775–77 (B.A.P. 9th Cir. 2012); *In re Wright Grp., Inc.*, 443 B.R. 795, 797–807 (Bankr. N.D. Ind. 2011); see also *In re Las Vegas Monorail Co.*, 429 B.R. 317, 333–36 (Bankr. D. Nev. 2010) (revenues generated from the operation of a monorail were not proceeds of the debtor’s franchise agreement permitting it to operate the monorail).

123. 735 F.3d 500 (6th Cir. 2013).

124. See 2012 Survey, *supra* note 26, at 1276–77.

125. *1st Source Bank*, 735 F.3d at 503–05.

126. See *id.* at 503. It is unclear from the reported facts whether the debtors *operated* the rigs (i.e., instructed employees to haul cargo for customers using the rigs) or *leased* the rigs. If the debtors leased the rigs, the resulting rights to payment would be “proceeds,” see U.C.C. § 9-102(a)(64)(A) (2013), and the court’s ruling would be incorrect.

Although the statutory definition of the term “proceeds” appears admittedly broad, accepting [the bank’s] interpretation of the statute would render the term “accounts”—a category defined separately in [Article] 9—meaningless. Because we are required “to construe statutes, whenever possible, in a way which gives meaning to every portion of the statute,” we decline to expand the definition of the general term, “proceeds,” in such a way that it would subsume the specific term, “accounts.”¹²⁷

This language is quite disturbing.¹²⁸ “Accounts” undeniably can be proceeds of other collateral and, to the extent that the court suggested otherwise, it was clearly wrong.¹²⁹

A particularly interesting issue arose in *In re Tusa-Expo Holdings, Inc.*,¹³⁰ in which a furniture dealer granted its supplier a security interest in existing and after-acquired inventory and accounts. Several years later, the dealer granted a security interest in the same property to a lender. The supplier and lender entered into an agreement providing that amounts owed to the supplier would not be subordinated.

Amounts paid by the dealer’s customers went into a lock box controlled by the lender. The lender swept the funds daily but, upon receipt of a borrowing base certificate from the dealer, would deposit funds into the debtor’s operating account at a bank. The dealer eventually sought Chapter 7 bankruptcy protection and the trustee sued the supplier to avoid preferential transfers—payments made within the preference period. The issue was whether the supplier was preferred under Bankruptcy Code § 547(b)(5), which came down to whether the supplier had a security interest in the debtor’s deposit account.

The trustee asserted that, because the lender swept the supplier’s collateral from the lock box and applied it to reduce the indebtedness owed to it by the dealer, the funds the lender subsequently released to the dealer were new and unencumbered funds for the dealer to use at its own discretion.¹³¹ The court rejected this argument for several reasons. First, because of the subordination

127. *1st Source Bank*, 735 F.3d at 504 (citations omitted).

128. One of the authors (Stephen L. Sepinuck) of this survey took the unusual step of writing the chief judge and the members of the panel urging them to modify the opinion on this point.

129. See U.C.C. §§ 9-102 cmt. 5.i, 9-322 cmt. 6, 9-324 cmts. 8–10, 9-509 cmt. 4 (2013) (expressly contemplating that accounts can be proceeds, and vice versa).

Indeed, *all* of the Article 9 classifications of collateral can be “proceeds.” See, e.g., *id.* §§ 9-102(a)(9) (indicating that “money,” “checks,” and “deposit accounts” can be “cash proceeds,” and thus necessarily also “proceeds”), 9-102 cmt. 13.e (indicating that some “investment property” can be “cash proceeds,” and hence also “proceeds”), 9-108 cmt. 4 (indicating that some investment property can be proceeds), 9-109(d)(12) & cmt. 15 (indicating that a “commercial tort claim” can be proceeds of other collateral), 9-109(d)(13) (indicating that deposit accounts can be proceeds of other collateral), 9-207 cmt. 7 (indicating that promissory notes and checks can be proceeds), 9-315(b)(1) (indicating that “goods” can be proceeds), 9-315 cmt. 5 (suggesting that “equipment” could be proceeds of inventory), 9-322 cmt. 8 (providing illustrations involving several different classifications of collateral as proceeds), 9-324(b) (referring to “chattel paper” and “instruments” as potential proceeds of inventory), 9-327 cmt. 5 (indicating that a deposit account might be proceeds of other collateral), 9-330(a), (b), (e) (referring to “chattel paper” as proceeds of inventory), 9-330 cmt. 7 (referring to an “instrument” as proceeds), 9-330 cmts. 9–11 (indicating that repossessed goods can be proceeds of “chattel paper”).

