

# Lender Beware: Two Recent Bankruptcy Cases Highlight Importance of Diligence in UCC-1 Filings

## WRITTEN BY

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Lenders should view as cautionary tales two recently handed down decisions regarding UCC-1 financing statements and the perfection of security interests. On December 20, 2019, the U.S. Bankruptcy Court for the District of Kansas in *In re Preston* held that security interests in personal property were unperfected because the UCC-1 incorrectly set forth the debtor's name. On January 2, 2020, the U.S. Bankruptcy Court for the Western District of North Carolina in *In re Jarvis* held that a parent company's filing of a UCC-1 did not perfect the security interest of its wholly owned subsidiary. The results of these cases show the importance of diligence and attention to state law requirements in filing UCC-1s.

### *In re Preston*

#### *Background*

In *In re Preston*, Dewey Dennis Preston, the debtor, entered into two separate retail installment sale and security agreements to finance his purchase of two pieces of farm equipment. The agreements were entered into with CNH Industrial Capital of America, LLC on June 26, 2015 and January 5, 2016, respectively. Following the execution of these financing agreements, CNH filed UCC-1s to perfect its liens on each purchase. Preston's name was set forth as "Preston" in the box for surname and "D.Dennis" (with a period and no space) in the box for first name. Preston's driver's license listed his name as "Preston D Dennis." Preston filed for bankruptcy under Chapter 12 on October 3, 2018.

Preston treated CNH's claim as unsecured, to which CNH objected. CNH argued its filing of the UCC-1s perfected its interest, giving CNH priority over any subsequent claims on the assets. Article 9 of the Kansas Uniform Commercial Code requires financing statements to bear the debtor's name exactly as it is listed on his or her driver's license. Article 9 addresses the potential for errors on a financing statement, and directs that financing statements are effective, even with a minor error or omission, as long as the error or omission does not make the statement "seriously misleading," and further that a statement that fails to list the debtor's name exactly as it appears on his or her driver's license is "seriously misleading." Preston asserted that the discrepancy in name on the UCC-1s was "seriously misleading" and that the financing statements were necessarily ineffective.

#### *Analysis*

The sole issue before the court was whether CNH's UCC-1s were effective in perfecting its security interests. The Bankruptcy Court for the District of Kansas determined they were not. CNH did not list Preston's name in the strict

manner required by Article 9, so the interests were unperfected. There is a “safe harbor” exception to this exacting requirement, which provides that a financing statement will not be considered seriously misleading, even with error, if a simple search of the debtor’s correct name, using the filing office’s standard search logic, would find it. Neither of the two searches conducted located CNH’s financing statements.

The court relied on official commentary from the 2010 revision of the UCC, which stated that the name should be exactly the same as it is on the debtor’s driver’s license, even if the name indicated on the license contains an error. The commentary further provided that, in the case of ambiguity or doubt, the party filing the financing statement may choose to file under a number of names for the debtor, which CNH did not do.

### *Outcome*

CNH’s financing statements were held to be seriously misleading because they did not conform to the debtor’s driver’s license, nor were they saved by the “safe harbor” exception. As a result, they were ineffective in perfecting CNH’s security interests. Accordingly, Preston’s treatment of the CNH claim as unsecured was proper.

### ***In re Jarvis***

#### *Background*

In *In re Jarvis*, the debtor, Jacob D. Jarvis, obtained a loan from Strategic Funding Source, Inc. on October 6, 2015. The parties entered into a security agreement in connection with the loan, in which Jarvis granted Strategic a security interest in his assets. Strategic, through its representative, Corporation Services Company (CSC), filed a UCC-1 to perfect its security interest. The secured party representative services agreement between CSC and Strategic listed Strategic as the customer, not any of its affiliates. The financing statement listed CSC as the secured party and did not make reference to any affiliates of Strategic. Jarvis repaid the Strategic loan in February 2016.

On February 20, 2018, Jarvis obtained two additional loans from a subsidiary of Strategic, Money Works Direct, Inc. The parties entered into separate security agreements, in which Jarvis granted Money Works a security interest in his assets. Money Works did not file a financing statement to perfect its interest. Strategic did not amend its initial financing statement to include Money Works as a secured party nor did it assign its initial financing statement to Money Works.

In March 2019, Jarvis filed for bankruptcy under Chapter 13, and listed Money Works as holding an unsecured claim against the estate. The servicing provider for Strategic responded with a proof of claim, alleging it held a secured claim on behalf of Strategic.

#### *Analysis*

Strategic argued that it was unnecessary for Money Works to file a financing statement because Strategic and Money Works are part of the same investment syndicate, with Strategic as lead syndicator and Money Works as its wholly owned subsidiary and affiliate. Strategic invested the funds involved in the 2015 and 2018 transactions with Jarvis. Strategic claimed that the secured parties were therefore the same and that Strategic was the secured

party under the Money Works transactions. Strategic argued that it acted both on its own behalf and as a representative of Money Works when it filed the UCC-1, so the Money Works security interests were perfected as a result of that UCC-1.

Strategic also argued that language in the Money Works security agreements supported its argument because the language references obligations owed to Money Works and its affiliates: “to secure [the Debtor’s] payment and performance to [Money Works] and its affiliates or the Funders, . . . [the Debtor] hereby grants to [Money Works] a security interest in all personal property of [the Debtor].” The court rejected this argument because the granting of a security interest was only to Money Works, and did not explicitly include affiliates.

In support of this rejection, the court cited *In re Adirondack Timber Enterprise, Inc.*, 2010 WL 1741378 (Bankr. N.D.N.Y. Apr. 28, 2010), which stated a security agreement executed solely between a debtor and their creditor does not grant security interests in the collateral to an affiliate of the creditor.

### *Outcome*

The court held that Strategic did not receive security interests by virtue of the security agreements between Money Works and Jarvis, and further that Strategic’s financing statements were not capable of perfecting Money Works’ security interests because the security agreements explicitly granted security interests to Money Works alone. Thus, Jarvis’s objection was sustained and the court’s treatment of the claim as unsecured was deemed proper. Although Money Works pursued many lines of argument, it was unsuccessful in its attempt to convince the court to allow it to rely on an earlier filed UCC-1 in favor of its parent company to perfect its security interests.

## **What Can Lenders Take Away From These Decisions?**

The court in *In re Preston* held that security interests in personal property were unperfected due to the lender’s misstatement of the debtor’s name on their UCC-1s. This case, specifically, highlights the importance of properly indicating the debtor’s name, consistent with the relevant state law. Particular attention may also be required where the debtor is a natural person. Lenders should look to controlling state law and UCC provisions to make sure they are in conformity with the required procedure and other various specifications. As the court in *In re Preston* discussed, when in doubt, lenders may want to consider submitting more than one financing statement or listing more than one version of the debtor’s name.

The court in *In re Jarvis* held that a party’s security interests were not perfected by their parent company’s filing of a UCC-1. Even where there appears to be an affiliation or relationship of some sort, such as parent-subsidiary as in this case, security interests are only granted to the named party and will not flow to affiliates solely by virtue of their relationship. The secured party should file its own UCC-1, and not rely on the UCC-1s of its affiliates.

The lenders in both cases made preventable errors. The result is that they were unable to perfect their interests and were left with unsecured claims. These cases illustrate the importance of diligence in completing and submitting UCC-1s when seeking to perfect security interests. It is important to check the pertinent provisions of the UCC and other relevant state law requirements. The ability of a lender to secure its claim may come down to a mere period.

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