

Personal Property Secured Transactions

By Steve Weise and Stephen L. Sepinuck*

I. THE SCOPE OF ARTICLE 9

Unless an exception applies, Article 9 of the U.C.C. applies to any transaction, regardless of the transaction's form, that creates a security interest in personal property.¹ Accordingly, the first task for a lawyer involved in a secured transaction is to 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 properly to perfect a security interest and end up losing all rights in the collateral to someone else. Two cases from last year dealt with this rule, although neither led to a disastrous result.

In *Holland v. Sullivan*,² each of two transactions was structured as a sale of an automobile with an option to repurchase ten days later for 110 percent of the sale price.³ The putative seller retained possession of the automobile and the putative buyer received possession of the certificate of title. The trial court ruled, and the court of appeals agreed, that each transaction was really a loan and a secured transaction with the automobile as collateral.⁴ Although the secured party was unperfected because he had not complied with the applicable certificate of title act, he nevertheless had an attached security interest enforceable against the debtors and thus had a valid claim against the debtors for selling one of the automobiles after obtaining a duplicate certificate of title.⁵

In *In re Jeff Benfield Nursery, Inc.*,⁶ an agricultural nursery delivered trees to a farmer for planting and cultivation on the farmer's leased property. The agreements looked somewhat like bailments in that they purported to reserve the nursery's title to the trees and gave the nursery the unilateral right to: (i) select the type and number of trees; (ii) determine when they would be delivered to the farmer; (iii) direct their maintenance and cultivation; and (iv) access the debtor's leased property. However, the agreements also provided that all of the planting

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1. See U.C.C. § 9-109(a)(1) (2013).

2. No. M2016-00538-COA-R3-CV, 2017 WL 3917142 (Tenn. Ct. App. Sept. 7, 2017).

3. The option price increased as time elapsed. *Id.* at *1.

4. *Id.* at *9.

5. *Id.*

6. 565 B.R. 603 (Bankr. W.D.N.C. 2017).

and maintenance costs that the nursery advanced to the debtor were to be repaid in the form of credits when the trees were finally harvested and sold to the nursery, pursuant to a formula that provided the nursery with the equivalent of interest under a more traditional financing agreement.⁷ Moreover, the farmer was required to repay the nursery all costs advanced for any trees the nursery elected not to purchase. As a result, the nursery would recoup the funds advanced, while the farmer bore the risk of loss and had to pay all related insurance costs, fees, and taxes. The court concluded, therefore, that the agreements were “disguised financing arrangements” in which the trees were sold to the farmer while the nursery retained an interest in the trees as collateral.⁸

Article 9 also governs several transactions that do not involve the use of collateral to secure an obligation. In particular, it applies to many consignment transactions,⁹ treating the consignment as a security interest, the consignor as a secured party, the consignee as the debtor, and the consigned goods as the collateral.¹⁰ More importantly, if the consignor’s security interest is unperfected, U.C.C. section 9-319 treats the consignee as having sufficient rights in the consigned goods to grant a security interest in them to someone else.¹¹ There was one noteworthy case from last year dealing with whether Article 9 applied to a consignment transaction.

In *Mellen, Inc. v. Biltmore Loan & Jewelry-Scottsdale, LLC*,¹² the owner of a four-carat diamond left the diamond “on memo” with a jeweler. That agreement expressly provided “only for examination and inspection by prospective purchasers,” and that the jeweler “acquire[d] no right or authority to sell, pledge, hypothecate or otherwise dispose of” the diamond.¹³ The court ruled that the agreement was not, therefore, for the purpose of sale and thus not a “consignment” within the meaning of Article 9.¹⁴ Consequently, the pawn broker that bought the diamond did not obtain title under U.C.C. section 9-319.¹⁵

One of the other transactions to which Article 9 generally applies but which does not involving collateral securing an obligation is a sale of accounts, chattel paper, payment intangibles, or promissory notes.¹⁶ There are, however, several exceptions to this rule.¹⁷ In particular, Article 9 does not apply to the assignment

7. *Id.* at 606–07.

8. *Id.* at 611–13.

9. See U.C.C. §§ 9-102(a)(20), 9-109(a)(4) (2013).

10. See U.C.C. § 1-201(b)(35) (2011); U.C.C. § 9-102(a)(12), (28)(C), (73)(C) (2013).

11. See U.C.C. § 9-319(a) (2013).

12. 247 F. Supp. 3d 1084 (D. Ariz. 2017). An appeal was filed with the Ninth Circuit on April 4, 2017.

13. *Id.* at 1088.

14. *Id.* at 1096.

15. *Id.* at 1095–96. The court also ruled that the pawn broker did not obtain good title under U.C.C. section 2-403(1) because the jeweler did not have voidable title, *id.* at 1089–90, and did not obtain good title under the entrustment doctrine of U.C.C. section 2-403(2) because the pawn broker had purchased the diamond not from the jeweler, but from another person who claimed that the jeweler was his agent, *id.* at 1090–93.

16. See U.C.C. § 9-109(a)(3) (2013).

17. See *id.* § 9-109(d)(4)–(7).

of a single receivable in full or partial satisfaction of an existing indebtedness.¹⁸ In *In re Voboril*,¹⁹ a retired insurance salesman assigned his right to receive renewal commissions to support his guaranty of a bank loan to a corporation. The bank did not file a financing statement. The court ruled that the transaction was not the assignment of a single account in satisfaction of an existing indebtedness, and, thus, the transaction was not excluded from the scope of Article 9 by section 9-109(d)(7).²⁰ In addition, the agreement expressly provided that the assignment was to give “collateral security” for the debtor’s existing and future debts to the bank, not an outright sale of the account.²¹ Accordingly, the bank’s failure to file a financing statement rendered its security interest unperfected.²²

II. ATTACHMENT OF A SECURITY INTEREST

A. IN GENERAL

In general, there are three requirements for a security interest to attach to collateral: (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.²³ There were interesting cases on the first and third requirements last year.

B. DESCRIPTION OF THE COLLATERAL IN THE SECURITY AGREEMENT

The requirement of an authenticated security agreement is fairly easy to satisfy. When the security interest secures an obligation,²⁴ the agreement must include language indicating that the debtor has transferred an interest in personal property to the secured party to secure payment or performance of an obligation²⁵ and must describe the collateral.²⁶ No specific language is required, but it is important that the right person authenticate the security agreement. If the debtor is a business entity, that means that an individual authorized to act on the entity’s behalf must authenticate the agreement.

In *GEOMC Co. v. Calmare Therapeutics, Inc.*,²⁷ a corporation’s chief executive officer authenticated a security agreement on behalf of the corporation. Two years later, the corporation’s board of directors declared that the CEO might have acted contrary to the best interests of the corporation and that the security

18. *Id.* § 9-109(d)(7).

19. 568 B.R. 797 (Bankr. E.D. Wis. 2017).

20. *Id.* at 800.

21. *Id.* at 799–800.

22. *Id.* at 800.

23. See U.C.C. § 9-203(b) (2013).

24. Some security interests arise from an outright sale of most types of payment rights. See *id.* § 9-109(a)(3). In such a transaction, the security interest does not secure an obligation.

25. See U.C.C. § 1-201(b)(35) (2011).

26. See U.C.C. § 9-203(b)(3)(A) (2013).

27. No. 3:14-cv-01222, 2017 WL 3585337 (D. Conn. Aug. 18, 2017).

agreement was retroactively “rendered unauthorized, rejected, and void.”²⁸ Nevertheless, in an action brought by the secured party, the court ruled that the CEO had both actual and apparent authority to enter into the security agreement at the time he authenticated it, the agreement was therefore not *ultra vires*, and the subsequent board declaration did not affect the agreement’s validity.²⁹

In general, the description of collateral in a security agreement does not need to be specific or to list expressly every item, it needs only to “reasonably identify” the collateral.³⁰ In other words, the security agreement must “make [it] possible” to identify the collateral.³¹ For most types of property, a description by a type defined in the U.C.C. is sufficient.³² In two cases before the Ninth Circuit Bankruptcy Appellate Panel, secured parties had mixed results in their efforts to satisfy this requirement last year.

