SECURED CREDITORS BEWARE OF YOUR DESCRIPTIONS, NOMENCLATURE AND TERMINATIONS

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Secured creditors can learn a great deal from a few recent bankruptcy cases involving the Uniform Commercial Code that remind us that the "devil is in the details." These cases show that it is unrealistic to expect forgiveness by a court after a misstep involving Article 9 of the Uniform Commercial Code (UCC). Once a debtor files bankruptcy, Bankruptcy Code Section 544(a), also known as the "strong arm clause," provides the trustee or the debtor the rights of a creditor with a judicial lien on the property of the debtor as of the date of the bankruptcy petition. *See*, Legislative History, Section544(a).

The consequences of failing to be properly perfected can mean that the trustee or debtor in a bankruptcy case can convert the incorrectly perfected secured claim into a general unsecured claim. Knowing and abiding by the precise terms of Article 9 in your jurisdiction can make a huge difference in the treatment of a claim in a bankruptcy case.

Did You Adequately Describe All the Collateral?

As one bank learned recently, it is a huge mistake to diligently describe your collateral in your security agreement, leave that detailed description out of your financing statement, and then fail to attach the security agreement containing the description to your filed UCC-1.

In *First Midwest Bank v. Reinbold (In Re: 180 Equip., LLC*), 2018 Bankr. LEXIS 2482, (Bankr.

C.D. Ill., Aug. 18, 2018), Midwest Bank made a pre-petition commercial loan to 180 Equipment, LLC and then filed a financing statement that contained no description of the collateral. The underlying security agreement between the bank and 180 Equipment, which refurbished bucket trucks, granted a security interest to the bank in 26 specifically identified categories of collateral. The collateral included accounts, chattel paper, equipment, general intangibles, goods, instruments and intangibles and all products and proceeds therefrom. 180 Equipment owned no real estate, so the security interest covered substantially all its assets.

180 Equipment later filed a bankruptcy case and litigation was commenced by the bank against the trustee seeking a declaratory judgment that its security interest in its collateral was properly perfected. The trustee denied that the bank was properly perfected and counterclaimed, asserting that she could avoid the interests in debtor's property that are unperfected using her strong arm powers under Section 544(a).

The court determined that under Revised Article 9, the issue of whether and in what manner collateral must be described in a financing statement is governed by UCC Sections 9-502, 9-504 and 9-108. UCC Section 9-502(a), which sets forth that "the mandatory requirements for the information that must be included in a financing statement, provides that the contents of the financing statement are sufficient only if it: (1) provides the name of the debtor; (2) provides the name of the secured party or a representative of the secured party; and (3) *indicates the collateral covered by the financing statement*." (Emphasis supplied).

In this case, the issue was whether the third prong of 9-502 (a) was satisfied. Stated another way, did the collateral description sufficiently "indicate the collateral" purportedly covered by the financing statement.

UCC Section 9-504 provides that a financing statement sufficiently indicates the collateral it covers if the financing statement provides: "(1) *a description of the collateral pursuant to Section 9-108*; or (2) an indication that the financing statement covers all assets or all personal property." (Emphasis supplied).

UCC Section 9-108, which governs the sufficiency of description of the collateral for both security agreements and financing statements, provides a non-exclusive list of ways to reasonably identify collateral such as: by category of the asset; a type of collateral defined in the UCC; a quantification of the collateral; a computational or allocation formula or procedure for determining a description of the collateral; or "any other method, if the identity of the collateral is objectively determinable."

The bank contended that its financing statement was sufficient under Section 9-108(b)(6) as an "other method" of reasonably identifying its collateral, asserting that the identity of its collateral was "objectively determinable by an examination of the amended security agreement, identified by its date."

The bankruptcy court determined that it could not simply incorporate the description in the unfiled security agreement. While the language of the financing statement may have raised a duty to inquire into the collateral description in the security agreement, the court felt that it left too many issues unresolved. For instance, the unfiled security agreement could have been changed by the parties and the financing statement may have directed a third party to the wrong instrument.

The lesson learned here is that it would be best to describe the collateral in your financing statement filed pursuant to the UCC, or at a minimum, attach the collateral description in the security agreement.

Did You Properly Refer a Third Party to Another Instrument?

In another recent case, the court handling the "debt adjustment" cases of Puerto Rico found that the original financing statements filed by the entities holding bonds issued by the Employees Retirement System of the Government of Puerto Rico (ERS) did not contain a sufficient collateral description and thus failed to perfect the bondholders' security interest when filed. In *In re: The Financial Oversight and Management Board for Puerto Rico (The Financial Oversight and Management Board for Puerto Rico vs. Altair Global Credit Opportunities Fund (a), LLC etal)*, 2018 WL 3968285 (D. Puerto Rico Aug. 17, 2018), the Financial Oversight and Management Board for Puerto filed an adversary complaint against entities holding bonds seeking, among other things, declarations concerning the scope, validity and perfection of bondholder's asserted security interest in various assets pledged by the ERS through a resolution enacted by the Pension Funding Board (the Resolution). The bondholders filed counterclaims seeking declaratory relief and the parties filed cross-motions for summary judgment.

A Resolution detailed the collateral, but the June 2008 security agreement pledging this collateral only granted a security interest in "Pledged Property" as described in the Resolution. The Pledged Property was not described with particularity in the security agreement. The filed financing statements merely described the collateral as '[t]he pledged property described in the security agreement attached as Exhibit A hereto and by reference made part hereof." Later, amended financing statements were filed, but the same basic description persisted in all amendments — Pledged Property as described in the Resolution. In addition, amended financing statements used another name for the debtor.

