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Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

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All Means All, But Some Does Not Always Mean Some When It Comes to UCC Financing Statements

By Bruce A. Wilson*

The author of this article discusses two recent decisions under Article 9 of the Uniform Commercial Code that provide valuable instruction on drafting appropriate collateral descriptions in UCC financing statements.

Two recent decisions under Article 9 of the Uniform Commercial Code ("UCC") provide valuable instruction on drafting appropriate collateral descriptions in UCC financing statements. In *In re The Financial Oversight and Management Board for Puerto Rico*,[1] the U.S. Court of Appeals for the First Circuit held that a UCC-1 financing statement describing the collateral solely by referring to the applicable security agreement contained an insufficient collateral description. The First Circuit also concluded, however, that defects in the initial UCC filing were cured by a subsequent UCC financing statement amendment.

The U.S. Bankruptcy Court for the Central District of Illinois, in *In re 180 Equipment, LLC*,[2] addressed a substantially similar issue in which a UCC-1 financing statement described collateral only by cross-referencing the applicable security agreement. After noting that "no published opinion by any court addresses this exact issue," the *180 Equipment* court also held that the financing statement at issue failed to adequately describe the related collateral.[3]

SUPERGENERIC VS. REASONABLE IDENTIFICATION

Section 9-504(2) of the UCC permits a UCC financing statement to contain a "supergeneric" collateral description where appropriate, such as "all assets" or "all personal property." However, where less than all assets of a debtor are pledged, a UCC financing statement is required by UCC Sections 9-502(a)(3) and 9-108 to contain an adequate description of the collateral that is covered by the financing statement. If a financing statement does not contain an

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* Bruce A. Wilson is a partner at Kutak Rock LLP practicing primarily in the areas of bankruptcy, workout, and Uniform Commercial Code matters, representing creditors, including financial guaranty insurers and indenture trustees. He may be reached at bruce.wilson@kutakrock.com.

1 914 F.3d 694 (1st Cir. 2019) ("*ERS*").

2 591 B.R. 353 (Bankr. C.D. Ill. 2018) ("*180 Equipment*").

3 *180 Equipment*, 591 B.R. at 356.

adequate description of the collateral that is covered, such financing statement will not be effective to perfect the security interest of a secured party in its collateral.[4]

Thus, in cases where a supergeneric collateral description cannot be used, it is important that the financing statement reasonably identify the collateral in which a security interest is granted. The importance of an adequate collateral description in a UCC financing statement is highlighted by the holdings in the *ERS* and *180 Equipment* cases.

THE *ERS* CASE

In the *ERS* case, bonds had been issued by the Employees Retirement System of Puerto Rico (the "ERS System"), an independent agency of the Commonwealth of Puerto Rico created to administer pension funds for government employees. The ERS System issued the bonds in 2008, to finance its purposes pursuant to a bond resolution (the "Resolution"). The ERS System granted a security interest in certain "Pledged Property" of the ERS System to secure the bonds. As defined in the Resolution, the Pledged Property included "Revenues" of the ERS System, and the Resolution contained detailed definitions of "Pledged Property," "Revenues" and other relevant terms. While the Resolution contained definitions of the "Pledged Property" and related terms, the security interest in favor of bondholders was granted in such Pledged Property under a separate security agreement (the "Security Agreement"). The Security Agreement did not contain a description of the Pledged Property, but instead incorporated by reference the terms used in the Resolution, including the definition of Pledged Property. To perfect the bondholders' security interest, the ERS System filed two UCC-1 financing statements in 2008 describing the collateral as "[t]he pledged property described in the Security Agreement attached as Exhibit A hereto and by this reference made a part hereof" and attached a copy of the Security Agreement to the financing statements.[5]

Subsequently, in 2015 and 2016, the applicable filing office received UCC-3 amendments of the initial UCC-1 filings, each of which amended the collateral description of the initial filings to provide that the bondholders' security interest encumbered "[t]he Pledged Property and all proceeds thereof and all after-

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[4] In contrast to UCC Section 9-504(2), which permits a UCC-1 financing statement to indicate collateral with a "supergeneric" collateral description, Section 9-108(c) does not permit a supergeneric collateral description in a security agreement. Instead, based on Section 9-108(c), a security agreement must reasonably identify the collateral in which a security interest is granted.

[5] *ERS*, 914 F.3d at 705.

acquired Property as described more fully in Exhibit A hereto and incorporated by reference."[6] The Exhibit A attached to the amended filings contained a detailed description of the Pledged Property, the Revenues and other terms included in the Pledged Property.