In *In re Wharton*,³³ an individual borrowed \$80,000 from his brother and signed a promissory note stating that “[t]his note is partially secured by 1965 Corvette automobile.”³⁴ The court ruled that this description was sufficient to grant the brother a security interest in the debtor’s Corvette.³⁵ In contrast, in *In re Escoto*,³⁶ an individual borrowed \$200,000 to finance litigation against the contractor that built the debtor’s home. The promissory note that the debtor signed granted the lender a security interest in the debtor’s dental practice and further pledged “any and all personal possessions holdings and items of value” and granted the lender “the right to remove any and all possessions . . . without the need of a court order.”³⁷ The court affirmed a lower court ruling that this language covered only tangible assets and provided for self-help remedies with respect only to those tangible assets; the collateral did not include the debtor’s rights under a settlement of a lawsuit that the loan was obtained to finance.³⁸

When the collateral is a commercial tort claim, a description that identifies it only by that type is insufficient;³⁹ hence a security agreement must describe such a claim with greater specificity. This requirement proved problematic for one secured party last year.

In *In re Gabriel Technologies Corp.*,⁴⁰ the lenders that financed the debtor’s unsuccessful tort action against another business claimed a security interest in the proceeds of a settlement of the debtor’s malpractice claim against its litigation counsel. Although the security agreement purported to cover “any successor claim or any claim related to [the funded tort claim], derived therefrom or arising

28. *Id.* at *4.

29. *Id.* at *14–15.

30. See U.C.C. § 9-108(a) (2013).

31. *Id.* cmt. 2.

32. *Id.* § 9-108(b)(3).

33. 563 B.R. 289 (9th Cir. BAP 2017).

34. *Id.* at 298.

35. *Id.* at 298–99.

36. No. NV-16-1211-LJuKu, 2017 WL 1075046 (9th Cir. BAP Mar. 21, 2017).

37. *Id.* at *4.

38. *Id.* at *5.

39. See U.C.C. § 9-108(e)(1) (2013).

40. No. 13-30340-DM, 2017 WL 6016287 (Bankr. N.D. Cal. Dec. 4, 2017).

thereunder,” the court ruled that the malpractice claim was not covered by that language and, even if it were, such language does not satisfy the specificity requirement of section 9-108(e).⁴¹

A security agreement may provide that the collateral secures advances made or obligations incurred after the agreement is authenticated.⁴² In *Ehrlich v. Commercial Factors of Atlanta*,⁴³ a security agreement provided that the collateral secured “all . . . obligations of ours to you, however and whenever created, arising or evidenced, . . . now or hereafter existing or due to become due.”⁴⁴ The court ruled that this language was sufficient to cover the debtor’s obligations to the secured party resulting from the phony invoices the debtor sold to the secured party.⁴⁵

C. RIGHTS IN THE COLLATERAL

When an issue arises about whether the debtor has rights in the collateral or the power to transfer rights in the collateral, most of the time law outside Article 9 will have to be consulted. For example, *In re Leonard*⁴⁶ involved a priority dispute between a partially unpaid seller of cattle and the lender that had financed the buyer’s acquisition of the cattle and who claimed to have a security interest in the cattle. Although the bill of sale provided by the seller did not comply with applicable state law because it was not signed by the debtor and did not list the address for either party,⁴⁷ the court ruled that the buyer nevertheless acquired ownership of the cattle,⁴⁸ and, therefore, the lender’s security interest had attached.⁴⁹ According to the court, passage of title is governed by Article 2 of U.C.C., and occurred when the cattle were delivered.⁵⁰ In *In re Delano Retail Partners, LLC*,⁵¹ the court ruled that the lender did not have a security interest in the proceeds of the debtor’s liquor license because a liquor license is not property of the licensee under California law, and hence no security interest could attach to it.⁵²

If the person authenticating the security agreement as the debtor does not own the collateral, the security interest can nevertheless attach if the debtor has the owner’s authorization to encumber the collateral.⁵³ However, the party claiming to have a security interest might have difficulty proving that such authorization was in fact given. Such was the problem last year in *United States v Myers*.⁵⁴ In

41. *Id.* at *4–5. The court also ruled that the security interest could not attach to the malpractice claims because such a claim is not assignable under California, Nevada, and New York law. *Id.* at *3.

42. See U.C.C. § 9-204(c) (2013).

43. 567 B.R. 684 (N.D.N.Y. 2017).

44. *Id.* at 689–90.

45. *Id.* at 700.

46. 565 B.R. 137 (8th Cir. BAP 2017).

47. *Id.* at 142–43.

48. *Id.* at 146–47.

49. *Id.* at 147–53.

50. *Id.* at 147.

51. No. 11-37711-B-7, 2017 WL 3500391 (Bankr. E.D. Cal. Aug. 14, 2017).

52. *Id.* at *12–14.

53. See U.C.C. § 1-103(b) (2011) (indicating that, unless displaced by a particular provision of the Code, law of principal and agent supplements the Code’s provisions).

54. No. 4:15-cv-04024-BHH, 2017 WL 412623 (D.S.C. Jan. 31, 2017).

that case, a farmer purported to grant a security interest in specified farm equipment and crops grown on leased land. After default, the lender sought to foreclose on the collateral. The court ruled that the lender was not entitled to summary judgment on its action to obtain the equipment, which was owned by the lessor, because the lessor had not authenticated the security agreement and the evidence was conflicting as to whether the lessor had permitted the farmer to use the equipment as collateral.⁵⁵

Even when a debtor's rights to transfer property are restricted by contract or law, the debtor might nevertheless be permitted to grant a security interest in that property. Article 9 contains several rules that override some contractual and legal restrictions on assignment.⁵⁶ Several of these rules were pivotal in cases decided last year.

In *Magnolia Financial Group v. Antos*,⁵⁷ a lender claimed a security interest in the borrower's right to payment under a settlement agreement. The settlement agreement contained language attempting to prohibit its assignment without the consent of the counterparty.⁵⁸ Nevertheless, the court ruled that the security interest attached because section 9-406 overrode that contractual restriction on assignment, as well as overriding a state statute that generally gives effect to contractual restrictions on assignment.⁵⁹

In *Estate of Grimm v. Encompass Indemnity Co.*,⁶⁰ an individual covered by no-fault automobile insurance was treated by several health care providers after suffering injuries in a motor vehicle accident. Each of the providers had received an assignment of the patient's rights under the insurance policy.⁶¹ When the insurer refused to pay the providers, the providers sued. Although the policy contained an anti-assignment clause, the court ruled that the assignments to the providers were nevertheless effective because the restriction on assignment violated state public policy and was overridden by section 9-408.⁶²

III. PERFECTION OF A SECURITY INTEREST

A. METHOD OF PERFECTION AND GOVERNING LAW

In general, perfection of a security interest is necessary, but not always sufficient, for the secured party to have priority over the rights of lien creditors, other secured parties, and buyers, lessees, and licensees of the collateral.⁶³ The method or methods by which a secured party can perfect a security interest depend on the type of collateral and the nature of the transaction. The dominant method of perfection is by filing a financing statement, but other methods include taking possession or control of the collateral, complying with a certificate-of-title stat-

55. *Id.* at *3.

56. See U.C.C. §§ 9-406(d)–(f), 9-407, 9-408, 9-409 (2013).

57. No. 15-7144, 2017 WL 4286126 (E.D. La. Sept. 27, 2017).

58. *Id.* at *3.

59. *Id.* at *4 (citing LA. CIV. CODE art. 2653).

60. No. 14-14646, 2017 WL 5592897 (E.D. Mich. Nov. 21, 2017).

61. *Id.* at *2–3.

62. *Id.* at *4–5.

63. See U.C.C. §§ 9-317, 9-322(a) (2013).

ute, and complying with any preemptive federal law.⁶⁴ Among the first steps in determining how to perfect are: (i) to identify and classify the collateral; (ii) to ascertain whether Article 9 applies to a security interest in that collateral; and (iii) to determine which state's law governs.

B. GOVERNING LAW

In general, the law of the jurisdiction where the debtor is located governs perfection of a security interest.⁶⁵ There are, however, several exceptions, including for security interests in deposit accounts,⁶⁶ investment property,⁶⁷ goods covered by a certificate-of-title statute,⁶⁸ and security interests perfected by possession.⁶⁹ There is also an exception for agricultural liens, which are created by statute rather than by agreement.⁷⁰ For such liens, the law of the jurisdiction where the farm products are located governs perfection.⁷¹

In *Fishback Nursery, Inc. v. PNC Bank*,⁷² the court correctly applied this rule and concluded the law of Michigan, Tennessee, and Oregon governed, respectively, the perfection of the agricultural liens on the farm products shipped to those states, even though the debtor's contracts with the agricultural lienholders purported to select only Oregon law.⁷³

Another court last year had more difficulty with Article 9's choice-of-law rules. In *Element Financial Corp. v. Marcinkoski Gradall, Inc.*,⁷⁴ a lender that financed a California debtor's acquisition of equipment perfected its security interest in the equipment by filing a financing statement in California, where the debtor was located. After the guarantor relocated the equipment to Florida and then sold it, the lender sought to recover the equipment from the buyers.

