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Less is More When Perfecting a Security Interest

The recent decision of the United States Court of Appeals for the Second Circuit (the “Second Circuit”), in *Ring v. First Niagara Bank, N.A.* is a wake-up call for trade creditors who take a security interest in their customer’s assets. Less is more when describing collateral in a UCC-1 financing statement that is filed to perfect a security interest in a debtor’s assets. The collateral description should be simple and exclude unnecessary verbiage. As the *Ring* decision makes clear, the collateral description necessary to perfect a security interest in all of a debtor’s property should be simple and need only contain the following five words: “all assets of the debtor.” As the secured creditor discovered in the *Ring* case, adding more language to that simple description risks the loss of secured status, and at a minimum, years of unnecessarily costly and expensive litigation.

Perfecting a Security Interest

A trade creditor seeking to obtain an enforceable security interest in a customer’s assets must satisfy the requirements specified in Article 9 of the Uniform Commercial Code (UCC). First, a creditor must satisfy Article 9’s requirements for the creation or attachment of a security interest in its customer’s property, which will serve as the creditor’s collateral securing payment of its claim. A security interest is created by the customer’s execution of a security agreement, which adequately describes the creditor’s collateral by category or

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type. A description such as all of a debtor’s present and future accounts, inventory, equipment, and general intangibles and all cash and noncash proceeds thereof should suffice. A description of all of a debtor’s assets will not pass muster.

Second, a creditor’s security interest must be perfected according to Article 9’s requirements. By obtaining a perfected security interest, a creditor’s security interest in a debtor’s property will withstand a challenge by a junior secured creditor, a judgment lien creditor, a



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bankruptcy trustee or a creditors’ committee. A creditor frequently perfects a security interest by filing a UCC-1 financing statement in the appropriate filing office. A UCC-1 financing statement must identify the debtor by its correct legal name and address and describe the collateral in a manner that is consistent with the collateral described in the security agreement, and will also contain other required information. If the collateral description in a security agreement is broad enough to include all of a debtor’s assets, then the collateral description in the UCC-1 financing statement only needs to state “all assets of the debtor.”

The public filing of a UCC financing statement serves two main purposes. Initially, it confirms a secured creditor’s priority rights in the collateral identified in the financing statement. It also provides notice to third parties that a secured creditor is claiming an interest in the assets referenced in the financing statement.

As the UCC is a “notice filing” system, the filing of a UCC financing statement is only intended to provide notice that a person *may* have a security interest in the specified collateral. A subsequent creditor has the burden to conduct additional diligence where there is a potential ambiguity in a financing statement.

Facts

Between 2005 and 2007, First Niagara Bank (“FNB”) loaned approximately \$1.2 million to United Graphics

Inc. (the “Debtor”). The Debtor’s business was initially located at 100 River Rock Drive in Buffalo, NY. FNB obtained a security interest in all of the Debtor’s assets by entering into a security agreement that properly described FNB’s collateral. All FNB had to do to perfect its security interest was to file UCC-1 financing statements that described FNB’s collateral as “all assets of the debtor.” However, in three separate UCC financing statements that FNB had filed between 2005 and 2007 (the “Original UCCs”), FNB included the following description of its collateral:

All assets of the Debtor ***including, but not limited to***, any and all equipment, fixtures, inventory, accounts, chattel paper, documents, instruments, investment property, general intangibles, letter-of-credit rights and deposit accounts now owned or hereafter acquired by Debtor and ***located or relating to the operation of the premises at 100 River Rock Drive, Suite 304, Buffalo, NY, together with any products and any proceeds thereof including, but not limited to***, a certain Komori 628 P&L Ten Color Press and Heidelberg B20 Folder and Prism Management System.

At some point in 2012, the Debtor changed its name to Sterling United Inc. and moved its offices to 6030 North Bailey Avenue in Amherst, NY. FNB subsequently filed UCC amendments that contained the Debtor’s new name, Sterling, and the Debtor’s new address in the address box in the UCC amendment. However, despite the Debtor’s move to a new location, FNB did not change the Debtor’s address in the description of

FNB’s collateral, which continued to state that the collateral was located and related to the operation of the Debtor’s former premises in Buffalo, NY.

FNB delayed filing additional UCC amendments (the “February 2013 UCCs”) until Feb. 19, 2013. The February 2013 UCCs changed the collateral description in the Original UCCs to:

All assets of the Debtor including, but not limited to, any and all equipment, fixtures, inventory, accounts, chattel paper, documents, instruments, investment property, general intangibles, letter-of-credit rights and deposit accounts now owned or hereafter acquired by Debtor, ***including, but not limited to, those located at or used in connection with the business premises at 6030 N. Bailey Avenue, Amherst, NY 14226***, together with any and all products and proceeds thereof.

