The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the decisions.

**Lyon Financial Services, Inc. v. Jude's Medical Center, Ltd.**

*2011 WL 6029195* (N.D. Ill. 2011)

This case highlights – or at least should have highlighted – some important differences between Articles 2A and 9.

Simplified slightly, the facts are as follows. Lyon Financial Services, Inc. leased two pieces of equipment to Jude’s Medical Center, Ltd. The leases required payments over sixty months, totaling $276,000 and $133,000, respectively. A few years later, Jude defaulted. Lyon repossessed the equipment and sold the items for $2,500 and $10,600. Lyon then pursued Jude’s CEO, Abboud, who had guaranteed the obligations under both leases.

Abboud defended on the basis that Lyon had not conducted the sales in a commercially reasonable manner, and claimed that factual issues about the commercial reasonableness of the sales were a basis for denying Lyon’s motion for summary judgment. Abboud also claimed that the leases had created security interests and were therefore governed by Article 9.

The court first dealt with whether the transactions were leases or sales with a retained security interest. Looking at the safe harbor in § 1-203(b), the court noted that the leases could not be terminated by the lessee but that no evidence was presented that any of the four characteristics identified in § 1-203(b) were present. Therefore, the court concluded, the transactions were true leases and Article 2A governed.

The court’s conclusion on this issue was probably correct but its analysis was flawed. If the safe harbor rule of § 1-203(b) is not met, the analysis is supposed to revert to subsection (a), which requires courts to examine all the facts and circumstances. *See, e.g., In re Pillowtex, Inc., 349 F.3d 711, 717-20 (3d Cir. 2003); In re Grubbs Construction Co., 319 B.R. 698 (Bankr. M.D. Fla. 2005); Coleman v. Daimlerchrysler Services of North America, LLC, 2005 WL 3031083 (Ga. Ct. App. 2005).* Under that analysis, the transaction might nevertheless be a sale with a retained security interest. For example, a lease with an option to buy at the end for non-nominal consideration might be a sale if the lessee’s only real economic choice was to exercise the option. This might be true if all of the lessee’s business equipment were subject to the lease and the lessee would have to find
alternative goods or go out of business if it failed to exercise the option. It might also be true if the costs incurred and damage likely to be caused in their removing and returning the goods were less than the option price.

Moving to the resales, the court first dealt with Abboud’s claim that he was not provided with adequate advance notification. On this point, the court observed that Abboud had failed to identify any requirement of notification after default under a lease, as opposed to a security agreement. Nevertheless, drawing from § 2-706, the court assumed that notification was required. In doing so, the court repeated the Minnesota Court of Appeals’ error in Deutz-Allis Credit Corp. v. Jensen, 458 N.W.2d 163, 166 (Minn. Ct. App. 1990), which it cited. The court then found that Lyon had given adequate notification. As to the commercial reasonableness of the sales, the court ruled that, given the low prices realized, this was a factual issue preventing summary judgment.

The court’s analysis on both notification and commercial reasonableness was flawed. Given the court’s conclusion that the transactions were leases, not sales with a retained security interest, Lyon was under no obligation to provide notification of the subsequent sales or to conduct the sales in a commercially reasonable manner. Nothing in Article 2A imposes these requirements and that omission is not an oversight. In fact, § 2A-502 states that, “[e]xcept as otherwise provided in this Article or the lease agreement, the lessor or lessee in default under the lease agreement is not entitled to notice of default or notice of enforcement from the other party to the lease agreement,” and its commentary makes it clear that this is a distinction between Articles 2A and 9. Furthermore, § 2A-527(2) includes a specific reference to “commercial reasonableness” in the context of disposition by a new lease agreement, but the portions of § 2A-527 relating to disposition by sale do not include such a reference, and none should be implied. That is because, unlike a seller’s right to resale damages under Article 2 or a secured party’s right to a deficiency under Article 9, a lessor’s damages are unaffected by the resale price. The lessor is instead entitled to: (i) the past rent due, plus; (ii) the present value of future rent for the remaining lease term minus the present value of market rent for the remaining lease term. §§ 2A-527(3), 2A-528(1). Had the court recognized and considered the irrelevance of the sale price to the measure of damages, it might have understood that notification and commercial reasonableness of the sale were not required, and granted Lyon’s motion for summary judgment.

Algonquin Power Income Fund v. Christine Falls of New York, Inc.,
2011 WL 6178802 (N.D.N.Y. 2011)

This case involves attachment of a security interest to a commercial tort claim and its proceeds. The court correctly analyzed the first issue, properly concluding that the security interest did not attach to the claim. However, the court grievously erred on the second issue when it ruled that the security interest did not attach to the proceeds of the claim.

