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Further Developments in UCC Financing Statements: Collateral Descriptions

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The decision of the U.S. Bankruptcy Court for the Central District of Illinois in the In re 180 Equipment, LLC*, case was appealed to the U.S. Court of Appeals for the Seventh Circuit. After acknowledging that the case "presents a matter of first impression for our court," the Seventh Circuit reversed the decision of the bankruptcy court and found the UCC-1 financing statement at issue contained a sufficient description of the related collateral. The author of this article discusses the Seventh Circuit's decision.*

My previous article entitled "All Means All, but Some Does not Always Mean Some When It Comes to UCC Financing Statements," as published in the July/August 2019 issue of *Pratt's Journal of Bankruptcy Law*,[1] addressed two similar cases of first impression under Article 9 of the Uniform Commercial Code ("UCC").The courts in both *In re The Financial Oversight and Management Board for Puerto Rico*,[2] and *In re 180 Equipment, LLC*,[3] held that UCC-1 financing statements describing collateral solely by referring to the applicable security agreement contained an insufficient collateral description and thus failed to perfect a secured party's security interest. Accordingly, based on such rulings, the security interests of the secured parties were avoidable in the bankruptcy cases of the related debtors.[4]

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1 https://www.kutakrock.com/-/media/files/news-and-publications/news/2019/08/wilson_prattsjournal.pdf?la=en&hash=C1793F38E0F344D448C2A1987E6F1348E9CBA8CE.

2 914 F.3d 694 (1st Cir. 2019) ("*ERS*").

3 591 B.R. 353 (Bankr. C.D. Ill. 2018).

4 Section 544(a) of the United States Bankruptcy Code, 11 U.S.C. §§ 101 et seq., permits a debtor or bankruptcy trustee to avoid interests in a debtor's property that are unperfected.

statement at issue contained a sufficient description of the related collateral.[5]

REQUIREMENT TO "INDICATE" COLLATERAL IN A FINANCING STATEMENT

Section 9-504(2) of the Uniform Commercial Code permits a UCC financing statement to contain a "supergeneric" collateral description where appropriate, such as "all assets" or "all personal property." However, in many cases less than all of a debtor's assets are pledged. In instances involving a pledge of less than all assets of a debtor, Sections 9-502(a)(3), 9-108, and 9-504 of the applicable UCC require a financing statement to sufficiently indicate the collateral that is covered. If a financing statement does not contain an adequate description of the collateral, the financing statement will not be effective to perfect the security interest of a secured party in its collateral.

THE *180 EQUIPMENT* CASE

The previous article examining the *180 Equipment* and *ERS* cases contains a more detailed description of the facts presented in the *180 Equipment* case. In sum, however, First Midwest Bank ("First Midwest") loaned funds to 180 Equipment, LLC and filed a UCC-1 financing statement describing its collateral as "All Collateral described in First Amended and Restated Security Agreement dated March 9, 2015 between Debtor and Secured Party."[6]

The debtor, 180 Equipment, LLC, subsequently filed bankruptcy. The bankruptcy court determined that the financing statement at issue failed to adequately describe the collateral. The bankruptcy court reasoned that First Midwest's financing statement failed to sufficiently indicate the related collateral because:

> 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 [d]ebtor's assets First Midwest is claiming a lien on, which is the primary function of a financing statement.[7]

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[5] *In re 180 Equipment, LLC*, 2019 U.S. App. LEXIS 27415 (7th Cir. Sept. 11, 2019) ("*180 Equipment*").

[6] *180 Equipment*, 591 B.R. at 355.

[7] *Id.* at 360.

Accordingly, the lower court concluded that the security interest of First Midwest was unperfected.[8]

On appeal, however, the Seventh Circuit recently reversed the bankruptcy court. The appellate court held that the description of collateral in the financing statement at issue sufficiently indicated the collateral covered by the financing statement.

In its decision, the Seventh Circuit focused primarily on the "ordinary meaning" of the term "indicate" as set forth in UCC Sections 9-502(a)(3) and 9-504. These Sections each require that a UCC financing statement sufficiently "indicates" the collateral that it covers. The Seventh Circuit stated that the ordinary meaning of "indicate" is to serve as a "signal" that "point[s] out" or "direct[s] attention to" the related security interest.[9] Based on that meaning, the court reasoned that a "plain reading" of these UCC Sections allows "a party to 'indicate' collateral in a financing statement by pointing or directing attention to a description of that collateral in the parties' security agreement."[10]

The Seventh Circuit also noted that the 2001 amendments to UCC Article 9 support its holding. As noted in the decision, a former Section of Article 9 required a financing statement to "contain" a description of collateral. However, the 2001 amendments revised this Section to instead provide that a financing statement "must only 'indicate' collateral."[11] In the court's view, this "pared down approach" reflects the function of financing statements to provide notice to third parties that a security interest exists, or may exist in the future, in a debtor's collateral.[12]

Last, the appellate court examined prior decisions of other courts, including

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[8] As discussed in the original article, the collateral descriptions presented in both the *180 Equipment* and the *ERS* cases were similar. In the *ERS* case, the financing statements at issue described 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." *ERS*, 914 F.3d at 705. The Security Agreement attached to the financing statements, however, did not contain a description of the collateral but instead referred to collateral described in an indenture (or loan agreement) that was not part of the UCC record. Thus, the *ERS* financing statements described the collateral solely by reference to an agreement that was not part of the UCC filing. The First Circuit in the *ERS* case held that such financing statements failed to adequately describe the related collateral.

[9] *180 Equipment*. The court cited the definitions of "indicate" in each of Webster's New World Collegiate Dictionary (4th ed. 2001), The American Heritage Dictionary (4th ed. 2000), and Merriam-Webster's Collegiate Dictionary (11th ed. 2003).

[10] *Id.*

[11] *Id.*

[12] *Id.*

lower courts in its circuit. The Seventh Circuit concluded that its interpretation of the UCC notice requirement "reflects how we and other courts have understood the UCC's notice function."[13] Thus, the Circuit held that "incorporation by reference is an available method for describing collateral."[14]

CONCLUSIONS

As explored in the initial article, neither the *ERS* case nor the *180 Equipment* case defined the scope of, or held that searchers do not have, a duty of inquiry. In fact, the effect of the Seventh Circuit's holding in the *180 Equipment* case is to effectively retain, and possibly expand, the obligation of UCC searchers in instances with ambiguous collateral descriptions to investigate the nature of collateral granted by a debtor to a prior secured party. This investigation may include direct contacts with a prior secured party and obtaining a copy of the related security agreement.

Moreover, notwithstanding the Seventh Circuit's holding in *180 Equipment*, it is still prudent when drafting collateral descriptions in financing statements to describe the collateral with some particularity and, at a minimum, by using the categories of UCC collateral (i.e., goods, accounts, chattel paper, general intangibles, etc.). Describing collateral by using UCC collateral types such as "accounts" or "chattel paper," for example, could provide searchers with notice that a security interest is granted in at least some of the debtor's accounts and chattel paper. It is certainly possible that other courts could hold contrary to the Seventh Circuit (and the U.S. Court of Appeals for the First Circuit in the *ERS* case in fact *did* hold differently) and find that collateral described only by cross-referencing a security agreement is insufficient. Describing collateral by, at a minimum, using the UCC collateral types may provide a better defense that adequate notice was provided, as opposed to a description that only cross-references collateral in a security agreement.

Finally, as referenced, if a security interest is granted in all or substantially all of a debtor's assets, it may be preferable to file a financing statement with an "all assets" or similar collateral description.

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[13] *Id.*

[14] *Id.*