Under revised Article 9, a security interest perfected under the law of the jurisdiction in which the debtor is located generally remains perfected until four months after the debtor moves to a new jurisdiction or one year after the goods are transferred to a debtor located in different jurisdiction.⁷⁵ The court concluded first—and correctly—that the guarantor was not the debtor.⁷⁶ However, the court then ruled, somewhat inexplicably, that “[w]hen the guarantor moved the goods from California to Florida, the guarantor became a debtor . . . and triggered the

64. See *id.* §§ 9-310 to -314.

65. See *id.* § 9-301(1).

66. See *id.* § 9-304.

67. See *id.* § 9-305.

68. See *id.* § 9-303.

69. See *id.* § 9-301(2).

70. See *id.* § 9-102(a)(5) (defining “agricultural lien”).

71. See *id.* § 9-302.

72. No. 3:16-CV-03267-B, 2017 WL 6497802 (Bankr. N.D. Tex. Dec. 19, 2017). An appeal was filed with the Fifth Circuit on January 22, 2018.

73. *Id.* at *3–7.

74. 215 So. 3d 1252 (Fla. Dist. Ct. App. 2017). Review was granted by the Florida Supreme Court on October 10, 2017.

75. See U.C.C. § 9-316(a)(2), (3) (2013).

76. 215 So. 3d at 1256 (citing Florida's version of U.C.C. § 9-102(a)(28)).

one-year grace period” in section 9-316(a)(3).⁷⁷ That ruling was incorrect (unless the debtor had transferred ownership of the equipment to the guarantor, but the court never stated that this had occurred). First, the guarantor did not become the debtor solely by transporting the goods. The debtor—as the court itself noted—is a person who has an ownership interest in the collateral; the guarantor apparently never did. Second, the one-year period does not apply when *the goods are moved* to a new jurisdiction, it applies when *ownership of goods is transferred* to a debtor located in a different jurisdiction; where the goods are located is irrelevant. However, because the lender apparently re-filed in Florida less than one year after the equipment was moved to Florida, and, thus, the security interest remained continuously perfected, the court’s error in analysis does not appear to have affected the result.⁷⁸

C. ADEQUACY OF A FINANCING STATEMENT

To be sufficient to perfect a security interest, a filed financing statement must provide the name of the debtor, provide the name of the secured party or a representative of the secured party, and indicate the collateral.⁷⁹ Of these three requirements, the name of the debtor is the most important because financing statements are indexed by—and searches are conducted using—the debtor’s name.⁸⁰ A filed financing statement that lists an incorrect name for the debtor is not effective to perfect unless the financing statement would be disclosed in response to a search under the debtor’s correct name, using the filing office’s standard search logic.⁸¹ In several cases from last year the secured party erred in identifying the debtor in a filed financing statement, with the result that the security interest was ineffective to perfect.

In *In re Nay*,⁸² a filed financing statement misstated the debtor’s middle name as it appeared in the debtor’s driver’s license by identifying the debtor as “Ronald Mark Nay” instead of “Ronald Markt Nay.” Because the middle name is part of the debtor’s name, and a search under the debtor’s full, correct name using the filing office’s standard search logic would not produce the filing, the court

77. *Id.*

78. There might be other complicating factors. Although the court did not focus on it, it appears that the equipment was sold several times. After the debtor acquired the equipment, a Nevada corporation sold it to a corporation located in Florida, which resold it to another corporation in Florida. *See id.* at 1254 (showing a chart of the transfers). However, it is unclear whether or when the Nevada corporation acquired the equipment, so there is a gap in the chain of ownership. Moreover, the court never indicated whether the subsequent buyers were Florida corporations or operated only in Florida. *Cf.* U.C.C. § 9-307(e) (2013) (a registered organization is located in the jurisdiction under whose law it is organized, not where it does business). Consequently, it is not clear when the one-year period provided for in section 9-316(a)(3) started to run. Finally, the court never indicated what debtor name for the debtor the lender used in its financing statement when it re-filed in Florida.

79. *See* U.C.C. § 9-502(a) (2013).

80. *See id.* §§ 9-519(c)(1), 9-523(c)(1)(A).

81. *See id.* § 9-506(a)–(c).

82. 563 B.R. 535 (Bankr. S.D. Ind. 2017).

ruled that the financing statement was ineffective to perfect.⁸³ It did not matter that a search could be conducted without using the debtor's middle name.⁸⁴

Courts reached a similar result in two cases involving an organizational debtor. In *SEC v. ISC, Inc.*,⁸⁵ a secured party's filed financing statement erroneously included a space between the "Inc" and the period that follows it in the debtor's name. The court ruled that the financing statement was ineffective to perfect because a search against the debtor's correct name using the filing office's standard search logic did not reveal the filing.⁸⁶ In *Fishback Nursery, Inc. v. PNC Bank*,⁸⁷ financing statements filed by agricultural lienholders in Michigan and Tennessee were ineffective to perfect agricultural liens in farm products located there because they added an assumed business name to the debtor's name, identifying the debtor as "BFN Operations, LLC abn Zelenka Farms" instead of as "BFN Operations, LLC," and a search in each of those states using the filing office's standard search logic would not have disclosed the filings.⁸⁸

In another case,⁸⁹ the secured party filed a financing statement that listed the name for an individual debtor in the box for an organizational debtor. The court ruled that this too was ineffective to perfect because a search under the debtor's name would not disclose the filing.⁹⁰

A filed financing statement's indication of collateral need not be specific, as long as it reasonably identifies the collateral.⁹¹ A description such as "all assets" or "all personal property" is sufficient in a financing statement,⁹² as is a description using a type of collateral defined in the U.C.C.⁹³ However, a description of collateral using an Article 9 classification will be effective only if the secured party has classified the collateral properly.

In *In re Lexington Hospitality Group, LLC*,⁹⁴ the court ruled that a lender's security interest in a hotel's credit card receivables was not perfected because such

83. *Id.* at 538–39.

84. *Id.* at 539.

85. No. 15-cv-45-jdp, 2017 WL 3736796 (W.D. Wis. Aug. 30, 2017).

86. *Id.* at *1–2. Note, the model rules of the International Association of Commercial Administrators (the trade association for filing officers) provide for punctuation and spaces to be disregarded when searching for filed financing statements. Int'l Ass'n of Commercial Adm'rs, Model Admin. Rule 5.1.3(b), (e) (2015). If the state had adopted those rules, the filed financing statement in this case would have been effective to perfect.

87. No. 3:16-CV-03267-B, 2017 WL 6497802 (Bankr. N.D. Tex. Dec. 19, 2017). An appeal was filed with the Fifth Circuit on January 22, 2018.

88. *Id.* at *8; see also *In re EDM Corp.*, No. BK08-40788-TLS, 2009 WL 367773 (Bankr. D. Neb. Feb. 10, 2009) (financing statement listing the debtor as "EDM Corporation d/b/a EDM Equipment" instead of its registered name, "EDM Corporation," was ineffective); *In re Jim Ross Tires, Inc.*, 379 B.R. 670 (Bankr. S.D. Tex. 2007) (a filed financing statement that added "dba HTC Tires & Automotive Centers" after the debtor's correct name was ineffective to perfect).

89. *In re Voboril*, 568 B.R. 797 (Bankr. E.D. Wis. 2017). The transaction in connection with which the financing statement was filed was different from the transaction discussed at *supra* notes 18–19 for which no financing statement was filed.

90. *Id.* at 803.