130. 496 B.R. 388 (Bankr. N.D. Tex. 2013).

131. *Id.* at 401.

agreement, the lender was not entitled to the funds.¹³² Second, the court considered the deposits as at least indirect proceeds of the accounts.¹³³

This second conclusion is questionable. While lenders whose cash proceeds are swept might take some comfort in this decision, they should not assume that they will have a proceeds claim to a deposit account into which cash proceeds were deposited, swept, and then re-loaned.

VI. DEFAULT AND FORECLOSURE

A. DEFAULT

Article 9 gives secured parties various rights upon default, including the rights to repossess, collect, and dispose of the collateral.¹³⁴ However, Article 9 does not define default, instead leaving that to the parties' agreement and other law. Several courts last year faced a dispute about whether the debtor had defaulted.

In *Regions Bank v. Thomas*,¹³⁵ the court ruled that the secured party did not breach the duty of good faith by declaring a default and accelerating the debt due to the debtor's failure to insure the collateral—an aircraft—even though the debtor was current on payments and the secured party later force-placed insurance pursuant to another clause in the agreement. The court ruled that the obligation of good faith and fair dealing does not create additional contractual rights or obligations and cannot be used to avoid the express terms of an agreement.¹³⁶ In *FirstMerit Bank v. Presbrey & Associates, P.C.*,¹³⁷ the court ruled that the debtor had defaulted on its secured loan when the guarantor died because that death was expressly listed in the transaction documents as an event of default.

In contrast, law outside Article 9 overrode the parties' agreements in *In re Henderson*.¹³⁸ In that case, the court dealt with several Chapter 7 bankruptcy debtors who sought to reaffirm their car loans, in part based on their concern that the default-on-bankruptcy clause in their security agreements created a risk of repossession once the automatic stay expired. The court rejected the reaffirmation after concluding that the debtors' concerns were misplaced.¹³⁹ Because a recently enacted Nevada law limits default in automobile retail installment contracts to a failure to pay as required by the agreement,¹⁴⁰ and to situations when "[t]he prospect of payment, performance or realization of collateral is significantly impaired,"¹⁴¹ the court ruled that the default-on-bankruptcy clauses were unenforceable.¹⁴²

132. *Id.* at 401–02.

133. *Id.* at 402–03.

134. See U.C.C. §§ 9-601(a), 9-607(a), 9-609(a)(1), 9-610(a) (2013).

135. 422 S.W.3d 550 (Tenn. Ct. App. 2013).

136. *Id.* at 558–61.

137. No. 12 C 8077, 2013 WL 4840472 (N.D. Ill. Sept. 10, 2013).

138. 492 B.R. 537 (Bankr. D. Nev. 2013).

139. *Id.* at 538–39.

140. See NEV. REV. STAT. ANN. § 97.304(1) (West Supp. 2014).

141. *Id.* § 97.304(2).

142. *Henderson*, 492 B.R. at 543–44.

B. REPOSSESSION OF COLLATERAL

Article 9 permits a secured party to repossess collateral without judicial process, provided it can do so without causing a breach of the peace.¹⁴³ This duty not to breach the peace is non-delegable; a secured party violates the rule even if an independent contractor causes a breach of the peace.¹⁴⁴ In *St. Clair v. Capital One Bank (USA)*,¹⁴⁵ the court drew a distinction, for this purpose, between a breach of the peace and a violation of some other legal duty. Specifically, an employee of the repossession company hired by the secured party violated the federal Driver's Privacy Protection Act of 1994¹⁴⁶ by improperly accessing information about the debtor in the state department of driver and vehicle services database. The court ruled the secured party was not liable for the violation because no breach of the peace occurred.¹⁴⁷

