SPOTLIGHT

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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.

In re WEB2B Payment Solutions, Inc., 488 B.R. 387 (B.A.P. 8th Cir. 2013)

In 2011, the spring and winter editions of this column sharply criticized two Bankruptcy Appellate Panel decisions – In re Ruiz, 455 B.R. 745 (B.A.P. 10th Cir. 2011), and In re Mwangi, 432 B.R. 812 (B.A.P. 9th Cir. 2010) – for treating a bank account as “funds” or “money” rather than what it is: a loan from the depositor to the bank. Unfortunately, yet another Bankruptcy Appellate Panel has fallen into that abyss.

The case involved a debtor that provided check clearing and payment processing services to its clients. The debtor in turn maintained a deposit account with North American Banking Company (the “Bank”). The debtor’s contract with the Bank authorized the Bank to charge back items that failed to clear or were fraudulent and expressly granted the Bank both a security interest in the deposit account and the right to set off any of the debtor’s obligations to the Bank against amounts the Bank owed to the debtor on the deposit account. When the debtor filed for bankruptcy, the Bank froze the deposit account, which then had a credit balance of $933,000. The trustee requested that the Bank turn over the funds and the Bank, with the trustee’s permission, held back $50,000 to cover future chargebacks. The Bank did not otherwise seek adequate protection.

Unfortunately for the Bank, the holdback proved woefully inadequate, as the Bank later had to pay more than $500,000 for items that did not clear or were fraudulent. So, nine months after it paid the trustee, the Bank sought return of the funds. The trustee resisted and the bankruptcy court ruled that the Bank had: (i) lost its contractual right to setoff when it turned the money over, since there were no longer any funds in its possession to set off; and (ii) lost its “possessory lien” in the funds turned over to the trustee because the Bank failed to obtain a court order granting adequate protection of its possessory lien. The Bank appealed the second ruling.

The Bankruptcy Appellate Panel affirmed. The court began its analysis by stating that “it is undisputed that [the Bank] had a contractual security interest in the account funds and that the
security interest was perfected by possession as of the petition date.” The court then ruled that this possessory lien was “by definition,” released when the Bank relinquished possession of the collateral. Finally, the court rejected the Bank’s argument that it maintained an interest in the proceeds of the deposit account, and thus had not needed an adequate protection order by perfunctorily stating: “[t]he funds at issue here are not proceeds.”

The court’s conclusion might well be correct but its analysis bordered on utter nonsense. The Bank did not have a possessory lien because a deposit account is not something that can be possessed: it is an intangible asset. Indeed, to support its statement that the bank’s security interest was perfected by “possession,” the court itself cited to Article 9’s rules on “control.” It is hard to understand how a court can cite to the relevant provisions and yet so mischaracterize what they say.

In essence, the court treated the deposit account as money and the Bank’s security interest as one for which possession was a necessary. As a result, the court did not clearly distinguish between loss of perfection and loss of attachment and gave inadequate consideration to the Bank’s argument that it maintained a security interest in the funds turned over to the trustee as proceeds of the deposit account.

A more thorough analysis would proceed as follows. Upon the filing of the bankruptcy petition the debtor’s deposit account became property of the estate and upon, appointment of the bankruptcy trustee, the trustee became the owner of the deposit account. In the language of Article 9, therefore, the trustee became the “debtor.” See § 9-102(a)(28). When the Bank responded to the trustee’s turnover demand by paying the trustee, presumably by check deposited at or funds wire transferred to another bank, the trustee’s resulting deposit account at that other bank was presumptively proceeds of the Bank’s original collateral. See § 9-332 cmt. 2, ex. 2. Moreover, the Bank’s security interest in that new deposit account would, despite the absence of control, remain perfected under § 9-315(d)(2). The only way around this analysis is if, by remitting payment to the trustee, the Bank had waived its security interest. Given the Bank’s request for a $50,000 holdback, it is entirely plausible that the Bank did waive its security interest in the portion turned over.


This is a fairly simple case about enforcement of a security interest. The court reached the correct result but for the wrong reason.

After the FDIC took over the Community Bank of Nevada, the FDIC sought to collect on a $250,000 secured loan the bank had made to Moore Pharmaceuticals. After selling some of the collateral for its appraised value of $500, the FDIC abandoned the remainder of the collateral, concluding that the cost of removing and transporting it would exceed the likely sale price. The FDIC then brought an action for the deficiency against the borrower and its owner who had guaranteed the debt.
The defendant’s challenged the commercial reasonableness of the FDIC’s actions, claiming that the cost of the collateral was $54,000 and criticizing the FDIC for its failure to adequately market or advertise the property and failure to conduct an auction sale. The court rejected these arguments in a single paragraph. Noting that the only credible evidence of the collateral’s value was an independent appraisal valuing it at $2,000 to $5,500, the court deemed reasonable the FDIC’s conclusion that the cost of selling the remaining collateral would exceed the proceeds from such a sale.