91. See U.C.C. § 9-108(a) (2013).

92. See *id.* § 9-504(2).

93. See *id.* §§ 9-108(b)(3), 9-504(1).

94. No. 17-51568, 2017 WL 5035081 (Bankr. E.D. Ky. Nov. 1, 2017).

receivables are payment intangibles, not accounts,⁹⁵ and while the security agreement covered both accounts and general intangibles, the lender's financing statement covered only accounts.⁹⁶ Although the financing statement did reference the security agreement, the court concluded that a reference to an unattached document does not describe what is in the document.⁹⁷

Secured parties had mixed success last year with respect to other issues involving financing statements. In *In re Tam of Allegheny LLC*,⁹⁸ a secured party made a fixture filing with the Allegheny County Recorder of Deeds, but did not file a financing statement with the Pennsylvania Secretary of the Commonwealth. The court ruled that the secured party's security interest in the debtor's Pennsylvania liquor license—which is a general intangible (not a fixture)—was not perfected by the fixture filing.⁹⁹

In *Farmer's & Miner's Bank v. Lee*,¹⁰⁰ a bank with security interest in three items of equipment filed a financing statement describing each item. It later filed an amendment to delete one of the items. The amendment was designated as "a Collateral Change-Delete" and in box 4, which contained the phrase "This financing statement covers the following collateral,"¹⁰¹ identified the item to be deleted. A competing creditor contended that the amendment indicated the only item that remained covered, but the court disagreed. In so ruling, the court concluded that the phrase "[t]his financing statement covers the following collateral" referred to the amendment deleting collateral, not the original financing statement.¹⁰²

In *In re Reckart Equipment Co.*,¹⁰³ a bank mailed two financing statements to the West Virginia Secretary of State, one identifying Reckart Equipment Co. as debtor and the other identifying a related entity as debtor. The secured party included in the envelope a check that covered only one filing fee, and the Secretary of State's Office stamped both financing statements with the same record identification number and indexed both under the name of the related entity. The error was discovered about twenty months later, at which time the filing office properly indexed the financing statement filed against the debtor. In the interim, another creditor has searched and filed against the debtor.¹⁰⁴ In the resulting priority dispute between the two secured parties, the court concluded that the bank's financing statement was filed when received by the filing office.¹⁰⁵ As the court noted, presentation of a record to the filing office with the appropriate

95. See *id.* at *9–10 (citing U.C.C. § 9-102 cmt. 5d).

96. See *id.* at *11–12. The court did not discuss whether the credit card receivables were proceeds of accounts created when the guest made the reservation or checked in.

97. *Id.* at *11.

98. 575 B.R. 131 (Bankr. W.D. Pa. 2017).

99. *Id.* at 135.

100. No. 6:15-CV-64-HAI, 2017 WL 4707457 (E.D. Ky. Oct. 19, 2017).

101. This language does not appear in the official form incorporated into U.C.C. § 9-521(b) (2013).

102. *Farmer's & Miner's Bank*, 2017 WL 4707457, at *6.

103. No. 12-bk-670, 2017 WL 943909 (Bankr. N.D. W. Va. Mar. 9, 2017).

104. See *id.* at *3.

105. *Id.* at *8.

fee constitutes filing,¹⁰⁶ even if the office fails to properly index the record.¹⁰⁷ The fact that the bank had submitted the fee for only one financing statement did not matter because the memo line on the bank's check indicated that payment was for a financing statement against the debtor and the Secretary of State should have filed that financing statement.¹⁰⁸

In *In re Wheeler*,¹⁰⁹ a bank perfected a security interest in a farmer's crops by filing a financing statement. The bank later mistakenly filed a termination statement. Ten minutes later, the bank filed an amendment to add itself as the secured party. The court ruled that even though the termination was inadvertent, it was authorized because it was filed by a loan processor of the bank that handles financing statements.¹¹⁰ As a result, the bank's security interest became subordinate to another perfected security interest.¹¹¹

D. PERFECTION OTHER THAN BY FILING A FINANCING STATEMENT

A secured party may perfect a security interest in certificated securities by taking delivery of the certificates,¹¹² or if someone else in possession of the certificates, other than a securities intermediary, that other person acknowledges that it holds the certificates for the secured party.¹¹³ This rather simple rule proved problematic for one secured party last year.

In *Citizens Bank & Trust v. Piggly Wiggly Alabama Distributing Co.*,¹¹⁴ a bank had a security interest in the debtor's shares of stock in a corporation. The issuing corporation retained possession of the stock certificate to perfect its own security interest in the shares. It did, however, provide a receipt for the certificate to the debtor, who in turn delivered the receipt to the bank. In dealing with a priority dispute between the bank and a garnishor, the court ruled that because the issuer never acknowledged that it had possession for the bank's benefit, the bank's security interest was unperfected.¹¹⁵

When goods, other than inventory held for sale or lease by a person engaged in the business of selling goods of that kind, is covered by a certificate of title statute, the way to perfect a security interest in the goods is through compliance with the certificate of title statute.¹¹⁶ In *In re Wharton*,¹¹⁷ the court ruled that a secured party's possession of the certificate of title and keys for a Corvette did

106. See *id.*; U.C.C. § 9-516(a) (2013).

107. See U.C.C. § 9-517 (2013).

108. *Farmer's & Miner's Bank*, 2017 WL 943909, at *8.

109. 580 B.R. 719 (Bankr. W.D. Ky. 2017).

110. *Id.* at 722–25.

111. *Id.* at 725.

112. U.C.C. § 8-301(a) (2011); U.C.C. § 9-313(a) (2013).

113. See *id.* § 8-301(a)(2).

114. 228 So. 3d 469 (Ala. Ct. Civ. App. 2017).

115. *Id.* at 475. It may also be that the corporation was too closely connected with the debtors, who were controlled by officers of the issuer, to act as bailee. See U.C.C. § 9-313 cmt. 3 (2013); *Heinicke Instruments Co. v. Republic Corp.*, 543 F.2d 700 (9th Cir. 1976).

116. See U.C.C. § 9-311(a)(2), (d) (2013). There are also limited circumstances in which the security interest in such goods may be perfected by possession. See *id.* §§ 9-313(b), 9-316(d).

117. 563 B.R. 289 (9th Cir. BAP 2017).

not perfect his security interest. Under Nevada law, perfection requires that the security interest be noted on the certificate.¹¹⁸ In *In re Edwards*,¹¹⁹ a mobile home dealer retained a security interest in a mobile home sold to a customer and all accessions, attachments, and accessories thereto. The dealer's security interest was properly noted on the certificate of title for the mobile home, thereby complying with the state certificate of title statute and perfecting the dealer's security interest in the mobile home and in accessions thereto.¹²⁰ However, the court ruled that the dealer's security interest in drapes, smoke detectors, ceiling fans, a set of steps, and a 4'-by-4' porch, each of which was readily detachable and not, therefore, an accession, was not perfected.¹²¹ To perfect a security interest in such property, the dealer needed to file a financing statement.¹²²

IV. PRIORITY OF A SECURITY INTEREST

A. BUYERS OF GOODS

Pursuant to U.C.C. section 9-317(b), a buyer of goods takes free of an unperfected security interest in the goods if the buyer gives value and receives delivery without knowledge of the security interest.¹²³ Two noteworthy cases from last year dealt with a priority dispute between a buyer and a secured party with an unperfected security interest.

In re SemCrude L.P.,¹²⁴ a case reported on previously,¹²⁵ involved debtors that had purchased oil from producers in several states and resold the oil to downstream purchasers. The unpaid producers brought claims against the purchasers, alleging that the purchasers violated the producers' security interests in the oil. The producers, which had not filed financing statements against the debtors, relied on nonuniform statutes in several states that purport to grant producers, such as themselves, an automatically perfected purchase-money security interest in the oil or gas they produce and then sell on credit. Unfortunately for the producers, because the law of the jurisdiction where the debtor is located governs perfection of a security interest,¹²⁶ and those jurisdictions had no such nonuniform statutes, the producers' security interests were unperfected.¹²⁷

118. *Id.* at 301. The law is similar in other states. *See, e.g., In re Skagit Pac. Corp.*, 316 B.R. 330, 340–41 (9th Cir. BAP 2004) (applying Washington law). *But cf. N.D. CENT. CODE* § 35-01-05.1 (2009) (indicating that perfection occurs if “the security interest is clearly indicated upon the certificate of title to the vehicle or . . . such certificate of title is in the possession of the secured party”).

119. No. 17-02821-5-SWH, 2017 WL 6754026 (Bankr. E.D.N.C. Dec. 29, 2017).

120. *Id.* at *5.

121. *Id.* at *6.

122. *Id.* at *5–6.

123. U.C.C. § 9-317(b) (2013).

124. 864 F.3d 280 (3d Cir. 2017).

125. *See* Steve Weise & Stephen L. Sepinuck, *Annual Survey of Commercial Law: Personal Property Secured Transactions*, 71 *BUS. LAW.* 1323, 1331–32 (2016).

126. *See* U.C.C. § 9-301(1) (2013).

127. *See In re SemCrude, L.P.*, 407 B.R. 82, 104–10 (Bankr. D. Del. 2009). For other decisions in this litigation, *see* the following: *In re SemCrude, L.P.*, 504 B.R. 39 (Bankr. D. Del. 2013), *recommendation adopted*, No. 14-CV-41 (SLR), 2015 WL 4594516 (D. Del. July 30, 2015).