C. NOTIFICATION OF FORECLOSURE SALE

In general, a secured party must send reasonable advance notification to the debtor of a planned disposition of collateral.¹⁴⁸ 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.¹⁴⁹ For transactions other than consumer transactions, there is a safe harbor as to timing, which provides that notification ten days in advance is sufficient,¹⁵⁰ as well as a safe harbor form,¹⁵¹ but a notification that fails to comply with either or both of these safe harbors might nevertheless be sufficient.¹⁵²

Secured parties in at least two cases did not have to comply with the requirements. In *In re Reno Snax Sales, LLC*,¹⁵³ a bankruptcy trustee conducted a sale of the collateral and remitted most of the proceeds to the secured party. The court ruled that this was not a disposition by the secured party under Article 9 and thus the secured party had no duty to notify a co-obligor of the sale.¹⁵⁴ In *Santander Consumer USA, Inc. v. Superior Pontiac Buick GMC, Inc.*,¹⁵⁵ the court ruled

143. See U.C.C. § 9-609(a)(1), (b)(1) (2013).

144. See *id.* § 9-609 cmt. 3. Some states have rules outside of Article 9 to the contrary. See, e.g., CAL. BUS. & PROF. CODE § 7507.13(b) (Deering 2007).

145. No. 12-1572 (MJD/AJB), 2013 WL 1110810 (D. Minn. Jan. 22, 2013), *recommendation adopted in pertinent part*, 2013 WL 1110803 (D. Minn. Mar. 18, 2013).

146. Pub. L. No. 103-322, §§ 300001-300003, 108 Stat. 1796, 2009-102 (codified as amended at 18 U.S.C. §§ 2721-2725 (2012)).

147. *St. Clair*, 2013 WL 1110810, at *3-4.

148. See U.C.C. § 9-611(b)-(d) (2013).

149. See *id.* § 9-613(1)(C).

150. See *id.* § 9-612(b).

151. See *id.* § 9-613(1).

152. See *id.* § 9-612(a) & cmt. 3 (referencing the timeliness of any notification as a question of fact and describing the ten-day period as a safe harbor); *id.* § 9-613(2)-(4) (referencing the sufficiency of the contents of any notification as a question of fact and specifying that no particular phrasing is required).

153. No. 11-53130-BTB, 2013 WL 3942974 (B.A.P. 9th Cir. July 31, 2013).

154. *Id.* at *3-4. For the same reason, the court ruled that the secured party had no duty to notify the co-obligor under a state statute governing the disposition of a repossessed vehicle. *Id.* (discussing NEV. REV. STAT. ANN. § 482.516).

155. No. 10-13181, 2013 WL 27921 (E.D. Mich. Jan. 2, 2013).

that a chattel paper financier had no duty to notify the car dealer that the financier financed sales of repossessed vehicles because the dealer had not shown that it was either the debtor or a secondary obligor with respect to such transactions.¹⁵⁶

A secured party that fails to send a required notification of disposition can suffer serious consequences. In addition to being liable for whatever damages its failure caused,¹⁵⁷ in a non-consumer transaction, the secured party will be presumptively not be entitled to collect any resulting deficiency.¹⁵⁸ That is, it will be presumed that, had the secured party complied with Article 9, the proceeds of the disposition would have fully satisfied the secured obligation.¹⁵⁹

In *Bank of America v. Sea-Ya Enterprises, LLC*,¹⁶⁰ the court ruled that a secured party that failed to send notification of disposition to one guarantor had successfully rebutted the presumption that the guarantor was not liable for the deficiency by showing that the sale was conducted in a commercially reasonable manner and that the guarantor—which never read the transaction documents—neither would nor could have affected the outcome of the sale.¹⁶¹

Occasionally, statutes outside Article 9 apply to a disposition under Article 9. Secured parties ignore such statutes at their peril. Such was the case in *Gardner v. Ally Financial Inc.*,¹⁶² in which a secured party sold vehicles repossessed from consumers after sending each debtor a notification that the vehicle would be sold at a public sale on a specified date. Neither notification mentioned that members of the public needed to pay a \$1,000 refundable deposit to attend. One of the debtors in fact attempted to attend but did not have time to raise the funds to do so once it learned of the fee. The court ruled that the sales were private sales, not public sales, under Maryland's Credit Grantor Closed End Credit Act because, even though the public was invited through weekly advertisements in the *Baltimore Sun*, the attendance fee obscured the transparency that is the hallmark of an open, public sale.¹⁶³ As a result, the secured party failed to send the required post-sale disclosure.¹⁶⁴