The ERS System subsequently became a debtor in a proceeding under PROMESA[7] and sought a declaratory judgment that the bondholders' security interest was unperfected. The ERS System filed a motion for summary judgment arguing, among other things, that the initial 2008 UCC filings failed to adequately describe the pledged collateral. The ERS System contended that the initial UCC filings themselves did not contain a description of the collateral, but only cross-referenced collateral that was described in an agreement (in this case, the Resolution), and that the Resolution was not part of the UCC filings. The ERS System further asserted that the 2015 and 2016 amendments, which contained their own detailed collateral descriptions, were ineffective and thus did not cure the inadequate collateral descriptions in the initial filings.[8]

The First Circuit in the *ERS* case, and the decision of the district court from which the *ERS* case was appealed,[9] referred to Sections 9-402 and 9-110 of the former version of UCC Article 9 (citing the applicable Puerto Rico statutes), which the courts each noted were in effect at the time of the initial UCC filings. Under former UCC Section 9-402(1), a financing statement was required to contain "a statement indicating the types, or describing the items, of collateral." Section 9-110 of former Article 9 specified that a collateral description was sufficient if it "reasonably identifies what is described."

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[6] *Id.*

[7] PROMESA is legislation enacted by Congress that includes, among other things, provisions permitting the Commonwealth and certain of its agencies and municipalities to file a reorganization proceeding substantially similar to reorganization proceedings under the United States Bankruptcy Code. PROMESA incorporates substantially all of Chapter 9 of the United States Bankruptcy Code, which governs bankruptcy cases of municipal debtors.

[8] The ERS System asserted that the 2015 and 2016 amendment filings were ineffective because they were filed under a debtor name that had become an incorrect name for the ERS System. This argument was somewhat unique to the ERS System and the facts presented. As noted by the First Circuit, arguments based on the correct debtor name were based on a "unique confluence of circumstances" that involved, among other things, changes in the legislation applicable to the ERS System, the use of different names at different times in such legislation, and the use of multiple names for the ERS System in the same legislative act. *Id.* at 703–04; *see also The Financial Oversight and Management Board for Puerto Rico*, 590 B.R. 577 (D. P.R. 2018), which was affirmed, in part, and reversed, in part, by the First Circuit's *ERS* decision.

[9] *See The Financial Oversight and Management Board for Puerto Rico*, 590 B.R. 577 (D.P.R. 2018).

While the courts referred to these Sections of former Article 9, Sections 9-502(a) and 9-108(a) of revised Article 9, which replaced former Article 9 and is currently in effect, use a similar approach. Section 9-502(a)(3) of revised Article 9 provides that a UCC financing statement is sufficient only if, among other requirements, it "indicates the collateral covered by the financing statement." Section 9-108(a) of revised Article 9 uses substantially identical language as former Article 9 in specifying that a description of collateral in a UCC financing statement "is sufficient" if it "reasonably identifies what is described." Thus, the arguments and holding of the *ERS* case remain applicable under current Article 9.

In response to the arguments of the ERS System, certain bondholders argued that the collateral descriptions in the initial UCC filings should be sufficient under the applicable UCC requirements. The bondholders asserted that a collateral description can be sufficient by cross-referencing collateral described in applicable agreements and such a description communicates to third parties that further inquiry is necessary. The bondholders also argued that the Resolution which contained the relevant defined terms for the Pledged Property was publicly available on the websites of the ERS System and the Electronic Municipal Market Access System, and could be obtained in hard copy from the ERS System.

The First Circuit disagreed with the bondholders with respect to the initial UCC filings. The court held that the collateral description at issue in the initial UCC filings, by only cross-referencing the applicable agreements, was insufficient. The court reasoned that the purpose of UCC financing statements is to provide "fair notice" to third parties and must disclose a minimum amount of information.[10] The court, however, explained that its holding was limited to the facts presented:

> Our holding of an insufficient collateral description depends heavily on the facts, where a) the collateral is not described, even by type(s), in the 2008 Financing Statements or attachments; b) the 2008 Financing Statements do not tell interested parties where to find the referenced document (the Resolution) which contains the fuller collateral description; and c) the Resolution is not at the UCC filing office.[11]

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[10] 914 F.3d at 711. The district court decision in the *ERS* case also distinguished between collateral described in security agreements, which can be based on a cross-reference to another document or incorporate a description by reference to another document, and UCC financing statements, which must provide sufficient notice to third parties of the collateral that is encumbered by the applicable security interest.

[11] *Id.* at 710.

