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SUBORDINATION RULING CREATES UNWARRANTED AND UNAVOIDABLE RISKS

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A recent decision of the Bankruptcy Appellate Panel in *In re Elieff*,[1] a case interpreting § 510(b) of the Bankruptcy Code, creates a significant impediment to ordinary transactions for no legitimate reason. Transactional lawyers need to be aware of the decision and its implications, so that they can properly advise their clients. This article begins by explaining § 510(b). It then analyzes the BAP's decision and its implications. It concludes by offering a bit of advice.

BANKRUPTCY CODE § 510(b)

Section 510(b) is reasonably short. The critical portions provide as follows:

> a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, [or] for damages arising from the purchase or sale of such a security, . . . shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security . . . .

The principal goal of § 510(b) is to prevent shareholder claimants from elevating their interests from the level of equity to general creditor claims.[2] It is based on two related premises. First, shareholders and creditors have dissimilar risks and expectations. Specifically, shareholders accept more risk than creditors in return for the potential for higher gain: the right to share in the profits of a business.[3] Second, when deciding whether to extend credit, creditors often rely on the financial cushion that equity investors provide.[4]

The prototypical case involving a § 510(b) claim would be one for securities fraud in connection with the debtor's issuance and sale of equity securities in the debtor. In such a case, the claimant never expected to be on par with creditors of the debtor.[5] Other fact patterns also present relatively easy cases under § 510(b), in the sense that subordination serves the underling purposes of the rule. For example, an equity security holder's claim against the debtor for breach of a contract to redeem an equity security in the debtor is subject to subordination.[6]

THE *ELIEFF* DECISION

In *Elieff*, two individuals – Kurtin and Elieff – who together owned and operated several real estate investment and development projects, settled a series of disputes. Pursuant to the settlement agreement, Kurtin transferred his interests in several entities to Elieff, and in return Kurtin was to receive a total of $48.8 million, to be paid in four unequal installments. Elieff and the entities were jointly and severally liable for the first payment. Only the entities were liable for the remainder of the payments. However, the agreement prohibited Elieff from taking distributions from any of the entities to the extent that such distributions would prevent satisfaction of the obligation to Kurtin.

The final two payments were not made and Kurtin obtained a $33.9 million judgment against Elieff for breach of the settlement agreement, based on Elieff's diversion of assets from the entities. With the judgment, Kurtin obtained a judgment lien on Elieff's real property. In Elieff's bankruptcy case, the trustee sought to subordinate Kurtin's claim under § 510(b). The bankruptcy court treated Kurtin's claim as "arising from" the transfer of Kurtin's interests in the various entities, and subordinated it. Following a request for clarification by both parties, the court ruled that Kurtin's lien was subsumed within the term "claim." As a result, Kurtin's judgment lien was subordinated to the same extent that his claim was subordinated.

The BAP affirmed. In doing so, the court first ruled that Kurtin's claim "arises from" a purchase or sale of securities because it shared a nexus or causal relationship with such a

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transaction.[7] It did not matter that the judgment was premised on Elieff's post-sale diversion of assets from the entities because, the BAP concluded, Elieff's liability shared a direct causal link to Kurtin's sale of his interests in the entities due to the fact that it arose from the sale agreement.[8] The BAP then ruled that there was no basis for allocating only a portion of the claim to the sale.[9]

Finally, and most relevant to this article, the BAP ruled that the bankruptcy court did not err in subordinating Kurtin's judgment lien.[10] Thus, whereas a bankruptcy discharge operates on only the debtor's *in personam* liability – leaving the *in rem* liability of any collateral unaffected – § 510 subordinates the whole claim, whether to be paid out of the debtor's unencumbered assets or from the property subject to the lien. As a result, a subordinated creditor, even one with a perfected lien, is not entitled to any payment until the general unsecured creditors are paid in full.[11] A contrary ruling, the BAP correctly noted, would permit an equity investor to elevate its right to payment ahead of general creditors, which was precisely what § 510(b)was enacted to prevent.[12]

The practical effect of the subordination of Kurtin's lien is that the estate will likely liquidate the encumbered property under § 363(f) and distribute the proceeds pursuant to the priority scheme in § 726. If the unsecured claimants are not paid in full, Kurtin would get nothing, thereby establishing that his subordinated liens were effectively worthless.[13]