In 1988, Trafalgar Power, Inc. and its affiliates (“Trafalgar”) acquired secured financing from Aetna Insurance Co., which later assigned its interest to Algonquin Power Income Fund (Algonquin”). The following year, Trafalgar sued the engineers that had designed some of
Trafalgar’s power plants for miscalculations that resulted in an estimate of energy production that was far larger than the completed power plants were able to attain. In 1999, a jury awarded Trafalgar $7.6 million on its claim. Trafalgar assigned its interest in the judgment to an affiliate and in 2000 Algonquin sued them both, claiming a prior security interest in the judgment. In 2001, the judgment was paid and put in escrow pending resolution of the dispute about which party was entitled to the funds. A few months later, Trafalgar filed for bankruptcy protection. The bankruptcy court ruled in favor of Trafalgar and Algonquin appealed.

The district court first concluded that a malpractice action was not assignable under Connecticut law. It also concluded that, even though the security agreement described the collateral to include “any interest in any kind of property or asset, whether real, personal or mixed, and whether tangible or intangible,” that language was insufficiently particular to include the malpractice claim. Both of these conclusions seem sound.

Although the court had no need to, and thus did not, examine revised Article 9, the result under current law would be no different. Revised Article 9 has two important limitations on the grant of a security interest in a commercial tort claim. First, the generic term “commercial tort claim” is not an adequate description, and the even more general language in Algonquin’s security agreement would similarly be inadequate. See § 9-108(e)(1); Beane v. Beane, 2011 WL 223167 (D.N.H. 2011) (generic references in the security agreement to “accounts and other rights to payment” and “payment intangibles” were insufficient to create a valid security interest in commercial tort claims); Conley v. Public Safety Group, Inc., 771 N.W.2d 653 (Iowa Ct. App. 2009) (generic reference in the security agreement to “proceeds from any lawsuit due or pending” was insufficient to create a valid security interest in commercial tort claims). Second, no security interest can attach to a commercial tort claim under an after-acquired property clause. See § 9-204(b)(2); In re American Cartage, Inc., 656 F.3d 82 (1st Cir. 2011); Waltrip v. Kimberlon, 79 Cal. Rptr. 3d 460 (Cal. Ct. App. 2008). For each of these reasons, Algonquin’s security interest would not attach to Trafalgar’s tort claim, which apparently arose after the security agreement was executed.

The court then turned to Algonquin’s argument that, even if its security interest did not attach to the malpractice claim, its security interest did attach when the claim was “transformed to a judgment, bond claim, contract claim, and interest in an escrow account,” types of collateral that its security agreement did cover. The court rejected this argument out of hand. Quoting the bankruptcy court, it stated that “[i]f the security agreement does not expressly grant a security interest in the underlying tort claim or its proceeds, no subsequent transformation will magically result in an automatic attachment of those proceeds.” It even repeated the reference to “magic,” as if Algonquin’s argument was somehow fanciful. But it was not Algonquin’s argument that was fanciful, it was the court’s understanding of secured transactions and Article 9.

Property transforms from one classification to another all the time. Thus, for example, a debtor may sell inventory to generate accounts. A security interest in the debtor’s existing and after-acquired accounts will not cover the inventory, but will attach automatically to any proceeds of inventory that fall under the definition of accounts. Similarly, a security interest in a bank account will extend to any funds subsequently deposited into the bank account, regardless of what kind of property the debtor liquidated to generate the funds. In other words, as the debtor’s property
transforms, it may shift from non-collateral to collateral. Even a simple change in use – such as when inventory is taken off the shelf and used as equipment – may cause a security interest to attach (or de-attach). It is not clear why the court had so much difficulty accepting this simple concept.

*In re Miller,*


This case shows why states need to enact the 2010 amendments to Article 9. Unfortunately, it does so at the expense of a secured party that quite arguably did nothing wrong.

The facts of the case are quite simple. The secured party filed a financing statement identifying one of the married debtors as “Bennie A. Miller.” This was the name the debtor had used much of his life and which appeared on his driver’s license, social security card, tax returns, and the deed to his residence. Seven months after the debtors filed a Chapter 13 bankruptcy petition, they sought to avoid the secured party’s lien. The bankruptcy court ruled for the debtors, concluding that the filing was ineffective to perfect because the debtor’s legal name was the name on his birth certificate, “Ben Miller,” and a search under that name did not reveal the filing. In making this ruling, the court rejected the argument that the debtor might have two acceptable names, such that a filing against either would be sufficient to perfect.