The court held that merely making reference to an unattached document (the Resolution) that was not publicly available in the office of the official that maintains UCC records was not sufficient to perfect a security interest. The court determined that the financing statements did not contain a sufficient collateral description because it did nothing to identify the collateral beyond simply indicating that some collateral existed.

Further, the amended financing failed to perfect the bondholders' security interest when they were filed because they failed to reference the debtor' official name.

The lesson learned here is that one can never be too detailed in securing a debt obligation. The courts will carefully scrutinize any transaction that refers to another document to make sure that one can draw a direct line between the financing statement and the instruments describing the collateral. Of course, it's simply better to make sure your description is in the office where the financing statement is filed. As an aside, the district court's opinion is on appeal in the First Circuit. There may be more to come.

Was the Correct Name of the Debtor Written on the Financing Statement?

While it sounds simple enough to state a name correctly on a financing statement, recent case law suggests otherwise. In *Pierce v. Farm Bureau Bank (In Re: Pierce)*, 581 B.R. 912 (Bankr.S.D. Ga. 2018), the Bankruptcy Court for the Southern District of Georgia determined that a financing statement filed by Farm Bureau Bank was seriously misleading for failure to correctly state the debtor's name.

The bank entered into a security agreement with Kenneth R. Pierce to finance his purchase of a fertilizer spreader for his farm. It filed a UCC-1 and wrote the debtor's name on the financing statement as "Kenneth Pierce." Thereafter Mr. Pierce filed a Chapter 12 bankruptcy case and the bank timely filed a secured proof of claim attaching its financing statement. Mr. Pierce objected to the bank's claim contending that it failed to correctly identify him as "Kenneth Ray Pierce" on its financing statement so its security interest was unperfected.

Georgia statute UCC Section 9-502(a) provides the name of an individual must be as indicated on the debtor's driver's license to perfect a financing statement. UCC Section 9-503(g) provides that if more than one license was issued, the creditor should use the most recent one. In this case, the latest license described the debtor as Kenneth Ray Pierce. The court determined that just because Debtor signed Kenneth Pierce did not matter. The court also ruled that the Chapter 12 Debtor had the ability, as did the Trustee, to avoid an imperfectly perfected *i.e.* unperfected lien. Lesson learned here – use the name on the debtor's driver's license. It's not that difficult to obtain.

Did You Actually Just File a Termination Statement and Think You Could Correct That?

The undisputed facts in *Crop Production Services, Inc. v. Wheeler (In re Wheeler)*, 580 B.R. 719 (Bankr. W.D. Kentucky 2017), show that the debtor, Mr. Wheeler, was engaged in farming until the end of the 2015 crop year. He obtained various loans and to secure repayment on such loans, granting creditors liens against his crops and other farming related collateral. Wheeler obtained such a loan from Farmers Bank & Trust (FBT) and granted FBT a lien in July 19, 2005 against "all crops growing or to be grown in fields or produce thereof." FBT perfected its lien by filing a UCC-1 financing statement with the Kentucky Secretary of State, and filed a timely continuation of its UCC-1 on May 7, 2015 extending its lien for five years (presumably it had initially extended it in 2010, but the opinion does not mention that).

On July 10, 2015, FBT filed a termination statement regarding its lien on Debtor's collateral, and ten minutes later filed an amendment to add itself as a secured party on the financing statement it had terminated. Nine months later, FBT filed a UCC-5 Correction Statement asserting that the termination was accidental. Meanwhile, on or about March 3, 2011, Wheeler formed K&D Farms, LLC, which entered a security agreement with FBT on March 29, 2012. That agreement purported to provide FBT with an interest in "all crops growing or to be grown, stored grains wherever located, crop insurance proceeds and

certain government payments, all equipment now owner or hereafter acquired, all livestock and offspring now owned or hereafter acquired."

In addition to the obligation to FBT, Wheeler received a credit limit of $600,000 from Crop Production Services, Inc. (CPS). On May 20, 2011, CPS filed a financing statement perfecting its lien on "all crops growing or to be grown, inventory, and proceeds thereof. CPS timely filed a continuation of its lien on May 17, 2017 continuing its lien for five years. CPS did not receive payment and filed an action in state court in Kentucky against Wheeler. It was proceeding with discovery when the Wheeler filed a Chapter 7 bankruptcy case. On Nov. 4, 2016 FBT filed a secured claim for $146,793.11 and on Nov. 7, 2016, CPS file a secured claim for $333,757.73. Both claims asserted secured status based on financing statements listing collateral as crops growing or to be grown.

CPS filed an adversary action against FBT to avoid the competing lien that FBT might have had on the crops and to recover payments made by the Wheeler to FBT. Pursuant to Kentucky's version of the UCC, Section 9-203 provides "A security interest attaches to collateral when it becomes enforceable against the debtor with respect to collateral." Moreover, the Kentucky UCC makes it clear that the only party authorized to file a termination statement is the secured party of record.

The court found that there was no dispute that FBT's 2005 lien was valid and properly perfected. When FBT filed its termination statement in July 2015, its 2005 lien became unperfected and the collateral was released. The court stated that it defied logic to say that FBT could add itself to a statement that was no longer effective, and quoted precedent from the Fourth Circuit Court of Appeals (*In re Kitchin Equipment Co. of Virginia, Inc.*, 960 F.2d 1242,1247 (4th Cir. 1992)) that a termination statements "effect on a security interest is dramatic and final." The Court determined that although the termination may have been inadvertent, FBT was the secured party of record authorizing the amendment and the fact that its loan processor was authorized to file was sufficient to bind FBT.

The lesson here is to never file a termination statement unless you are totally certain that it should be terminated and you are giving up your secured claim. You or your clients should have checks and balances in place to make sure that terminations are authorized and appropriate.