THE IMPLICATIONS OF THE *ELIEFF* DECISION

The BAP's decision has some truly alarming implications. Before exploring them, it is important to note that nothing in the court's decision is in any way tied to the non-consensual nature of Kurtin's judgment lien or the type of property involved. Hence, even if Kurtin had obtained and perfected a security interest in Elieff's personal property or obtained and recorded mortgages on Elieff's real property, the result would presumably have been the same. When § 510(b) subordinates the *claim*, any lien securing that claim is also subordinated.[14]

As for implications, consider this fairly simple scenario:

> Able and Baker have for 20 years owned and operated LLC. Each had a 50% membership interest. Last year, Able sold Able's membership interest to Baker for $4 million. Perhaps the parties had a falling out; perhaps Able simply wished to retire. The reason is not particularly relevant but there was no fraud or impropriety in connection with the sale.
>
> Baker paid $500,000 at the time of the sale and agreed to pay the remainder over the next seven years. Baker granted Able a security interest in Baker's entire interest in LLC as collateral for the debt. Able perfected that security interest.
>
> One year after the sale, Baker filed for bankruptcy protection. The cause was unrelated to LLC.

Following the *Elieff* decision, Able's claim (and lien) will likely be subordinated to all other claimants in Baker's bankruptcy. After all, the claim is for "damages"[15] arising from the sale of a "security."[16] And LLC is an "affiliate" of the debtor because Baker owned more than a 20% interest in LLC.[17] The consequences of this are somewhat staggering.

If Able sold on credit any other type of property to Baker – real property, goods, intellectual property, cryptocurrency – there would be no basis to subordinate Able's claim under § 510(b). Only because the property sold was a security is the resulting claim (and related lien) subordinated. Yet none of the policies underlying § 510(b) is in any way implicated in this scenario. The general creditors of LLC have no claim at all in Baker's bankruptcy,[18] so Able's claim is not being elevated above theirs. Indeed, Baker's bankruptcy estate might have benefitted from the transaction between Able and Baker: the value of the membership interest that Baker purchased from Able might be worth more than the purchase price. But even if that were not the case, there would be no basis in equity to subordinate Able's claim.

Yet there is little the transactional lawyer could do to protect Able at the outset of the transaction, short of insisting on full payment at the time of the sale, a letter of credit, or a guaranty from some third party.

But the problems do not end there. If Baker obtained a bank loan to finance the transaction with Able, that might solve Able's problem under § 510 but the bank's claim would appear to be subject to subordination to the same extent as Able's claim would have been. In short, anyone financing the purchase of 20% or more of the equity in a business entity runs a risk of being subordinated under § 510(b). And under *Elieff*, obtaining and perfecting a security interest or mortgage provides no protection.

The same result would occur if Able accepted Baker's negotiable note for the balance of the purchase price and then sold the note to a bank for cash. Even the bank's status as a holder in due course would fail to protect the bank from subordination in Baker's subsequent bankruptcy.[19] None of this serves any legitimate purpose. Beyond that, subordination in such a situation is a trap for the unwary and will undoubtedly interfere with legitimate business transactions.

Oddly, if Able and Baker had owned a limited partnership, rather than an LLC, the result would apparently be different. That is because a limited partnership probably cannot be an "affiliate" of an individual debtor.[20] Hence, § 510(b) probably would not subordinate Able's claim for nonpayment of the purchase price for an interest in a limited partnership. If this is correct, it is another reason why *Elieff* and the cases it relies on

are wrong. An interpretation of the Bankruptcy Code that generates hugely different results depending on the type of entity involved simply makes no sense. There would be no justification for such a distinction.

Now consider this second hypothetical:

> Charlie Corp. is interested in acquiring control of SubCo, a corporation. Charlie currently owns no shares of SubCo stock directly, but does own 37% indirectly through various subsidiaries. Charlie contracts to buy a 15% interest in SubCo from Delta Corp. for $15 million, and to pay the purchase price over a nine-month period. Delta retains and perfects a security interest in the shares it sold to Charlie. In connection with the sale, Charlie represents and warrants that Charlie does not directly or indirectly own any shares of SubCo.
>
> A few months after the transaction closes, while still owing most of the purchase price (whether to Delta or to a third party that acquired the receivable from Delta), Charlie files for bankruptcy protection.