In the latest decision in the ongoing dispute, the U.S. Court of Appeals for the Third Circuit affirmed a judgment for the buyers.¹²⁸ After agreeing that the producers' security interests were unperfected,¹²⁹ the court concluded that the buyer took free of the unperfected security interests of the producers because they gave value and lacked knowledge of the security interests.¹³⁰ Although the buyers allegedly knew of: (i) the state lien laws that created the security interests, (ii) the identities of some of the suppliers, and (iii) the fact that the suppliers were unpaid, that was insufficient proof of knowledge of the security interests, especially because it is customary for payment not to be made until the month following delivery.¹³¹

In contrast, in *SMS Financial JDC, LP v. Cope*,¹³² a bank's security interest in a yacht, which was unperfected due to the bank's failure to document the yacht with the Coast Guard, nevertheless had priority over the rights of the debtor's wife, who had acquired ownership of the yacht. The debtor had initially transferred the yacht to a corporation of which he was president, and the court concluded that his knowledge of the security interest was imputed to the corporation.¹³³ The corporation then transferred the yacht to the debtor's wife, who had "implied actual notice."¹³⁴ Although section 9-317(b) refers to "knowledge" of the unperfected security interest, not "notice,"¹³⁵ pursuant to the Ship Mortgage Act a conveyance that is not properly recorded is nevertheless valid against a person with "actual notice" of it.¹³⁶

A buyer normally takes subject to a perfected security interest in goods.¹³⁷ There are, however, three exceptions. A buyer of consumer goods takes free of a purchase-money security interest that is perfected automatically but not by the filing of a financing statement.¹³⁸ A buyer in ordinary course of business takes free of a perfected security interest created by the seller.¹³⁹ And a buyer of goods covered by a certificate of title takes free of a security interest perfected under the law of another jurisdiction if the buyer gives value and receives delivery without knowledge of the security interest and the certificate neither shows that the goods are subject to the security interest nor contains a statement that they might be subject to a security interest.¹⁴⁰ There were interesting cases last year involving the latter two exceptions.

128. *In re SemCrude L.P.*, 864 F.3d at 301.

129. *Id.* at 292.

130. *Id.* at 295.

131. *Id.*

132. 685 F. App'x 648 (10th Cir. 2017).

133. *Id.* at 654.

134. *Id.*

135. See U.C.C. § 1-202(a), (b) (2011) (distinguishing "notice" from "knowledge").

136. See 46 U.S.C. § 31321(a)(1)(C) (2012).

137. See U.C.C. § 9-201(a) (2013).

138. See *id.* § 9-320(b).

139. See *id.* § 9-320(a).

140. See *id.* § 9-337(a); see also *id.* § 9-316(d), (e).

In *Element Financial Corp. v. Marcinkoski Gradall, Inc.*,¹⁴¹ the court ruled that even if the buyers of three Bobcat utility vehicles were buyers in ordinary course of business, they did not take free of a perfected security interest because the security interest was not created by the buyers' seller.¹⁴²

In *Cyber Solutions International, LLC v. Priva Security Corp.*,¹⁴³ a secured party had a perfected security interest in a computer chip manufacturer's assets, including the advanced computer chips it manufactured pursuant to a licensing agreement with a customer. After default, it seized the chips and a dispute arose between the secured party and the customer. Although the customer had paid for and directed the manufacturing and testing of the chips, the court concluded that nothing in the agreements between the manufacturer and its customer indicated that the customer owned the chips.¹⁴⁴ Accordingly, the chips remained property of the manufacturer and subject to the security interest, and, therefore, the secured party would be permitted to sell the chips.¹⁴⁵ The court did not discuss, presumably because no one argued, whether the customer qualified as a buyer in ordinary course of business.¹⁴⁶

In *BMW Financial Services, N.A., LLC v. Felice*,¹⁴⁷ a secured party perfected a security interest in a Porsche by having its interest noted on the certificate of title. The debtor filed an unauthorized lien release, obtained a duplicate certificate that did not indicate the security interest (but did state "[t]his is a duplicate certificate and may be subject to the rights of a person under the original certificate"), and sold the car to a dealer with no knowledge of the security interest. The dealer then sold the car to an individual who also had no knowledge of the security interest. After the secured party sought to replevy the car, the dealer repurchased the car from the individual.

The trial court ruled for the secured party and the court of appeals affirmed.¹⁴⁸ It concluded that the dealer did not take free under section 9-337(1) because that provision applies only when the new certificate is issued by a different state, which was not what occurred in this case.¹⁴⁹ It ruled that the individual did not take free

141. 215 So. 3d 1252 (Fla. Dist. Ct. App. 2017). Review was dismissed by the Florida Supreme Court on March 2, 2018. The perfection issue in the case is discussed at *supra* notes 74–77.

142. *Id.* at 1257.

143. No. 1:13-cv-867, 2017 WL 3599578 (W.D. Mich. Aug. 22, 2017).

144. *Id.* at *4.

145. *Id.* at *5.

146. To qualify as a buyer in ordinary course of business, a buyer must take possession of the goods or have the right to recover the goods from the seller under Article 2. *See* U.C.C. § 1-201(b)(9) (2011). Because these computer chips were specially manufactured for the customer, there was a good chance that the customer had either a right to specific performance under U.C.C. section 2-716(1) or a right of replevin under U.C.C. section 2-716(3).

147. 75 N.E.3d 368 (Ill. App. Ct. 2017).

148. *Id.* at 370.

149. *Id.* at 372–73. Although the court was correct, this might be drafting error; there is no good reason why the rule of section 9-337(a) should apply only when the new certificate is issued by a state other than the one that issued the original certificate. However, two additional reasons supported the court's conclusion. Section 9-337(1) does not protect a buyer if the new certificate contains a statement that there might be a security interest not shown on the certificate, and in this case the new certificate expressly stated that it was a "duplicate certificate and may be subject to the rights

of the security interest as a buyer in ordinary course of business because section 9-320(a) allows such a buyer to take free only of a security interest created by the seller, and the security interest was not created by the dealer, but by a previous owner.¹⁵⁰

In another case last year, *Focarino v. Travelers Personal Insurance Co.*,¹⁵¹ a buyer of goods was allowed to take free of a perfected security interest under U.C.C. Article 2, but that decision was incorrect. The case began when an individual who owned a Bentley subject to a perfected security interest sold the car to a dealer who promised to pay off the debt to the secured party. The dealer did not do so, and instead sold the car to a buyer. When the original owner discovered what happened, he filed a theft claim with his insurer. The insurer paid the secured party and was, presumably, subrogated to the secured party's rights. The buyer then sought an order restraining the insurer from repossessing the car.¹⁵²

Section 2-403(1) provides in pertinent part:

A purchaser of goods acquires all title which the transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value.¹⁵³

The court concluded that the dealer acquired voidable title when it purchased the car from the individual but failed to pay as promised the secured party.¹⁵⁴ The fact that the individual reported the car as stolen did not prevent the dealer from being a purchaser because the transaction between the individual and the dealer was consensual.¹⁵⁵ The court then ruled that because the dealer could transfer good title to a good faith purchaser for value, and there was no dispute that the buyer was such a purchaser, the buyer took free of the security interest.¹⁵⁶ This latter conclusion was incorrect. Nothing in section 2-403(1) allows a purchaser to take free of a perfected security interest. The provision's reference to "good title" does not allow a good faith purchaser to take free of encumbrances; it means that the purchaser takes free of a avoidance or rescission claim of the prior owner.¹⁵⁷

B. OTHER PRIORITY ISSUES

There were several other cases of note last year dealing with priority issues. In *re Pettit Oil Co.*,¹⁵⁸ a fuel supplier consigned goods to the debtor, a distributor.

of a person under the original certificate." Second, section 9-337(1) protects only a buyer other than a person in the business of selling goods of that kind, but the dealer was in the business of selling cars.

150. *Id.* at 373.

151. No. C-96-15, 2017 WL 1456967 (N.J. Super. Ct. Apr. 25, 2017).

152. *Id.* at *1.

153. U.C.C. § 2-403(1) (2011).

154. *Focarino*, 2017 WL 1456967, at *4.

155. *Id.*

156. *Id.*

157. See Carl S. Bjerre & Stephen L. Sepinuck, *UCC Spotlight*, 2018 COM. L. NEWS. (ABA Bus. Law Section, Chicago, IL, Spring 2018), at 8, 11.

158. 575 B.R. 905 (9th Cir. BAP 2017).