Prior to May of 2013, the Debtor defaulted on the loan and FNB began liquidating its collateral. On May 17, 2013, an involuntary Chapter 7 bankruptcy case was filed against the Debtor in the United States Bankruptcy Court for the Western District of New York (the “Bankruptcy Court”). An order of relief was entered on June 12, 2013, and John H. Ring III was appointed as the Debtor’s Chapter 7 Trustee (the “Trustee”).

The Trustee and FNB agreed that any change in the collateral description contained in the February 2013 UCCs that expanded FNB’s collateral was avoidable as a preference

under Section 547 of the Bankruptcy Code because the February 2013 UCCs were filed within 90 days of the bankruptcy filing date. Therefore, the issue in the *Ring* case was whether the collateral description in the Original UCCs was sufficient to properly perfect FNB's security interest in all of the Debtor's assets, despite the Debtor's move from Buffalo to Amherst, NY.

In March of 2014, the Trustee filed an adversary proceeding against FNB in the Bankruptcy Court, seeking the recovery of all of the sums the Debtor had paid to FNB during the 90-day period prior to the commencement of the bankruptcy case as avoidable preferences under Bankruptcy Code Section 547¹. The Trustee asserted that FNB was unsecured during the 90-day preference period because the collateral description in the Original UCCs restricted FNB's "all assets" reference to the Debtor's assets located or relating to 100 River Rock Drive in Buffalo, NY, and none of the Debtor's assets remained there after the Debtor's earlier move.

The *Ring* decision illustrates the pitfalls that a trade creditor seeking secured status faces when a collateral description in a UCC-1 financing statement is unclear and overly complicated.

The Bankruptcy Court granted FNB's motion to dismiss and denied the Trustee's cross-motion for summary judgment, holding that the Original UCCs properly described FNB's collateral and FNB's "all assets" security interest was not avoidable. The Trustee then appealed the Bankruptcy Court's ruling to United States District Court for the Western District of New York (the "District Court"), which affirmed the Bankruptcy Court's ruling. The Trustee then appealed the District Court's ruling to the Second Circuit.

The Second Circuit's Decision

The Second Circuit held that the Original UCCs were sufficient to perfect FNB's security interest in all of the Debtor's assets, despite the reference to the Debtor's incorrect address in the collateral description, because the collateral description had unambiguously referred to "[a]ll assets of the Debtor," regardless of their location. The inclusion of the phrase "including, but not limited to" (highlighted in the collateral description in the Original UCCs above) referred to a subset of the Debtor's assets and did not limit the Original UCCs' "all assets" collateral description. The reference to a list of assets in the Original UCCs was nonexclusive and considered illustrative and not exhaustive.

The Second Circuit rejected the Trustee's arguments that the reference to the Buffalo, New York, address in the Original UCCs modified the term "[a]ll assets," and, at a minimum, made the collateral reference seriously misleading under Section 9-506 of the UCC² following the Debtor's move. Unlike the Original UCCs, which included an unambiguously broad term, "all assets," and additional language, "including, but not

limited to," that did not limit its scope, the UCC financing statements in the cases the Trustee had relied upon contained broad "all assets" collateral descriptions that were limited to the debtor's property at a particular location or described in a mortgage. Accordingly, the Second Circuit determined that the collateral description in the Original UCCs was unambiguous and not seriously misleading.

Conclusion

Five simple words can make the difference between a properly perfected security interest and the risk of unsecured status, and, at a minimum, years of unnecessary and costly litigation over whether a security interest was properly perfected. The *Ring* decision illustrates the pitfalls that a trade creditor seeking secured status faces when a collateral description in a UCC-1 financing statement is unclear and overly complicated. Assuming a security agreement includes a sufficient collateral description that describes all of a debtor's assets, a trade creditor seeking to perfect a security interest in all of a debtor's property only has to include the phrase "all assets of the debtor." The inclusion of superfluous language in the collateral description exposes the creditor to a challenge from, among others, a bankruptcy trustee—like in the *Ring* case—or a creditors' committee in a Chapter 11 bankruptcy case. The same is true when a trade creditor obtaining a security interest in discrete assets of the customer, like equipment, includes an overly detailed description in its security agreement and/or UCC-1 financing statement. Using a description, such as all of a debtor's equipment, or a particular type of equipment, instead of identifying the equipment by a serial number, reduces the risk of a mistake that would subject the creditor to a challenge of its secured status. Bottom line: less is always better! ■

1. Under Bankruptcy Code Section 547, the Trustee can avoid as a preference "any transfer of an interest of the debtor in property....madeon or within 90 days before" the bankruptcy filing. A debtor's payments to an unsecured creditor during the 90-day preference period are subject to preference risk. A security interest perfected outside the 90-day preference period cannot be avoided.

2. Section 9-506 of the UCC states that a financing statement that substantially satisfies the requirements of the UCC is effective, despite the existence of minor errors or omissions, unless those errors or omissions are "seriously misleading."

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