As in the first hypothetical, the policies underlying § 510(b) do not apply. Nevertheless, under *Elieff*, the claim for the unpaid portion of the purchase price, and lien securing it, will be subordinated to all of Charlie's general creditors. That is because the claim undoubtedly arises out of a purchase and sale of "securities" of an "affiliate" of Charlie. It makes no difference that Charlie misrepresented the facts and breached the warranty that it had no direct or indirect ownership interest in SubCo.

Finally, consider this third hypothetical:

> Pat and Morgan decide to divorce after 15 years of marriage. They jointly own a 100% interest in an LLC. Morgan runs the LLC's business. Pursuant to the parties' separation agreement, Morgan is to receive Pat's interest in the LLC and Morgan is to pay Pat $500,000 over the next five years. Pat's right to payment is secured by Morgan's interest in the LLC. Shortly after the divorce becomes final, Morgan seeks bankruptcy protection for reasons having nothing to do with the LLC.

Under *Elieff*, Pat's claim in Morgan's bankruptcy would appear to be subordinated under § 510(b). Yet Pat's claim might be entitled to priority under § 507(a)(1), as a claim for a domestic support obligation. Although a domestic support obligation must be "in the nature of alimony, maintenance, or support," as distinct from an obligation arising from a division of marital property,[21] courts have historically been extremely protective of ex-spouses and have characterized as domestic support obligations many things that look a lot like a division of property.[22]

There is nothing in the Bankruptcy Code that purports to address how to deal with a claim that is simultaneously entitled to priority under § 507(a) and subordinated under § 510(b). One possible implication of that silence is that such a conflict should not be possible. In other words, the two provisions should be interpreted as not overlapping. But the *Elieff* decision makes this conflict possible; it gives a green light to two trains heading toward each other on the same track.

GROUNDS FOR APPEAL

The BAP decision has already been appealed to the Ninth Circuit. Unfortunately, the likelihood of reversal seems small. The Ninth Circuit has already rejected most of the textual arguments that could be used to attack the BAP's decision. For example, the Ninth Circuit has rejected a narrow interpretation of the term "damages" in § 510(b).[23] It has ruled that a membership interest in a limited liability company is a "security" for purposes of § 510(b).[24] And most important, it has ruled that § 510(b) applies to individual debtors,[25] even though there can be no equity interest in an individual, and thus neither the policies underlying § 510(b) nor the last portion of the statutory text seem to apply in such a situation.[26] On top of all this, the Ninth Circuit – along with several other circuit courts – has repeatedly made it clear that § 510 is to be interpreted broadly.[27]

But a broad interpretation nevertheless should be – must be – guided by the underlying purposes to be served. Fidelity to the statutory text, a generally noble principle, transforms into something grotesque in the face of the parade of horribles mentioned above. Perhaps that is why the Second Circuit has made it quite clear that § 510(b) should be applied only when its underlying purposes apply.[28]

In that context, it is worth noting that: (i) Kurtin's claim in *Elieff* was based on Elieff's breach of contract by taking distributions from the entities; and (ii) the bankruptcy was a substantively consolidated case of both Elieff individually and the entities. As a result, allowing Kurtin – who had sold his equity interests in the entities – to use his judgment lien to extract value ahead of the general creditors *of the entities* would arguably allow him to elevate his claim in a way that § 510(b) was intended to prevent. Nothing in the BAP's decision suggests that these facts are critical. But perhaps if the Ninth Circuit carefully limits its own ruling to these facts, and disavows application of § 510 in the hypothetical scenarios described above, significant damage to commercial finance can be avoided.

ADVICE FOR TRANSACTIONAL LAWYERS

Unless and until the Ninth Circuit limits the scope of the BAP's ruling, lawyers representing a credit seller of a 20% or

greater interest in a corporation or LLC – or representing a lender financing such a transaction – should be very careful. They should advise their client of the danger that their claim might be subordinated in the debtor's bankruptcy.

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Notes:

1. 637 B.R. 612 (9th Cir. BAP 2022).

