

UCC Financing Statement Mistakes Can Be Deadly

Abbreviated Debtor Name Left a Creditor with an Unperfected Security Interest



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A creditor may protect itself against collection risks by having its customer grant the creditor a security interest in the customer's assets to secure obligations owing to the creditor. The creditor perfects its security interest by filing a financing statement according to Article 9 of the Uniform Commercial Code (UCC), as adopted in the applicable state where the creditor is filing the financing statement. UCC Article 9 prescribes the form and manner in which a UCC-1 financing statement must be filed. These requirements are intended to ensure that the financing statement sufficiently identifies the debtor and the pledged collateral so as to put other potential creditors on notice of the existence of the security interest.

Recent decisions of the Supreme Court of Florida (the "Florida Supreme Court") and the United States Court of Appeals for the Eleventh Circuit (the "Eleventh Circuit")—in *1944 Beach Boulevard, LLC v. Live Oak Banking Company* and *In re NRP Lease Holdings, LLC*, respectively—have made clear that even the slightest deviation from UCC Article 9's requirements for perfecting a security interest, such as abbreviating a debtor's name in a UCC-1 financing statement, can leave the creditor with an unperfected security interest subject to avoidance by a bankruptcy estate fiduciary.

Background Regarding the UCC's Filing Requirements

A trade creditor seeking to obtain a valid, perfected and enforceable security interest in its customer's personal property must comply with UCC Article 9. First, a creditor must satisfy the requirements for the creation or attachment of a security interest in its customer's property that will serve as collateral securing payment of the creditor's claim. A security interest is created by the customer's execution of a security agreement that adequately describes the creditor's collateral by category or type. A collateral description, such as all of a debtor's present and future accounts, inventory, equipment and general intangibles and all cash and non-cash proceeds thereof, should suffice. A collateral description such as "all of a debtor's assets" will not suffice.

Second, the security interest must be perfected according to UCC Article 9's requirements. A creditor frequently perfects a security interest in personal property by filing a UCC-1 financing statement in the appropriate filing office. A UCC-1 financing statement must, among other things, identify the debtor by its correct legal name. The comments to UCC Section 9-503 state that properly identifying the debtor's name "is particularly important" since "those who wish to find financing statements search for them under the debtor's name."

The public filing of a UCC-1 financing statement serves two main purposes: it confirms a secured creditor's priority rights in the collateral identified in the financing statement, and provides notice to third parties that a secured creditor is claiming an interest in the assets identified in the financing statement. Properly identifying the debtor in a financing statement is paramount to achieving these purposes. According to UCC Section 9-503(a)(1):

"[I]f the debtor is a registered organization, ... [a financing statement sufficiently provides the name of the debtor] only if the financing statement provides the name that is stated to be the registered organization's name on the public organic record most recently filed with or issued or enacted by the registered organization's jurisdiction of organization which purports to state, amend, or restate the registered organization's name."

According to UCC Section 9-506(a), a UCC-1 financing statement that "substantially" complies with UCC Article 9's requirements is effective even if it contains minor errors or omissions, unless they make the financing statement "seriously misleading." UCC Section 9-506(b) further states that a financing statement is "seriously misleading" if it fails to sufficiently state the debtor's name in accordance with UCC Section 9-503(a). This is sometimes referred to as the "zero-tolerance rule."

That said, UCC Section 9-506(c) provides the following safe harbor exception to this zero-tolerance rule: "[I]f a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement that fails to sufficiently provide the name of the debtor in accordance with Section 9-503(a), the name provided does not make the financing statement seriously misleading." The *NRP* and *1944 Beach Boulevard* decisions ultimately turned on the Florida Supreme Court's application of UCC 9-506(c), as adopted virtually verbatim by the State of Florida via Florida Statute § 679.5061(3). The Florida Supreme Court held that creditors cannot avail themselves of the safe

harbor exception to the zero-tolerance rule regarding mistakes in identifying a debtor's name in a UCC-1 financing statement because Florida's UCC filing office does not have a "standard search logic." This led to the Eleventh Circuit's holding that a UCC-1 financing statement with an abbreviated debtor name was "seriously misleading," leaving the creditor with an unperfected security interest subject to avoidance by a bankruptcy estate fiduciary.

Background Regarding the Eleventh Circuit and Florida Supreme Court Decisions

On December 5, 2019 (the "Petition Date"), 1944 Beach Boulevard, LLC ("Beach Boulevard") and its affiliates filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code. As of the Petition Date, Beach Boulevard and its affiliates were jointly and severally liable to Live Oak Banking Company (the "Lender") in the approximate amount of \$3,000,000 on account of two loans that were purportedly secured by a blanket security interest in all of 1944 Beach Boulevard, LLC's assets. The Lender filed two UCC-1 financing statements with the Florida Secured Transaction Registry (the "Registry") in order to perfect its security interest pursuant to the UCC (as adopted by the State of Florida, i.e., the "Florida UCC"). However, the Lender's financing statements identified Beach Boulevard as "1944 Beach Blvd., LLC," and not by its correct unabbreviated legal name, 1944 Beach Boulevard, LLC.

Beach Boulevard filed a complaint in the bankruptcy court asserting that the Lender had an unperfected security interest. Beach Boulevard asserted that the Lender's UCC-1 financing statements were "seriously misleading" because they had failed to correctly identify Beach Boulevard by its correct (i.e., unabbreviated) legal name as the Florida UCC requires. In response, the Lender argued that Florida UCC § 679.5061(3)'s safe harbor provision applied because a search of the Registry disclosed the financing statements, despite the abbreviation of Beach Boulevard's name on the financing statements. However, when Beach Boulevard had searched the Registry, the Lender's financing statements did not

appear within the first 20 search results as shown alphabetically on the initial search results tab, but were listed on the immediately preceding tab.