The consignment was an Article 9 transaction,¹⁵⁹ and as a result the consignor is treated as a secured party with a security interest in the consigned fuel,¹⁶⁰ and the debtor is deemed to have the consignor's rights to the consigned fuel.¹⁶¹ The consignor failed to perfect its interest. After the debtor sold the fuel and filed for bankruptcy protection, a dispute arose between the consignor and the bankruptcy trustee with respect to the accounts receivable and cash constituting proceeds of the fuel. The court held that the consignor had only an unperfected security interest in proceeds, which interest was subordinate to the rights of the consignee's trustee in bankruptcy.¹⁶² The court ruled that even though section 9-319 refers only to the consigned goods, not their proceeds, when treating the consignor's interest as a security interest, Article 9's rules regarding proceeds were applicable.¹⁶³

Two cases last year dealt with priority in amounts owed to a contractor, and they reached somewhat inconsistent results. In *Berkley Insurance Co. v. Hawthorn Bank*,¹⁶⁴ a surety company that had issued a performance bond for a general contractor later completed the contractor's obligations on the bonded project. The surety then sought priority in the contractor's rights to payment on the project over the bank with a perfected security interest in the contractor's accounts. The court ruled that even if the surety were entitled to be equitably subrogated to the contractor's rights—and even if that would give it priority over the bank—the right to equitable subrogation applies only after complete performance, not on the date the bond was issued, and because the bank did not receive payment after the date performance was completed, the bank had no liability to the surety.¹⁶⁵

*Prestige Capital Corp. v. United Surety & Indemnity Co.*¹⁶⁶ also involved a surety that issued a performance bond for a contractor and then completed the contractor's work after the project owner terminated the contractor for default. The court ruled that, under Puerto Rico law, a factor's perfected security interest in a contractor's accounts did not have priority over the surety in the amounts due from and interpleaded by the owner.¹⁶⁷

The most troubling priority decision from last year is *In re Delano Retail Partners, LLC*.¹⁶⁸ The case involved a secured party with a perfected security interest in, among other things, the debtor's inventory. The debtor deposited proceeds of inventory into its lawyer's trust account. After the debtor filed for bankruptcy protection, those funds were transferred to the bankruptcy trustee. In a dispute

159. See U.C.C. §§ 9-102(a)(20), 9-109(a)(4) (2013).

160. See *id.* § 9-102(a)(12)(C), (73)(C).

161. See *id.* § 9-319(a).

162. *In re Pettit Oil Co.*, 575 B.R. at 911.

163. *Id.* at 911–12.

164. No. 2:16-cv-04136-NKL, 2017 WL 4391774 (W.D. Mo. Sept. 29, 2017).

165. *Id.* at *4. The court also ruled that even if the agreement between the contractor and the surety established a valid trust for the benefit of the surety, because the bank was not a party to that agreement and was not made aware of the agreement until after it had exercised setoff, the bank had no liability to the surety. *Id.* at *7.

166. 245 F. Supp. 3d 349 (D.P.R. 2017).

167. *Id.* at 354–57.

168. No. 11-37711-B-7, 2017 WL 3500391 (Bankr. E.D. Cal. Aug. 14, 2017).

between the secured party and the trustee, the court ruled that the trustee took free of the security interest under section 9-332.¹⁶⁹ In doing so, the court relied on a decision heavily criticized in this survey last year.¹⁷⁰ The court also failed to realize that its ruling subjects virtually all secured parties with a perfected security interest in a deposit account to being primed by the bankruptcy trustee.¹⁷¹

V. ENFORCEMENT OF A SECURITY INTEREST

A. NOTIFICATION OF DISPOSITION

After default, a secured party may repossess and dispose of the collateral.¹⁷² Before most dispositions, the secured party must send notification of the disposition to the debtor and any secondary obligor.¹⁷³ Such a notification should, among other things, indicate the method of the intended disposition and state the time and place of a public disposition or the time after which any other disposition is to be made.¹⁷⁴ This duty cannot be waived or varied in the security agreement,¹⁷⁵ but can be waived in an agreement authenticated after default.¹⁷⁶ There were two notable cases about the notification requirement last year.

In *Kinzel v. Bank of America*,¹⁷⁷ a brokerage house liquidated, without prior notice, the securities in its customers' securities account and used the proceeds to pay down the customers' secured obligation to the brokerage. The court ruled that these actions did not violate the brokerage's duties to the customers for two independent reasons.¹⁷⁸ First, notification of a disposition is required only after default, and in this case the brokerage exercised its contractual discretion to liquidate the collateral in the absence of a default.¹⁷⁹ Second, notification is not re-

169. *Id.* at *8–9. The court alternatively ruled that, because the lawyer's client trust account contained funds from other sources and held for the benefit of other clients—that is, the inventory proceeds were commingled with funds that were clearly not collateral—the funds were not “identifiable” cash proceeds of the inventory within the meaning of U.C.C. section 9-315(d)(2). See *In re Delano Retail Partners, LLC*, 2017 WL 3500391, at *9–10.

170. *In re Delano Retail Partners, LLC*, 2017 WL 3500391, at *7–8 (citing *Stierwalt v. Associated Third Party Adm'rs*, No. 16-mc-80059-EMC, 2016 WL 2996936 (N.D. Cal. May 25, 2016)); Steve Weise & Stephen L. Sepinuck, *Annual Survey of Commercial Law: Personal Property Secured Transactions*, 72 BUS. LAW. 1143, 1153–54 (2017).

171. For further discussion and criticism of this decision, see Bjerre & Sepinuck, *supra* note 157, at 10–11.

172. See U.C.C. §§ 9-609, 9-610 (2013).

173. See *id.* § 9-611(b)–(d).

174. See *id.* § 9-613(1). In a transaction other than a consumer-goods transaction, a notification that does not include this information might nevertheless be sufficient. Compare *id.* § 9-613(1), (2), with *id.* § 9-614(1).

175. See *id.* § 9-602(7).

176. See *id.* § 9-624(a).

177. 850 F.3d 275 (6th Cir. 2017).

178. *Id.* at 282.

179. *Id.* (citing U.C.C. § 9-611(b)). Despite this ruling, it is not clear a security agreement must expressly identify an event as a default for Article 9's rules relating to default to apply. In the absence of agreement on this, a court might look to ordinary rules of contract law and determine if there had been a material breach. Arguably, if a security agreement expressly authorizes the secured party to use and sell the collateral and use the proceeds to satisfy the secured obligation after a specified event, that event is a default under the security agreement.

quired when the collateral is traded on a recognized market, and in this case the securities were traded on the New York Stock Exchange, which is a recognized market.¹⁸⁰

In *Volvo Financial Services v. Williamson*,¹⁸¹ the court ruled that a secured party with a security interest in eight trucks provided sufficient notification of its disposition of five of them by using the safe-harbor form provided in U.C.C. section 9-613 even though the notifications did not specify that the disposition would be conducted on internet websites or contain information about the amount of advertising.¹⁸² The secured party's notification of two other dispositions was also sufficient, the court ruled, even though that notification did not mention that vehicles would be sold on the salvage market.¹⁸³

B. CONDUCTING A COMMERCIALLY REASONABLE DISPOSITION

A secured party may dispose of collateral by a sale, lease, license, or other disposition.¹⁸⁴ The disposition may be public—that is, typically an auction—or private.¹⁸⁵ However, every aspect of a disposition must be “commercially reasonable.”¹⁸⁶ If a secured party's compliance with this standard is challenged, the secured party has the burden of proof.¹⁸⁷ In several cases last year, the secured party was able to obtain summary judgment that its disposition was commercially reasonable.

In the *Williams* case discussed above, the court ruled that the secured party did not act in a commercially unreasonable manner by failing to recondition two of the trucks and selling them for salvage.¹⁸⁸ The trucks had been inspected by an independent appraisal service and the estimated costs of reconditioning were higher than their reconditioned value. Although the salvage buyer later offered the trucks for sale at a significantly higher price, that was only an asking price, not evidence of current value, and there was no evidence of the amount spent on reconditioning.¹⁸⁹ The court also ruled that secured party acted in a commercially reasonable manner in selling for \$69,010 another truck with an estimated wholesale value of \$80,850.¹⁹⁰ The fact that the value of the collateral exceeded the disposition price was insufficient to establish that the disposition was commercially unreasonable and although the sale might have yielded a higher price if the secured party had first reconditioned the truck, the value took its lack of reconditioning into account.¹⁹¹

180. *Id.* (citing U.C.C. § 9-611(d)).

181. No. 1:17CV104-LG-RHW, 2017 WL 4708136 (S.D. Miss. Oct. 18, 2017).

182. *Id.* at *5.

183. *Id.*

184. U.C.C. § 9-610(a) (2013).

185. *See id.* § 9-610(b).

186. *Id.*

187. *Id.* § 9-626(a)(1), (2).

188. *Williamson*, 2017 WL 4708136, at *5–6.

189. *Id.* at *6–7.