2. Colliers on Bankruptcy ¶ 510.04[1]. *See also* In re American Housing Found., 785 F.3d 143, 153 (5th Cir. 2015).

3. In re Del Biaggio, 834 F.3d 1003, 1010-11 (9th Cir. 2016) (*quoting* In re Betacom of Phoenix, Inc., 240 F.3d 823, 830 (9th Cir. 2001)); In re SeaQuest Diving, LP, 579 F.3d 411, 420 (5th Cir. 2009); In re Med Diversified, Inc., 461 F.3d 251, 256 (2d Cir. 2006); In re Telegroup, Inc., 281 F.3d 133, 139-40 (3d Cir. 2002) (quoting a law review article that apparently served as the inspiration for § 510(b)).

4. In re Del Biaggio, 834 F.3d at 1010-11; In re SeaQuest Diving, LP, 579 F.3d 418; In re Med Diversified, Inc., 461 F.3d at 256; Colliers on Bankruptcy ¶ 510.04[2].

5. *See, e.g.*, In re Telegroup, Inc., 281 F.3d at 139-40 (discussing the legislative history of § 510(b) but concluding that the provision is broader and subordinates a claim for breach of a provision of a stock purchase agreement requiring the issuer to use its best efforts to register its stock).

6. *See, e.g.*, In re Tristar Esperanza Properties, LLC, 782 F.3d 492 (9th Cir. 2015) (a claim against an LLC for failing to repurchase a membership interest had to be subordinated under § 510(b) in the LLC's bankruptcy even though the claimant was no longer an equity holder); In re Spectrum Alliance, LP, 609 B.R. 11 (E.D. Pa. 2019) (a limited partner's contractual right to redeem its partnership interest if its investment fell below 95% of its initial value was an interest, not a claim, and hence was properly subordinated under § 510(b)). *See also* In re American Housing Found., 785 F.3d 143 (the claim of a creditor, who had invested in limited partnerships controlled by and affiliated with the debtor, based on the debtor's guaranty of those investments, had to be subordinated under § 510(b)); Ebert v. Gecker, 2022 WL 2439992 (N.D. Ill. 2022) (an individual's claim for reimbursement of funds paid under a stock subscription plan that was conditioned on approval by the Illinois Gaming Board, and which approval was never received, had to be subordinated under § 510(b)); In re RTI Holding Co., 2021 WL 3409802 (Bankr. D. Del. 2021) (shareholders who did not assent to the debtor's prepetition merger and were entitled to payment based on an appraisal of the value of their shares did not have a general unsecured claim but a claim subordinated under § 510(b)). *But cf.* In re Channel Clarity Holdings LLC, 2022 WL 2811901 (Bankr. N.D. Ill. 2022) (an individual's claim for breach of a settlement agreement to redeem his interest in a LLC was not subject to subordination under § 510(b) because the debtor was neither the LLC in which the individual had an interest nor an affiliate of the LLC; it was instead another entity owned by the other owner of the LLC).

There are older cases suggesting the opposite. *See, e.g.*, In re Swift Instruments, Inc., 2012 WL 762833 (9th Cir. BAP 2012) (refusing to subordinate claims on notes issued by a corporate debtor in connection with stock redemption transactions); In re Montgomery Ward Holding Corp., 272 B.R. 836 (Bankr. D. Del. 2001) (a claim based on the nonpayment of a promissory note issued by the debtor to consummate the repurchase of its own stock is not one for damages "arising from" the purchase or sale of its securities; the claimant is not an equity holder trying to better his position by undoing the purchase transaction with a rescission or damage claim; the claimant is attempting to enforce the sale of stock). However, such cases no longer appear to be good law.

7. 637 B.R. at 622 (relying on In re Tristar Esperanza Properties, LLC, 782 F.3d at 497; In re American Wagering, Inc., 493 F.3d 1067, 1072 (9th Cir. 2007); and In re Telegroup, Inc., 281 F.3d at 138).

8. *Id.* at 623.

9. *Id.* at 624.

10. *Id.* at 625-29.

11. *Id.* at 626.

12. *Id.* at 626-27.

13. *Id.* at 628.

14. The court seemed untroubled by the linguistic nonsense of this statement. Debts are often subordinated to other debts, and liens are often subordinated to other liens. But subordinating a lien to debts does seem to be confusing apples with oranges, and not in a way that makes a refreshing smoothie.

15. *See infra* note 23.

16. *See infra* note 24.