This is the only known decision to invalidate a filing that identified the debtor by the name used on the debtor’s driver’s license. Certainly numerous cases have refused to treat as effective a filing against the debtor’s nickname, but none of those cases involved a name that actually appeared on the debtor’s driver’s license. See *In re Larsen,* 2010 WL 909138 (Bankr. S.D. Iowa 2010) (“Mike D. Larsen” instead of “Michael D. Larsen”); *In re Jones,* 2006 WL 3590097 (Bankr. B. Kan. 2006) (“Chris Jones” instead “Christopher Gary Jones”); *In re Borden,* 353 B.R. 886 (Bankr. D. Neb. 2006) (“Mike Borden” instead of “Michael R. Borden”), aff’d, 2007 WL 2407032 (D. Neb. 2007); *In re Berry,* 2006 WL 2795507 (Bankr. D. Kan.), opinion supplemented, 2006 WL 3499682 (2006) (“Mike” instead of “Michael”); *In re Kinderknecht,* 308 B.R. 71 (10th Cir. BAP 2004) (“Terry J. Kinderknecht” instead of “Terrance Joseph Kinderknecht”). Indeed, in *Borden,* the court rejected the use of a nickname in part because that was not the name that appeared on his birth certificate, driver’s license, real estate deeds, bank accounts, tax returns, and bankruptcy petition. 353 B.R at 887.

The flaws in the *Miller* court’s analysis were twofold: (i) in requiring the debtor’s “legal” name on the financing statement; and (ii) even if the debtor’s legal name were necessary, equating the name on debtor’s birth certificate with the debtor’s legal name. Nowhere in its text or comments does Article 9 use the phrase “legal name.” Instead, § 9-502 requires the name of the debtor, § 9-503(a)(4)(A) supplements that marginally by indicating the name of an individual should be the “individual . . . name,” and § 9-506(c) indicates that if a search under the debtor’s “correct name” yields the filing, then the filing is not seriously misleading. In short, Article 9 requires the debtor’s correct individual name, not the debtor’s legal name. Even if the legal name were required, there is no reason to assume, as the court blithely did, that the birth certificate name is the legal name of an
adult who goes by something different. Although the *Kinderknecht, Borden,* and *Pankratz Implement* decisions, all of which the court cited, referred to the debtor’s “legal name,” none of those cases equated “legal name” with the name on the debtor’s birth certificate. In fact, none of these cases purported to define the term at all. In most states, an individual’s legal name can be anything the debtor regularly uses for non-fraudulent purposes. *See* Darrel Pierce, *The Revised Article 9 Filing System: Did It Meet Its Objectives?*, 44 U.C.C. L.J. 1, 12-13 (2011).

So, what is an individual debtor’s *correct* name? A strong argument can be made that, under current law, the debtor’s correct name is the name that the debtor uses and by which the debtor is generally known, particularly by creditors. *See Peoples Bank v. Bryan Brothers Cattle Co.*, 504 F.3d 549 (5th Cir. 2007) (“Louie Dickerson” instead of Brooks L. Dickerson” was effective because the debtor held himself out to the community as Louie Dickerson and frequently used his nickname in business affairs). *Cf. Barkley Clark & Barbara Clark, 1 The Law of Secured Transactions, ¶ 2.09[1][d] (3d ed. 2011)* (suggesting that in most cases the name on the debtor’s driver’s license, bankruptcy petition, or social security card is the best evidence of the debtor’s “legal” name and only in cases of conflict among those documents should the name on the debtor’s birth certificate be used). After all, the UCC is intended to facilitate commercial transactions, not frustrate them. *See* § 1-103(a). Given that few debtors carry around their birth certificate, it would be a hassle for secured parties to require that the debtor exhibit that document before completing a financing statement. Moreover, it is far easier for searchers to search under the name the debtor uses than by the name on a piece of paper that few ever see.

Admittedly, this standard lacks certainty and can be quite problematic when the debtor goes by more than one name. However, in *Miller*, the debtor was known by only one first name – “Bennie” – and that name appeared on his state-issued driver’s license and all his contemporary financials. Only his birth certificate, which was of course quite old in comparison, indicated a different first name. Therefore, “Bennie” was his correct name, even if not his legal name.

Fortunately, the 2010 amendments will add clarity on this point and change the result. Under either version of § 9-503 offered for states to enact – Alternative A or Alternative B – a filing that identifies an individual debtor by the name on the debtor’s driver’s license will be effective, provided the license is current and is issued by the state in which the debtor is located.