190. *Id.* at *7.

191. *Id.*

In *Bank Leumi USA v. GM Diamonds, Inc.*,¹⁹² a secured party presented prima facie evidence that it disposed of collateralized diamonds in a commercially reasonable manner by showing that, prior to putting the goods up for auction, it had at least two experts appraise the value of the diamonds, it reached out to four potential bidders, three of which submitted bids, and it accepted the highest bid, which was reasonably close to the appraised value.¹⁹³ The court ruled that the debtor did not rebut that evidence merely alleging that: (i) the secured party unreasonably rejected a better offer made to the debtor for only a portion of the diamonds before the secured party took possession of the collateral; or (ii) the diamonds had a book value over twice as high as the accepted offer.¹⁹⁴

In *BMO Harris Bank v. Custom Diesel Express, Inc.*,¹⁹⁵ the court ruled that the debtor did not place in issue the commercial reasonableness of the secured party's disposition of collateralized equipment by alleging that equipment sold was worth much more than the secured obligation.¹⁹⁶ Instead, summary judgment on the secured party's deficiency claim against the debtor and the guarantor was warranted because the secured party provided evidence that it: (i) evaluated each item of collateral independently to determine the best method to sell it; (ii) sold the equipment by unit, rather than in bulk, to maximize the sales price; (iii) advertised nationally, in print, digital, and other media for several months; (iv) invested resources to repair some items of collateral; (v) negotiated private sales for some items of collateral; and (vi) offered other items for public auction by a well-established industrial engineer who routinely buys and sells commercial vehicles through multiple selling platforms.¹⁹⁷

In another case from last year, *In re Comprehensive Power, Inc.*,¹⁹⁸ the secured party did not fare so well. The court ruled that the debtor's bankruptcy trustee pled sufficient facts to state a claim that a secured party's prepetition disposition of substantially all of the debtor's assets was not commercially reasonable.¹⁹⁹ The trustee had alleged that the secured party: (i) did not employ a process intended to generate a reasonable sale price and the price obtained was substantially less than assets' appraised value; (ii) conducted the auction sale as a formality to consolidate its control the debtor's assets; (iii) failed to market adequately the property; (iv) was the sole bidder at a sale conducted on only fourteen days' notice, so that other potential purchasers were effectively prevented from participating; and (v) without providing the debtor with the expected six-month period to obtain alternative financing.²⁰⁰

192. 149 A.D. 3d 662 (N.Y. App. Div. 2017).

193. *Id.* at 662.

194. *Id.* at 662–63.

195. No. 2:16-cv-60, 2017 WL 1367205 (E.D. Tenn. Apr. 12, 2017).

196. *Id.* at *2.

197. *Id.* at *3.

198. 578 B.R. 14 (Bankr. D. Mass. 2017).

199. *Id.* at 42.

200. *Id.* at 40–42.

Section 9-610(c)²⁰¹ provides that a secured party may purchase the collateral at a public sale or, if the collateral is of a type customarily sold on a recognized market, at a private sale. In *Bruce v. Cauthen*,²⁰² a limited partner who had a security interest in another partner's partnership interest purchased that interest at a private sale. The secured party argued that because the partnership agreement expressly acknowledged that a public sale might be impossible due to securities laws, the partnership agreement had modified the rule in section 9-610(c) that prohibits a secured party from buying at most private sales.²⁰³ The court rejected this argument after noting that the agreement did not include express language either modifying section 9-610(c) or permitting the secured party to acquire the partnership interest at a private sale.²⁰⁴

C. COLLECTING ON COLLATERAL

Upon default, or when the debtor agrees otherwise, a secured party may instruct account debtors to make payment directly to the secured party.²⁰⁵ After receipt of such an instruction, along with proof of the secured party's security interest, if requested and not previously provided, an account debtor may discharge its obligation only by paying the secured party; payment to the debtor will not discharge the obligation.²⁰⁶

In *Durham Commercial Capital Corp. v. Ocwen Loan Servicing, LLC*,²⁰⁷ a factor that had purchased the accounts of a law firm sent to one of the firm's clients a letter that indicated that the firm's accounts receivable had been assigned to the factor and instructed the client to pay the factor. When the client did not pay, the factor sued. The court ruled that the letter was an effective instruction to pay the factor even though it the letter did not identify the underlying transactions giving rise to the client's obligation to the firm.²⁰⁸ The court also ruled that even if the law firm violated the rules of professional conduct by giving the factor access to confidential files, and even if that formed the basis for a claim of malpractice against the firm, the factoring agreement was enforceable.²⁰⁹ However, there were unresolved issues regarding the client's defenses and setoff rights that prohibited summary judgment on the factor's claim against the client.²¹⁰

In general, an account debtor or other person obligated on collateral may assert against a secured party any defense or claim in recoupment arising from the same transaction that gave rise to the collateralize obligation, as well as any other

201. U.C.C. § 9-610(c) (2013).

202. 515 S.W.3d 495 (Tex. App. 2017).

203. *Id.* at 503; see also U.C.C. § 1-302 (2011) (not including § 9-610(c) in the list of provisions that cannot be modified by agreement); U.C.C. § 9-610 (2013).

204. *Bruce*, 515 S.W.3d at 505. Even if the agreement had included that language, it may have been unenforceable. U.C.C. § 9-624 cmt. 2 (2013).

205. See *id.* § 9-607(a)(1).

206. See *id.* § 9-406(a), (c).

207. No. 15-80200-CIV-MARRA/MATTHEWMAN, 2017 WL 1196574 (S.D. Fla. Mar. 31, 2017).

208. *Id.* at *3-4.

209. *Id.* at *5.

210. *Id.*

defense or claim against the debtor that arose before the account debtor received notification of grant of the security interest to the secured party.²¹¹ However, these rights can be waived by agreement.²¹² In one very interesting case from last year, *Blue Ridge Bank, Inc. v. City of Fairmont*,²¹³ the secured party thought such rights had been waived, but the court ruled otherwise.

The case involved a finance lease of water filtration equipment to a city. The lessor assigned the lease to a secured party before acquiring the equipment. In fact, the lessor never paid the supplier for the equipment, so the city paid the supplier directly, thereby acquiring a defense to payment against any effort by the secured party. Nevertheless, the secured party sought payment from the city. In doing so, the secured party relied on the lease's hell-or-high-water clause, which stated that "[t]he obligation of [the City] to make Rental Payments or any other payments required hereunder shall be absolute and unconditional in all events."²¹⁴ The secured party also relied on U.C.C. section 2A-407(1), which provides that "[i]n the case of a finance lease that is not a consumer lease the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods."²¹⁵ The court ruled, however, that both the hell-or-high-water clause and section 2A-407 apply only after the finance lessee accepts the goods.²¹⁶ In this case, the city accepted the goods not under the lease, but under its own purchase contract with the supplier.²¹⁷ Consequently, the city's defenses to payment were good against the secured party.²¹⁸

D. OTHER ENFORCEMENT ISSUES

In general, if a secured party fails to prove that it complied with Part 6 of Article 9 when enforcing its security interest, the secured party is presumptively not entitled to collect any resulting deficiency from the debtor or a secondary obligor.²¹⁹ This presumption is rebuttable, however. In *Regions Bank v. Thomas*,²²⁰ the secured party failed to provide guarantors with the required notification of its disposition of the collateral. However, the secured party rebutted the resulting presumption that no deficiency was owing, and created an issue of fact, by submitting evidence that the disposition proceeds exceeded the fair market value of the collateral.²²¹ Nevertheless, the court ruled that because the secured party had the burden of proof on the amount of the deficiency

211. See U.C.C. § 9-404(a) (2013).

212. See *id.*

213. 807 S.E.2d 794 (W. Va. 2017).

214. *Id.* at 800.

215. *Id.* (citing U.C.C. § 2A-407).

216. *Id.* at 800-01.

217. *Id.* The court did not seem to distinguish between the hell-or-high-water clause and section 2A-407(1), and did not discuss the fact that former, unlike the latter, did not reference acceptance of the goods.

218. *Id.* at 801.

219. See U.C.C. § 9-626(a)(3), (4) (2013).

220. 532 S.W.3d 330 (Tenn. 2017).