17. Section 101(2) of the Bankruptcy Code defines "affiliate" to include a "corporation," 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with the power to vote by the debtor." Section 101(9) contains a non-exhaustive list of entities that qualify as a "corporation" under the Bankruptcy Code. Among them are: (i) an association having a power or privilege that a private corporation, but not an individual or a partnership, possesses; (ii) a "partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association"; and (iii) an unincorporated company or

association. It seems likely, therefore, that an LLC can be an affiliate of an individual debtor and there is no good policy reason it should not be. *See* In re Del Biaggio, 834 F.3d at 1008 & n.3 (noting that this point was undisputed by the parties).

18. A claimant that had a guaranty from Baker would have a contingent claim in Baker's bankruptcy, and that claim could be estimated and allowed under § 502. But there would be no policy justification for subordinating that claim to Able's claim.

19. *Cf.* In re KB Toys, Inc., 736 F.3d 247 (3d Cir. 2013) (purchasers of claims from creditors identified on the debtor's statement of financial affairs as having received potentially avoidable preferential transfers took the claims subject to their disabilities in the hands of the original creditors, and thus subject to disallowance under § 502(d) because of the failure of the original creditors to pay back avoidable preferential transfers); In re Firestar Diamond, Inc., 615 B.R. 161 (Bankr. S.D.N.Y. 2020) (a claim subject to disallowance under § 502(d) remains subject to disallowance after transfer. It does not matter whether the transfer is by way of assignment or sale). *But cf.* In re Enron, 379 B.R. 425 (S.D.N.Y. 2007) (a purchaser of a bankruptcy claim is not subject to equitable subordination or disallowance under § 502(d) based on conduct of seller, but a mere assignee may be.

20. Although "security" is defined to include an interest in a limited partnership, *see infra* note 24, the definition of "corporation" expressly excludes a limited partnership. *See* 11 U.S.C. § 101(9)(B). Consequently, a limited partnership cannot be an "affiliate" of an individual debtor under § 101(2)(B). Moreover, it seems unlikely that a limited partnership would be an affiliate of an individual debtor under any other paragraph of § 102(2).

21. *See* 11 U.S.C. § 101(14A)(B).

22. *See, e.g.*, Cummings v. Cummings, 244 F.3d 1263 (11th Cir. 2001) (a portion of a divorce decree ordering the ex-husband to pay $6.3 million as an equitable distribution of the marital estate, in addition to $5,150 per month in child support and 15 months of rehabilitative alimony, might be support); In re Brody, 3 F.3d 35 (2d Cir. 1993) (a separation agreement providing for payment of $1 million over four years, in satisfaction of the wife's right to equitable distribution of the marital estate and $3,250/month for support for 36 months, terminable on her death, remarriage, or cohabitation was all for support); Shaver v. Shaver, 736 F.2d 1314 (9th Cir. 1984) (a $190,000 debt to a former spouse was for support – largely because the debt terminated on the creditor spouse's death and she had no other means of support – even though the family court decree described it as in exchange for property rights and the court had no authority to award alimony).

23. In re Tristar Esperanza Properties, LLC, 782 F.3d at 495-96. *See also* In re American Housing Found., 785 F.3d at 153-54.

24. In re Del Biaggio, 834 F.3d at 1008 n.2. *See also* In re SeaQuest Diving, LP, 579 F.3d at 418; In re Alta+Cast, LLC, 301 B.R. 150, 154-55 (Bankr. D. Del. 2003).

An interest in a limited partnership is also a security. *See* § 101(49)(A)(xiii) (defining "security" to include an interest in a limited partnership); In re American Housing Found., 785 F.3d at 154-55 (so ruling); In re SeaQuest Diving, LP, 579 F.3d at 418.

25. In re Del Biaggio, 834 F.3d at 1010-11.

26. Section 510(b) subordinates claims arising from a purchase or sale of a security "to all claims or interests that are senior to or equal the claim or interest represented by such security." Because there are no securities in an individual debtor, there would seem to be nothing to subordinate the security transaction claim to. *Cf.* In re Lernout & Hauspie Speech Products, N.V., 264 B.R. 336 (Bankr. D. Del. 2001) (with respect to claims for fraud against both a subsidiary and a parent company arising out of the purchase of stock in the parent, the claim against the parent had to be subordinated to the parent's creditors only, and the claim against the subsidiary had to be subordinated to the subsidiary's creditors only).