Although the initial UCC filings contained an insufficient collateral description, the initial filings were subsequently amended by the 2015 and 2016 amendment filings. The court ruled that the amendment filings, which were timely filed and contained a detailed description of the related collateral, effectively cured the defects in the initial filings. The amended filings, the court noted, contained "[e]ach of the relevant capitalized terms in the definition of 'Pledged Property.'"[12] As a result, the initial filings, when combined with the amendments, were sufficient to perfect the security interest granted by the ERS System in the applicable collateral. Absent the subsequent amendment filings, however, the bondholders' security interest would have been unperfected.

THE *180 EQUIPMENT* CASE

The bankruptcy court in the *180 Equipment* case addressed a substantially similar issue as the court in the *ERS* case. In the *180 Equipment* case, First Midwest Bank ("First Midwest") made a commercial loan to 180 Equipment, LLC. The borrower, 180 Equipment, LLC, delivered a security agreement in connection with the loan, granting a security interest to First Midwest in substantially all of the property of the borrower.

In connection with the loan, First Midwest filed a financing statement describing the collateral as, "All Collateral described in First Amended and Restated Security Agreement dated March 9, 2015 between Debtor and Secured Party."[13] First Midwest did not attach the security agreement to the financing statement.

Similar to the ERS System in the case above, 180 Equipment, LLC, subsequently filed bankruptcy. The bankruptcy trustee in a declaratory judgment action asserted that the collateral description in the First Midwest financing statement was insufficient and that, accordingly, the security interest of First Midwest was unperfected. The bankruptcy trustee of 180 Equipment, LLC, argued that the cross-reference to the security agreement alone, without also describing the collateral or attaching a copy of the security agreement, did not adequately describe the collateral.

In response, First Midwest asserted that the identity of its collateral was "objectively determinable" by an examination of the applicable security agreement, which was identified in the financing statement. First Midwest asserted that "the concept of inquiry notice should be applied broadly."[14]

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[12] *Id.* at 714.

[13] *180 Equipment*, 591 B.R. at 355.

[14] *Id.* at 357.

After acknowledging that courts "have routinely held that creditors may incorporate by reference security agreements into financing statements," the bankruptcy court determined that the financing statement at issue failed to adequately describe the collateral.[15] The court stated that it:

> agrees with the Trustee that First Midwest's financing statement does not describe the collateral. Rather, it attempts to incorporate by reference the description of collateral set forth in a separate document, not attached to the financing statement. The financing statement, on its face, provides no information whatsoever, and therefore no notice to any third party, as to which of the Debtor's assets First Midwest is claiming a lien on, which is the primary function of a financing statement.[16]

Accordingly, the court concluded that the security interest of First Midwest was unperfected.

CONCLUSIONS

Several lessons can be learned from the *ERS* and *180 Equipment* cases. If a security interest is granted in all or substantially all of a borrower's assets, it may be preferable to file a financing statement with an "all assets" or similar collateral description. In all other cases, it is important that a financing statement itself independently contain a description of all collateral in which a security interest is granted. In addition, if an Exhibit A (or even a security agreement) is attached to a financing statement, a secured party may need to make sure the Exhibit remains attached after the financing statement is filed. It could also be helpful in certain cases, even when using an Exhibit A, to describe the collateral in the financing statement itself and state that such collateral includes or is described in more detail in the Exhibit A, rather than just stating "See Exhibit A" in the collateral box.[17]

In addition, neither the *ERS* case nor the *180 Equipment* case held that there is no duty of inquiry for searchers. If a filed financing statement discovered in

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[15] *Id.* at 356.

[16] *Id.* at 360.

[17] When using an exhibit attached to a financing statement to describe the collateral, it is important to ensure that the exhibit is filed with, and as part of, the UCC-1 financing statement filing. Filing offices have, on occasion, filed the UCC-1 form without the attached exhibit. In addition, the filing office of a particular state has recently notified certain filers that the office inadvertently discarded, and thus did not file, exhibits to certain financing statements. *See Missing UCC Attachments in Pennsylvania*, https://businesslawtoday.org/month-in-brief/april-brief-bankruptcy-finance-2019/?utm_source=newsletter&utm_campaign=april19_mib.

a UCC search does not describe collateral in detail, the description may still be sufficient for UCC purposes (or a court could later conclude the description was sufficient). Thus, even in cases where collateral is not described with particularity, a searcher may need to perform diligence with the debtor or the applicable secured party to discover the collateral covered by a financing statement.

Last, legal opinions are often delivered on perfection matters under the UCC. An opinion to the effect that a security interest is perfected under Article 9 may depend, in part, on the sufficiency of the collateral description in a related financing statement. Thus, counsel delivering perfection opinions that rely on a UCC filing will need to be comfortable with the sufficiency of the collateral description in such UCC filing, and that such description includes all collateral described in the related security agreement.