221. *Id.* at 351.

still owing, the lower court should have allowed the guarantors to submit evidence that, with notification, they had the ability and motivation to satisfy the secured obligation.²²²

A secured party's disposition of collateral after default transfers to a transferee for value all of the debtor's rights in the collateral.²²³ This is true even if the secured party fails to comply with Article 9 when conducting the disposition, provided the transferee acts in good faith.²²⁴ One court last year appears to have overlooked this rule when concluding that, because the evidence was insufficient to determine whether the foreclosing secured party sent the required notification of its disposition to the debtor's other secured creditors, summary judgment would be denied on whether the buyer of the debtor's trademarks at the sale acquired rights in the trademarks.²²⁵

After default, a secured party may repossess collateral without judicial process provided it does so without causing a breach of the peace.²²⁶ 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.²²⁷ A secured party may, however, keep the issue of what liability it has for a repossession agent's actions away from a jury by including an arbitration clause in the security agreement with the debtor. In one case last year, the secured party was only party successful in that endeavor.

In *Santander Consumer USA, Inc. v. Mata*,²²⁸ a secured party was sued by the debtor for actions relating to a repossession, and moved to compel arbitration pursuant to a clause in the security agreement. The court granted the motion, but refused to compel the repossession agent hired by the secured party, or the agent's subcontractors, to arbitrate the secured party's claims against them for indemnification and contribution.²²⁹ The secured party's agreement with the repossession agent neither contained an arbitration clause nor incorporated by reference the terms of the security agreement.²³⁰

VI. LIABILITY ISSUES

There were several interesting cases last year about liability in connection with a secured transaction.

222. *Id.* at 351–52. The court also ruled that the guarantors lack standing to seek recovery of a surplus, even if a proper disposition would have yielded a surplus. *Id.* at 355.

223. See U.C.C. § 9-617(a)(1) (2013).

224. *Id.* § 9-617(b).

225. See *United Tactical Sys., LLC v. Real Action Paintball, Inc.*, No. 14-cv-04050-MEJ, 2017 WL 713135, at *19 (N.D. Cal. Feb. 23, 2017).

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

227. *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) (West, Westlaw through ch. 2 of 2015 Reg. Sess.).

228. No. 03-14-00782-CV, 2017 WL 1208767 (Tex. App. Mar. 29, 2017).

229. *Id.* at *4.

230. *Id.* For further discussion of this case and how transactional lawyers might respond to it, see Jaxon C. Munns, *Binding All Relevant Parties to an Agreement to Arbitrate*, 8 TRANSACTIONAL LAW. 1 (Feb. 2018).

A buyer of collateral at an Article 9 disposition acquires the debtor's rights in the collateral²³¹ but does not normally assume responsibility for the debtor's obligations. However, the fact that the collateral is sold through an Article 9 disposition does not insulate the buyer from the principles of successor liability.²³² There were three notable cases last year on a foreclosure sale buyer's successor liability.

In *In re Comprehensive Power, Inc.*,²³³ a bankruptcy trustee for the debtor stated a claim under both the *de facto* merger and alter ego theories of successor liability against the secured party that purchased the debtor's assets at a public disposition pursuant to a "loan to own" strategy and then hired many of the debtor's employees to engage in the same business, even though there was no continuity of ownership.²³⁴

In contrast, in *US Herbs, Inc. v. Riverside Partners, LLC*,²³⁵ the court ruled that the entity that purchased the assets of the debtor from the debtor and its secured creditors—in lieu of a private foreclosure sale—was not liable to an existing creditor of the debtor because: (i) the buyer expressly disclaimed liability in the purchase agreement; (ii) there was no *de facto* merger because the debtor did not immediately or rapidly dissolve; and (iii) and the buyer was not a mere continuation of the debtor because there was no continuity of ownership.²³⁶ Similarly, in *Wass v. County of Nassau*,²³⁷ an individual injured by an allegedly defective ladder brought a products liability claim against the corporation that bought the assets of the manufacturer from the Small Business Administration ("SBA"), after the SBA had acquired the assets in a foreclosure of its security interest in them. The court held that the "mere continuation" doctrine of successor liability did not apply because, even though the corporation employed some of the people who had worked for the manufacturer, there was no sale between manufacturer and the corporation, no continuity of ownership or control, and no corporate reorganization.²³⁸

There were several cases last year involving the liability of a law firm in connection with its handling of a secured transaction. In *Oakland Police & Fire Re-*

231. See U.C.C. § 9-617(a)(1) (2013).

232. See, e.g., *Call Center Techs., Inc. v. Grand Adventures Tour & Travel Pub. Corp.*, 635 F.3d 48 (2d Cir. 2011); *Elvis Presley Enters., Inc. v. Passport Video*, 334 F. App'x 810 (9th Cir. 2009); *Murphy v. Blackjet, Inc.*, No. 13-80280-CIV-HURLEY, 2016 WL 3017224 (S.D. Fla. May 26, 2016); *Sourcing Mgmt., Inc. v. Simclar, Inc.*, 118 F. Supp. 3d 899 (N.D. Tex. 2015); *Opportunity Fund, LLC v. Savana, Inc.*, No. 2:11-CV-528, 2014 WL 4079974 (S.D. Ohio Aug. 19, 2014); *Ortiz v. Green Bull, Inc.*, No. 10-CV-3747 (ADS) (ETB), 2011 WL 5554522 (E.D.N.Y. Nov. 14, 2011); *Perception, Inc. v. Silicon Video, Inc.*, No. 5:06-CV-0412 (GTS/DEP), 2010 WL 3463098 (N.D.N.Y. Aug. 27, 2010); *Miller v. Forge Mench P'ship Ltd.*, No. 00 Civ. 4314 (MBM), 2005 WL 267551 (S.D.N.Y. Feb. 2, 2005); *Milliken & Co. v. Duro Textiles, LLC*, 887 N.E.2d 244 (Mass. 2008); *Cont'l Ins. Co. v. Schneider, Inc.*, 873 A.2d 1286 (Pa. 2005).

233. 578 B.R. 14 (Bankr. D. Mass. 2017).

234. *Id.* at 35–37.

235. No. 1:15 CV 2557, 2017 WL 238446 (N.D. Ohio Jan. 19, 2017).

236. *Id.* at *5–7.

237. 153 A.D. 3d 887 (N.Y. Sup. Ct. 2017).

238. *Id.* at 887–88.

tirement System v. Mayer Brown, LLP,²³⁹ a law firm representing the debtor had provided transaction documents to counsel for the creditors' agent, resulting in the filing of termination statements for a \$1.5 billion term loan that was not paid off. The court held that the firm had no liability to the creditors because the firm owed no duty to the creditors.²⁴⁰ It did not matter that the firm represented the agent in unrelated matters or that it had prepared the documents.²⁴¹ In *GemCap Lending, LLC v. Quarles & Brady, LLP*,²⁴² the court ruled that a secured party did not have a cause of action against the debtor's counsel for professional malpractice in connection with an opinion letter that counsel issued because, even though the opinion stated that the "Loan and Security Agreement" created a valid security interest in favor of the secured party in the debtor's rights in the "collateral," and some of the intended collateral was in fact owned by a related entity, the opinion letter defined "collateral" to be the debtor's property and, thus, was not incorrect.²⁴³

The law firm in *DLA Piper LLP (US) v. Linegar*²⁴⁴ did not fare as well. The firm had represented the surviving company in a merger, in connection with which the company received a bridge loan from an entity controlled by one of the company's principal owners. The firm was liable for damages resulting from the failure to perfect the security interest that secured the loan because, even though the firm did not represent the secured party or the principal owner, a member of the firm had told the principal owner that the security interest was not at risk and that "everything would be taken care of," and failed to make clear who the firm represented.²⁴⁵

One final case of note from last year is *Edwards Family Partnership, L.P. v. BancorpSouth Bank*,²⁴⁶ in which the assignee of a secured party that had a control agreement with a bank brought a claim against the bank for allegedly permitting the debtor to make thirteen transfers from the blocked account to accounts other than the one to which the control agreement permitted transfer. The court ruled for the bank.²⁴⁷ It concluded that even if the assignee could enforce the control agreement, the assignee, through its course of conduct, had waived that restriction in the control agreement because the assignee was aware of numerous transfers to other accounts—including some of its own accounts—yet did not complain and instead relied on the debtor to replenish the blocked account.²⁴⁸

239. 861 F.3d 644 (7th Cir. 2017).

240. *Id.* at 655.

241. *Id.*

242. 269 F. Supp. 3d 1007 (C.D. Cal. 2017).

243. *Id.* at 1033–34. An appeal was filed with the Ninth Circuit on October 6, 2017.

244. 539 S.W.3d 512 (Tex. App. Dec. 21, 2017).

245. *Id.* at *5.

246. 236 F. Supp. 3d 964 (S.D. Miss.), *aff'd*, No. 17-60182, 2017 WL 4641274 (5th Cir. Oct. 16, 2017).

247. *Id.* at 974.

248. *Id.* at 973.