27. *See, e.g.*, In re Tristar Esperanza Properties, LLC, 782 F.3d at 495; (citing In re SeaQuest Diving, 579 F.3d at 423-24; In re Med Diversified, Inc., 461 F.3d 251, 254-55 (2d Cir. 2006); In re Telegroup, Inc., 281 F.3d at 143-44).

28. In re Med Diversified, Inc., 461 F.3d at 256 ("Because there are only two rationales for mandatory subordination expressly or implicitly adopted by the Congress that enacted section 510(b), we conform our interpretation of the statute to require subordination here only if [the claimant] (1) took on the risk and return expectations of a shareholder, rather than a creditor, or (2) seeks to recover a contribution to the equity pool presumably relied upon by creditors in deciding whether to extend credit to the debtor.").

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Recent Cases

SECURED TRANSACTIONS

Scope Issues

In re Roberts,
2022 WL 2294014 (Bankr. E.D. Wis. 2022)
Transactions structured as rent-to-own leases of consumer goods were true leases. The consumers could become the owners by: (i) paying rent for 24 months, by which time they would have paid double the cash price of the goods, or (ii) by paying a lump sum equal to half of the remaining rental payments for that 24-month period. However, the consumers could terminate the leases at any time by returning the goods, and the useful life of the goods exceeded the initial one-month term of the lease. As a result, the lessor retained an economically significant reversionary interest in the goods.

Fleetwood Services, LLC v. RAM Capital Funding, LLC,
2022 WL 1997207 (S.D.N.Y. 2022)
A transaction structured as a sale of future receivables for a price of $100,000 until $149,000 was repaid, and that provided for a daily ACH transfer of $1,399, was a loan. The agreement had none of the characteristics of a true sale of receivables in terms of the transfer of risks and rewards. The putative buyer had no risk of loss arising from any account debtor's failure to pay, and received no reward if account debtors performed better than expected. The agreement also imposed liability on the putative seller and the guarantors in almost every imaginable circumstance. Although the agreement contained a reconciliation provision for adjusting the amount of the daily payment, that provision was largely illusory because adjustment was within the sole discretion the putative buyer. Because the transaction was usurious regardless of whether New York or Texas law applied, the lender and its principals were liable under RICO for receiving income through collection of an unlawful debt.

Attachment Issues

In re Main Street Business Funding, LLC,
2022 WL 2073343 (Bankr. D. Del. 2022)
Of the debtor's claims against a consultant for fraudulent misrepresentation, conversion, civil conspiracy, unjust enrichment, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and legal malpractice, only the unjust enrichment claim sounded in contract; all the others sounded in tort. Pursuant to the "gist of the action" doctrine, the entire claim was therefore a commercial tort claim. A secured party's security agreement did not adequately describe commercial tort claims and therefore did not cover the claims themselves. Nor did the security interest attach to the bankruptcy trustee's postpetition settlement of the claim because a clause in the security agreement encumbering after-acquired general intangibles does not reach proceeds of a commercial tort claim.

Blessing v. Sandy Spring Bank,
2022 WL 2282681 (Md. Ct. Spec. App. 2022)
An individual could not have acquired goods through a putative secured party because the security agreement was authenticated on behalf of the parent company of the entity that owned the goods, and therefore no security interest attached.

In re Flint,
2022 WL 1600322 (Bankr. D.S.C. 2022)
A seller who owned 220 shares of stock in a closely held corporation, which shares were represented by Stock Certificate No. 5 that was not signed by officers of the corporation, who sold 120 shares on credit to a buyer, and who retained possession of the certificate, did not have a security interest in the shares of stock. The security agreement described the collateral as stock in the corporation "represented by Certificate No. 3," but no certificate with that number was ever created or issued. Moreover, Certificate No. 5 was not properly issued and, because it was never indorsed to the buyer, could not represent both the seller's and the buyer's shares. Even if the seller did have a security interest in the buyer's shares, the security interest was unperfected. Possession of the certificate was ineffective to perfect because the certificate did not represent the buyer's shares and the seller's filed financing statement had lapsed.