156. *Id.* at *7–8. If the dealership had a right of recourse against the car buyer, then the dealership would be a “secondary obligor,” see U.C.C. § 9-102(a)(72)(B) (2013), and would be entitled to notification if the chattel paper financier had made a loan secured by the chattel paper. See *id.* § 9-611(c)(1), (2). However, if the financier were a buyer of the chattel paper, then it would have no duty under Part 6 of Article 9, other than to collect in a commercially reasonable manner if it has recourse against the debtor, and thus would not be required to notify the dealer. See *id.* § 9-601(g); *TexStar Motors, Inc. v. Regal Fin. Co.*, 401 S.W.3d 190, 199–200 (Tex. App. 2012).

157. See U.C.C. § 9-625(b) (2013).

158. See *id.* § 9-626(a)(3), (4).

159. See *id.* § 9-626 cmt. 3 (“Unless the secured party proves that compliance with the relevant provisions would have yielded a smaller amount, the debtor . . . is to be credited with the greater of the actual proceeds of the disposition or the proceeds that would have been realized had the secured party complied with the relevant provisions.”); *id.* (“Under this rebuttable presumption rule, . . . the secured party may not recover any deficiency . . .”).

160. No. 11-445-RGA, 2013 WL 126268 (D. Del. Jan. 9, 2013).

161. *Id.* at *3.

162. 61 A.3d 817 (Md. 2013).

163. *Id.* at 827–28.

164. See *id.* at 828.

Although the court was not interpreting Article 9, its analysis might be persuasive in distinguishing a “public sale” from a “private sale” for the purposes of Article 9.¹⁶⁵ In some settings, a secured party might be able to avoid the issue by not labeling the sale in the notification as either “public” or “private,” provided the notification contains the information required for whatever type of sale the disposition actually is.¹⁶⁶

D. COMMERCIAL REASONABLENESS OF FORECLOSURE SALE

Every aspect of a foreclosure sale must be “commercially reasonable.”¹⁶⁷ If a secured party’s compliance with this standard is challenged, the secured party has the burden of proof.¹⁶⁸ Because commercial reasonableness is a fact-intensive question, this burden can be difficult to satisfy.

In *Security Alarm Financing Enterprises, Inc. v. Parmer*,¹⁶⁹ the court ruled that a judgment lienor stated a claim against the senior secured party for conducting a commercially unreasonable disposition by alleging that the secured party conducted the sale on a Saturday morning, imposed unusual and restrictive financial conditions upon potential bidders, and refused to allow potential bidders to inspect or otherwise access the assets being sold, all in an effort to orchestrate a sale to a company owned by a related party to escape liability for its unsecured debt.¹⁷⁰

In contrast, in *Smith v. Firstbank Corp.*,¹⁷¹ the secured party sold publicly traded stock in blocks of 600,000 and 450,000 shares to brokerage firms at prices below the prevailing market price per share. However, the court ruled that the sales were commercially reasonable due to the concern that sales of such large blocks on the exchange would depress the price, a concern that was reasonable given that it had occurred the previous year with respect to this stock.¹⁷²

In *Edgewater Growth Capital Partners LP v. H.I.G. Capital, Inc.*,¹⁷³ the secured party sold the debtor’s entire business at a public sale to an affiliate of the se-

165. See U.C.C. § 9-610(c) (2013) (providing that secured party may purchase collateral at a public sale or a private sale, but at the latter only if the collateral is a type customarily sold on a recognized market or is the subject of widely distributed standard price quotations).

166. See *id.* § 9-613 (providing requirements for contents and form of notification for other than consumer-goods transactions); *id.* § 9-614 (providing requirements for contents and form of notification for consumer-goods transactions). If the sale is a private sale, the secured party generally is not permitted to be the buyer regardless of how the notification is phrased. See generally *id.* § 9-610(c) (imposing limitations on circumstances in which a secured party may purchase collateral at a private sale).