The bankruptcy court granted summary judgment in the Lender's favor, concluding that the financing statements fell within the UCC safe harbor because "the Registry's standard search logic discloses the financing statements on the page immediately preceding the initial page on the Registry's website." The bankruptcy court, therefore, concluded that the financing statements were not seriously misleading and the Lender had valid and perfected security interests in all of Beach Boulevard's assets. Beach Boulevard appealed the bankruptcy court's decision to the district court, which affirmed the bankruptcy court's holding.

Beach Boulevard then appealed the decision to the Eleventh Circuit. The Eleventh Circuit noted that there were competing interpretations of the scope of the search that is necessary to determine the applicability of the safe harbor exception under Florida UCC Section 679.5061(3) to the zero-tolerance rule. One Florida-based bankruptcy court had held that the statutorily-established "standard search logic" must generate a single page of search results, which constitutes the entirety of the search for purposes of the safe harbor exception. On the other hand, another Florida-based bankruptcy court had held that the initial page did not constitute the entire "search" for purposes of the UCC's safe harbor provision. Instead, that court concluded that the search included the entire Registry, which could be scrolled to and from the actual page of twenty names. Noting that the issue is a matter of state law, and uncertain as to how the Florida Supreme Court would resolve the split in authority, the Eleventh Circuit certified the following issues to the Florida Supreme Court:

- (1) Is the "search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic," as provided for by [the safe harbor set forth in Florida UCC § 679.5061(3)], limited to or otherwise satisfied by the initial page of twenty

names displayed to the user of the Registry's search function?

- (2) If not, does that search consist of all names in the filing office's database, which the user can browse to using the command tabs displayed on the initial page?
- (3) If the search consists of all names in the filing office's database, are there any limitations on a user's obligation to review the names and, if so, what factors should courts consider when determining whether a user has satisfied those obligations?

The Courts' Holdings

The Florida Supreme Court held that the safe harbor exception to the zero tolerance rule set forth in Florida UCC § 679.5061(3) (which is derived from UCC 9-506(c)) did not apply since the Lender's financing statements were seriously misleading and were accordingly ineffective. The Florida Supreme Court did not need to address the questions certified to it by the Eleventh Circuit. Instead, the Florida Supreme Court focused on whether the Florida Registry provides a "standard search logic," since the applicability of UCC's safe harbor provision depends on the disclosure of the financing statement using a "standard search logic."

The Florida Supreme Court stated that the meaning of "standard search logic" as used in UCC Article 9 (and, in turn, the Florida UCC) is "well understood within the industry" to mean a procedure that identifies "the set (which might be empty) of financing statements on file that constitute hits for the search" or that produces an "[u]nambiguous identification of hits." As the Florida Supreme Court reasoned, this is because the purpose of the "standard search logic rule" is to establish an objective procedure for determining whether a given financing statement is sufficient. A procedure that does not identify which financing statements are hits and which are not is alien to the purpose of the rule."

The Florida Supreme Court concluded that the Florida's Registry does not provide a "standard search logic" to search its records. A search of the Registry does not return a finite list of hits, but instead

provides a list of twenty names starting with the name that most closely matches the name entered. From there, the searcher can navigate the list or additional search result pages beyond the initial list forward and backwards through names listed alphabetically in the Registry. As the Florida Supreme Court aptly put it, "'a search' of the Registry returns an index of all of the financing statements in the Registry." The Florida Supreme Court also noted that the Registry produces inconsistent results depending on the date on which a search is conducted because financing statements are continuously being filed, amended and removed from the Registry, "so that a financing statement included in a list of twenty [names] today might not be on the same list tomorrow."

The Florida Supreme Court, therefore, concluded that Florida's Registry lacked a standard search logic because a standard search logic must yield unambiguous "hits" and the Registry's search option returns the entire index of financing statements filed in the Registry. In turn, the Florida Supreme Court held that filers in Florida are left with no exception to the zero-tolerance rule established by the UCC, since the UCC's safe harbor exception to the zero-tolerance rule requires a search of the filing office's records using a "standard search logic."

The Eleventh Circuit relied on the Florida Supreme Court's decision in concluding that it was impossible to conduct a search necessary to qualify for the safe harbor exception. The Eleventh Circuit reversed the district court's (and bankruptcy court's) holdings, ruling that the Lender's financing statements were "seriously misleading" and the lower courts had erred in concluding that the Lender had perfected its security interest.

Conclusion

The Eleventh Circuit's and Florida Supreme Court's decisions serve as yet another cautionary tale for anyone who seeks to perfect a security interest by filing a financing statement in accordance with UCC Article 9. Creditors filing UCC-1 financing statements must do their diligence and be extremely careful to ensure that their financing statements meet all of the requirements of Article 9, including

properly identifying the debtor entity by its correct legal name. As we have seen time and time again, and as demonstrated by the Eleventh Circuit's and Florida Supreme Court's decisions in *NRP* and *1944 Beach Boulevard*, even the slightest deviations in the debtor's correct legal name in a financing statement may result in a court holding that the creditor's security interest is subject to avoidance by a bankruptcy estate fiduciary since the creditor had failed to perfect its security interest, leaving the creditor with an unsecured claim and exposing the creditor to increased collection risk.

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