In this priority dispute between two secured parties, the court reached the correct result but its analysis was unnecessarily complicated. The case also illustrates a common practice that secured parties needlessly follow.

The facts of the case are essentially as follows. In 1997, 1999, and 2009, the debtor borrowed funds from Farm Service Agency (“FSA”). Each debt was secured by the debtor’s farming equipment. FSA filed a proper financing statement for each transaction, each time on the date the
loan was made or a few days before. It also filed timely continuation statements for the first financing statement. In 2011, the debtors paid off the first and second loans but they remained obligated on the third loan, for approximately $428,000.

In 2005, the debtors borrowed approximately $500,000 from Commercial Capital Bank ("CCB"). Fifteen months later, the debtors granted CCB a security interest in their equipment. CCB perfected that security interest by filing a proper financing statement. In 2011, CCB brought an action against FSA, raising numerous arguments why FSA’s perfection had lapsed.

The court ruled in favor of FSA. Citing § 9-322(a), it stated that priority between secured parties is based on “the date of perfection.” The court then concluded that, even though the debtors had paid off the first loan, because the security agreement for that transaction covered future advances, the security interest created in that transaction secured the third loan. Hence the date of FSA’s perfection for priority purposes was the date of the first loan.

The decision is correct but the fact that the security agreement covered future advances is immaterial. Priority among perfected secured parties is not, as the court indicated, based on the first to perfect, but the first to file or perfect, as long as there is no period thereafter when there is neither filing nor perfection. See § 9-322(a)(1). Thus, as long as the third loan was in fact secured – whether pursuant to a future-advances clause in one of the previous security agreements or pursuant to a new security agreement – priority would be based on the date of the first filing. Secured creditors such as FSA routinely file new financing statements for each transaction but, provided the financing statements cover the same collateral, there is no reason to do so. Financing statements identify the debtor, the collateral, and the secured party, not a particular loan or transaction. There is absolutely no need for a second, duplicative filing, provided the first is properly continued.


This decision should be very distressing for lenders with a security interest in accounts generated from trademarked goods.

The dispute in the case began with the sale of trademarked apparel by Prime Apparel, Inc. to one of its wholesale customers. Quick Response Marketing, Inc. ("QRMI") claimed that it owned the trademark and instructed the customer to make payment to QRMI. The customer brought an interpleader action seeking a ruling on who was entitled to the payment and it deposited $235,000 with the court. CIT Group Commercial Services, Inc. ("CIT") intervened, claiming a perfected security interest in Prime’s accounts and entitlement to the funds.

The trial court ruled for QRMI and CIT appealed. CIT argued that even if Prime had violated QRMI’s trademark rights, QRMI had merely an unsecured claim for infringement, which would be subordinate to CIT’s security interest in the account. In a very brief opinion, the appellate court affirmed. Its entire analysis consisted of the following syllogism:
Prime’s violation of QRMI’s trademark meant that Prime had no right to the goods sold, nor any money generated from the sale of those goods. Prime therefore had no right in the account receivable to pass on to CIT. Thus, CIT had no security interest in the interpleader funds.

This analysis is simply wrong. The Lanham Act makes a trademark violator liable to the trademark owner, see 15 U.S.C. § 1125(a), but does not make all proceeds of the trademarked goods the property of the trademark owner. Nor should it, given that the damages for the trademark violation may have little relationship to the total sales price of the goods. Moreover, nothing in the Lanham Act imposes a constructive trust on all proceeds received for the trademarked goods. While a constructive trust might be an equitable remedy available to the trademark owner in some instances, it is a remedy that does not normally override the property rights of a third party. In other words, while a constructive trust can be used to obtain priority over unsecured creditors, it does not allow for priority over secured creditors. See Restatement (Third) of the Restitution and Unjust Enrichment § 55 cmt. d (2011).

This unfortunate decision puts a wrinkle in accounts financing that cannot readily be smoothed over. The court ruled that the debtor lacked property rights in the infringing goods and their proceeds, and there is nothing that a lender could put in the security agreement to alter that conclusion. So, if this decision holds up, accounts financiers will need to include trademark issues in their due diligence.

Of course, accounts financiers should probably already be concerned about the debtor’s trademark infringement. After all, a trademark owner might have the right to impound the goods, particularly if the infringer’s buyer intends to resell them. This would prevent new accounts from being generated. Moreover, a debtor who sold infringing goods that the buyer could not resell would no doubt be violating the warranty of title. See § 2-312(3). In such a case, the buyer would have a defense to payment of the purchase price, see § 9-404(a)(1), rendering the account rather poor collateral.

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