167. *Id.* § 9-610(b).

168. *Id.* § 9-626(a)(1), (2).

169. No. 1:12CV88, 2013 WL 593767 (N.D. W. Va. Feb. 15, 2013).

170. *Id.* at *4–5. The court also ruled that the judgment lienor sufficiently alleged a basis for successor liability by claiming that the management and operation of the business remained the same after the sale. *Id.* at *5.

171. No. 309547, 2013 WL 951377 (Mich. Ct. App. Mar. 7, 2013).

172. *Id.* at *4–5.

173. 68 A.3d 197 (Del. Ch. 2013).

cured party after previously allowing the debtor to market the business for three months with the assistance of a financial consultant hired by the secured party. A private equity firm, which had created the debtor and had guaranteed some of the secured obligation, sued the secured party claiming that the sale was not commercially reasonable. The court first ruled that the marketing arrangement enhanced the commercial reasonableness of the ultimate sale, rather than detracted from it, because it helped identify the interested parties to whom an invitation to bid was sent.¹⁷⁴ The court then concluded that the commercial reasonableness requirement did not require the secured party to extend the sale process, given that the business to be sold was insolvent and losing money.¹⁷⁵ Finally, the court ruled that the sale was commercially reasonable even though none of the thirty-six entities that signed a nondisclosure agreement and received confidential information about the business made an offer or showed up at the foreclosure sale.¹⁷⁶

Although the duty to conduct a disposition of collateral in a commercially reasonable manner cannot be waived,¹⁷⁷ the parties are permitted by agreement to set the standards by which the reasonableness of a disposition will be evaluated, provided those standards are not themselves manifestly unreasonable.¹⁷⁸ This authority proved very beneficial to the secured party in *Gulf Coast Farms, LLC v. Fifth Third Bank*.¹⁷⁹ The court ruled that, because the security agreement covering equine collateral expressly provided that “any disposition of Collateral at a regularly scheduled auction where similar Collateral is ordinarily sold (e.g., Keeneland or Fasig-Tipton sales) with or without reserve . . . is per se commercially reasonable,”¹⁸⁰ the bank’s sale of the collateral at a Keeneland sale was commercially reasonable and the debtors could not argue, even with expert testimony, that the bank’s disposition was commercially unreasonable.¹⁸¹

E. OTHER ENFORCEMENT ISSUES

A secured party need not dispose of collateral to extract value from it. If the collateral consists of a right to payment, the secured party may instead collect on the collateral by instructing the account debtor or other obligor to pay the secured party directly.¹⁸² In general, once the secured party has instructed an

174. *Id.* at 212–14.

175. *Id.* at 216–18.

176. *Id.* at 218–29.

177. See U.C.C. § 9-602(7) (2013).

178. See *id.* § 9-603(a).

179. No. 2011-CA-000965-MR, 2013 WL 1688458 (Ky. Ct. App. Apr. 19, 2013).

180. *Id.* at *6.

181. *Id.* at *5–6; see also *Spizizen v. Nat’l City Corp.*, No. 09-11713, 2011 WL 1429226, at *3–4 (E.D. Mich. Apr. 14, 2011) (secured party was entitled to freeze the collateralized securities account containing securities entitlements valued in excess of the secured obligation because the security agreement expressly gave the secured party the right to refuse the debtor access to the account, and, while the U.C.C. gave the secured party the *right* to sell the entitlements, it did not impose an *obligation* to do so), *aff’d*, 516 F. App’x 426 (6th Cir. 2013).

182. See U.C.C. § 9-607(a)(1) (2013).

account debtor to pay the secured party, the account debtor pays the debtor at its own peril.¹⁸³

That peril was particularly high in *Reading Co-Operative Bank v. Suffolk Construction Co.*,¹⁸⁴ in which the account debtor, despite agreeing to pay the secured party directly, sent twelve checks to the debtor. The court ruled that the account debtor was liable to the secured party for the full amount of all those checks—\$3 million—even though the secured obligation was only \$530,000.¹⁸⁵ Because that resulted in a surplus, which the secured party owed to the debtor, the account debtor could seek to recover the resulting surplus under section 9-608¹⁸⁶ by establishing itself as a subordinate creditor of the debtor.¹⁸⁷