The court’s conclusion and ruling were undoubtedly correct. However, it was a mistake to subject the FDIC decision not to sell most of the collateral to the requirement of commercial reasonableness. Article 9 mandates that every aspect of a disposition of collateral be commercially reasonable. § 9-610(b). But that requirement applies only to an actual disposition. The secured party remains free to bring an action on the debt and reduce its claim to judgment without having proceeded against the collateral. See § 9-601(a); see also, e.g., General Electric Capital Corp. v. John Carlo, Inc., 2010 WL 3937313 (E.D. Mich. 2010); In re King, 2010 WL 4290527 (Bankr. N.D.N.Y. 2010). Thus, the commercial reasonableness of the FDIC’s decision to abandon most of the collateral was irrelevant. While abandonment of collateral might, absent an effective waiver of suretyship defenses, release a guarantor or other secondary obligor, see Restatement (Third) of Suretyship and Guaranty § 42, it has no bearing on the liability of the debtor or other principal obligor.


This case is a fairly simple one about a potato supplier’s claim against a wholesaler for interest on overdue payments and attorney’s fees incurred in collecting such payments. Each of the transactions proceeded as follows. First, the wholesaler sent the supplier a purchase order describing the item it sought to purchase, the quantity it needed, the rate it was willing to pay, and the place of delivery. If the supplier chose to fill the order, the supplier responded by sending a message via email that confirmed the product to be shipped, the price, and the shipping terms. After the wholesaler agreed to these terms, the supplier shipped the produce pursuant to the delivery schedule stated in the purchase order and confirmed in the email message. Immediately afterwards, the supplier sent an invoice listing the quantity and description of the produce shipped, the price, the delivery location and date, and a provision regarding interest and attorney’s fees.

After concluding that the UCC, and not The United Nations Convention on Contracts for the International Sale of Goods (CISG), controlled the parties’ relationship, the court looked to § 2-207 to determine if the term in the invoice providing for interest and attorney’s fees became part of the parties’ agreement. Given that the wholesaler had never, over the course of its dealings with the supplier, objected to the terms in the invoice, and uncontroverted testimony that such charges were normal in the produce industry, the court concluded that the terms in the invoice were not an
unreasonable surprise or material alteration, and thus became part of the parties’ agreement under § 2-207(2).

The problem with the court’s analysis is that it gave no thought to when the agreement was formed. Section 2-207(2) lays a process for dealing with proposals for additional terms. However, the reference in § 2-207(2) to “the additional terms” is a reference back to subsection (1), which speaks to additional terms stated in “[a] definite and seasonable expression of acceptance or written confirmation.” In other words, § 2-207 deals with the contract formation process. Subsection (1) forms agreements when none would have existed under the common law (because of the mirror-image rule). Subsection (2) then provides rules regarding the terms of such a resulting agreement. Neither subsection has any relevance to how an agreement – once reached – is thereafter modified. Because the supplier and wholesaler in this case had reached their agreement before the supplier sent the invoice, the court’s reliance on § 2-207 was erroneous. Not only was it erroneous, it is dangerous. The court’s analysis suggests that any party to a sales contract may, at any time, add terms to the contract simply by sending a communication that adds them, provided the terms are not material and the other party fails to object.

This is not to say that the court reached the wrong result. Perhaps the terms on interest and attorney’s fees are so ubiquitous in the produce industry that they would be part of the usage of trade, and thus supplement the express terms to which the parties agreed. See § 1-201(b)(3) (defining “Agreement” to include usage of trade). Without more evidence on that, however, it is difficult to know.

_In re Cunningham_,


This case involves an issue of great concern to issuers of consumer credit cards and revolving lines of credit: if the debt is to be secured by the assets purchased on credit, how to describe the collateral in the agreement. Article 9 of the UCC requires a “reasonable,” not a “specific,” description of the collateral. § 9-108(a). It goes on to provide that, generally, a description by Article 9 classification, such as “inventory,” “equipment,” or “accounts” is sufficient. § 9-108(b). However, in a consumer transaction, a description of consumer goods “only by type of collateral” is insufficient. § 9-108(e)(2). This presents a bit of a problem for those that provide revolving secured credit to consumers because there is no way to know at the time the debtor authenticates the agreement what items the debtor will purchase on credit months or years later.