Instead of disposing of collateral or collecting on collateral, a secured party may enforce a security interest by accepting the collateral in full or partial satisfaction of the secured obligation.¹⁸⁸ This process, known as “strict foreclosure,” is not subject to a requirement of commercial reasonableness. It is, however, subject to the requirement of good faith.¹⁸⁹

In *McDonald v. Yarchenko*,¹⁹⁰ the secured party sent the debtor a written proposal to accept the collateral—the debtor’s one-sixth interest in an LLC—in full satisfaction of the secured obligation. The debtor did not object. The court ruled that the acceptance was effective even though the collateral was worth at least \$407,000, and possibly as much as \$1.6 million, while the secured obligation was only about \$12,000.¹⁹¹

VII. LIABILITY ISSUES

Several cases last year involved attempts to hold an attorney liable for damages resulting from the failure to perfect a client’s security interest. In *Garten v. Shearman & Sterling LLP*,¹⁹² the court held that a secured party had no cause of action against his attorneys for malpractice in failing to provide him with a first-priority security interest because he knew the identity of the senior creditor and fully understood that his position would be junior when he advanced the loan.¹⁹³

183. *See id.* § 9-406(a).

184. 984 N.E.2d 776 (Mass. 2013).

185. *See id.* at 778, 780–84.

186. U.C.C. § 9-608 (2013).

187. *Reading Coop. Bank*, 984 N.E.2d at 784–85. The court also ruled that, because the secured party was entitled to the full amount of the misdirected checks, not merely its actual damages, it had no duty to mitigate damages by applying a guarantor’s payment to the secured obligation. *Id.* at 785–86. Further, although there was evidence that the secured party was aware of the account debtor’s misdirection of payments before the final two checks were sent, the secured party’s silence did not give rise to estoppel because there was no evidence that the account debtor was aware of, or relied upon, the secured party’s implicit consent. *Id.* at 786–87.

188. *See* U.C.C. §§ 9-620, 9-621, 9-622 (2013).

189. *See id.* § 9-620 cmt. 11.

190. No. 03:12-cv-00656-HZ, 2013 WL 3809512 (D. Or. July 23, 2013).

191. *Id.* at *5–6; *cf.* *Eddy v. Glen Devore Personal Trust*, No. 54868-9-I, 2006 WL 198077, at *1 (Wash. Ct. App. Jan. 23, 2006) (concluding that acceptance of \$90,000 promissory note in satisfaction of \$5,000 debt was not unconscionable).

192. 958 N.Y.S.2d 107 (App. Div. 2013).

193. *Id.* at 107–09.

The fact that the debtor misled the secured party about the amount owing to the senior lienors and the debtor's own financial health were irrelevant, the court concluded, because the secured party did not retain the attorneys to review the debtor's financial records.¹⁹⁴

In *Hattem v. Smith*,¹⁹⁵ the court reversed a seller's legal malpractice judgment against his attorney for failing to perfect a security interest in the assets of the business sold to a buyer, which failure led to a loss of priority, because a jury instruction on the seller's comparative negligence had not been given. There was evidence that the seller, who was experienced in commercial transactions, introduced the lender that acquired a prior security interest to the buyer for the purpose of financing the purchase and never informed the attorney of the lender's involvement in the transaction.¹⁹⁶

The malpractice issue arose in a different context in *FDIC v. Lowis & Gellen, LLP*.¹⁹⁷ In that case, a law firm was sued for negligently failing initially to perfect its client's security interest in chattel paper. The law firm brought a cause of action for contribution against the client's subsequent counsel. The court ruled that the law firm stated a cognizable claim by alleging that the subsequent counsel's "overly zealous litigation tactics" forced the debtor to file for bankruptcy protection within ninety days of when the security interest was eventually perfected, resulting in the security interest being avoided as a preference in bankruptcy.¹⁹⁸

194. *Id.* at 108–09.

195. 977 N.Y.S.2d 411 (App. Div. 2013).

196. *Id.* at 413–14.

197. No. 11-cv-5902, 2013 WL 788188 (N.D. Ill. Mar. 1, 2013).

198. *Id.* at *4.