In the cited case, the debtors used a Best Buy credit card, issued by Capital One, to purchase consumer electronics in twelve separate transactions. The cardholder application, in the form of an application and authenticated by the debtors, provided that “you grant the Bank a purchase money security interest in the goods purchased on your Account.” After filing a Chapter 7 bankruptcy petition, the debtors sought a declaration that Capital One did not have a security interest in the items purchased with the card.
The court ruled for the debtors. It concluded that the description on the cardholder agreement was insufficient under the rule of § 9-108(e)(2). 489 B.R. at 606-08. It then refused to read the signed sales receipts for each transaction with the cardholder agreement because nothing in the sale receipts referenced the cardholder agreement. Id. at 608. Moreover, the receipts were not sufficient by themselves because they lacked language purporting to grant a security interest. Id.

The court suggested in distinguishing earlier cases, that the result would have been different if the receipts contain granting language. While it may be possible with modern technology to include granting language on the sales receipts, it is worth noting that in many instances the credit card will not be issued by the retailer. Indeed, that was the situation in this case. The debtors used a Best Buy credit card to purchase goods from Best Buy, but the card was issued by a bank, not by the retailer. Moreover, when consumers use a Visa or MasterCard, the card issuer will never be the retailer. Because not all card issuers seek to obtain a security interest in the goods purchased with the card, retailers may not have the technological ability to determine when to include granting language on a sales receipt and when to not.

The UCC is supposed to facilitate commercial transactions, not to frustrate them. See § 1-103(a)(2). For that reason, the court’s ruling would be proper only if it were compelled by the statutory language or, perhaps, by the policy underlying that language. It was not. As for the statutory text, § 9-108(e)(2) invalidates a description of collateral “only by type of collateral.” However, the description in this case was not only by type. The description did not say merely “goods” or “consumer goods,” it said “the goods purchased on your Account.” 489 B.R. at 608 (emphasis added). The court ignored the import of those additional words. Put another way, that statute does not invalidate a description of collateral “by type,” it invalidates a description “only by type.” § 9-108(e) (emphasis added). The court paid no attention to that crucial adjective, which is also italicized in the official comments. See § 9-108 cmt. 5.

Similarly, the policy underlying § 9-108(e)(2) does not support the court’s ruling. The reason for the heightened description requirement in consumer transactions is not to make sure the collateral is identifiable. There is no reason to think “all consumer goods” is any more difficult to interpret or apply than “all inventory” or “all equipment.” Instead, the concern underlying § 9-108(e)(2) is with overreaching: taking a security interest in items that the debtor did not expect. See § 9-108 cmt. 5. “Goods purchased with your card” does not result in such overreaching. Debtors can readily understand that language.

Fortunately, in just over two months after Judge Berger issued the Cunningham decision, two contrary rulings were issued, including one by another judge in the same court dealing with the same creditor and the same contractual language. See In re Murphy, 2013 WL 1856337 (Bankr. D. Kan. 2013) (signed credit card application in which the debtors purported to grant the card issuer a security interest “in the goods purchased with your Card,” was an adequate description of the collateral because it was not a description only by collateral type); In re Thrun, 2013 WL 2585636 (Bankr. W.D. Wis. 2013) (customer’s signed Consumer Lending Plan with credit union providing that credit union would have a security interest in “all goods, property, or other items purchased under this Plan . . . either now or in the future” was sufficient to cover motor vehicle purchased with
an advance under the plan even without considering the unsigned advance receipt referencing the plan and describing the vehicle); see also In re Estate of Wheeler, 2013 WL 3440953 (Colo. App. 2013) (commercial real estate lease that purported to grant the landlord a security interest in “all property now owned or hereafter acquired by [the tenant] which shall come in or be placed upon the Premises,” was a sufficient description of the collateral); In re Dalebout, 454 B.R. 158 (Bankr. D. Kan. 2011) (language in cardholder agreement providing for a security interest in “the merchandise purchased on your account” together with language on the charge slip providing for a security interest in “any goods, described in this charge slip” was sufficient). But cf. In re Gene Express, Inc., 2013 WL 1787971 (Bankr. E.D.N.C. 2013) (commercial real estate lease that purported to grant the landlord a security interest in “any personal property belonging to Tenant and left on the Premises” did not adequately describe the collateral because “personal property” is not a permissible description and because it refers to property that may be abandoned in the future, rather than property that is presently identifiable). Perhaps, if given the opportunity, Judge Berger will reconsider.

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