McGrath as Trustee v. Addy & McGrath Fireworks, Inc.,
2022 WL 2299165 (Ill. Ct. App. 2022)
A lender had a security interest in the inventory of a fireworks company even though the debtor lacked the state and federal licenses needed to lawfully purchase, possess, and sell fireworks, and had purchased fireworks using the license number of another entity. The debtor had possession of and ownership rights in the fireworks because they were purchased with the debtor's funds, stored in a facility leased by the debtor, and stamped with the debtor's assumed business name. The security interest is not invalidated because of the debtor's wrongdoing because the security interest did not require either the lender or the debtor to engage in illegal activity. Indeed, the debtor represented in the security agreement that it had obtained and would maintain all licenses necessary to conduct its business, and the lender had no knowledge or reason to know that the debtor would illegally acquire fireworks without a valid license and had no duty to investigate whether the debtor actually had all necessary licenses prior to making the loan.

Enforcement Issues

SMC Specialty Finance LLC v. Zhenfu Pictures Ltd.,
2022 WL 2255230 (Cal. Ct. App. 2022)

A Chinese company that allegedly used its rights in a film distribution agreement as collateral for a bridge loan to an affiliate was not entitled to a preliminary injunction against the secured party that had bought the rights at a foreclosure sale. The Chinese company had not shown a likelihood of success on the merits of its claim that the security interest was invalid. Although the distribution agreement contained a provision generally prohibiting assignment, the language suggested that the restriction was concerned with the Chinese company transferring all or part of its duties under the agreement to someone else, and hence did not restrict the granting of a security interest. As a result, there was no need to determine how § 9-408 would apply to a restriction on assignment. The Chinese company also failed to show that the harm to it if the injunction were denied was greater than the harm to the secured party if the injunction were issued because the secured party had not sought to collect from the other party to the distribution agreement or asserted any right to control distribution; it merely wanted to preserve its status as the owner of the rights under the distribution agreement while the litigation played out.

Stream TV Networks, Inc. v. SeeCubic, Inc.,
2022 WL 2149437 (Del. 2022)

Because a corporation's charter required approval of the Class B shareholders for any "sale, lease or other disposition of all or substantially all of the assets," the shareholders' approval was needed to transfer substantially all of the corporation's personal property to a newly formed entity controlled by the creditors that had a security interest in the assets. The privately structured foreclosure transaction was a "disposition" within the meaning of the charter. Moreover, there is no insolvency exception to the Delaware statute that requires unanimous shareholder consent to a sale, lease or exchange of substantially all of a corporation's assets.

Mitchell v. Auto Mart, LLC,
2022 WL 2818346 (D. Nev. 2022)

A debtor was entitled to summary judgment on its claim that a repossession company violated the Fair Debt Collection Practices Act by repossessing her car before she was in default. The sales agreement for the car provided that the debtor would be in default if she failed to make payment within 30 days after its due date, but the company repossessed the car before the 30-day period expired. Although the agreement also prohibited the debtor from "permanently" taking the car out of Nevada without the secured party's written consent, and the debtor had taken the car to Florida, the agreement did not indicate that doing so constitutes a default, nor had the repossession company made any such argument.

Liability Issues

Ballou v. Kurtenbach,
2022 WL 2824286 (Iowa Ct. App. 2022)

Landowners who leased farmland, who had a security interest in the crops the tenant grew there, and who filed a financing statement covering those crops, were not liable for slander of title when, years after the lease was terminated, they refused to terminate the financing statement or amend it to specify the crop years to which it applied because: (i) the indication of collateral in the financing statement was not false; (ii) the landowners did not act maliciously because they had reason to believe the debtor still possessed some crops harvested from the property and no evidence to the contrary was provided to them; and (iii) the debtor failed to offer any competent evidence that he was denied financing due to the financing statement.

In re S-Tek 1, LLC,
2022 WL 2133980 (Bankr. D.N.M. 2022)

A secured party that accepted a late payment, thereby waiving the default, and did not proceed with a planned sale of the collateral, but failed to cancel a newspaper advertisement of the sale, incurred no liability because, even if such conduct is improper, the debtor did not present evidence of any damage suffered as a result of the advertisement.

Intellectual Tech LLC v. Zebra Technologies Corp.,
2022 WL 1608014 (W.D. Tex. 2022)

Even though the collateral – a patent – did not automatically transfer to the secured party upon the debtor's default, the secured party did thereby acquire the right to license the patent. As a result, the debtor no longer retained the exclusive right to license the patent and therefore lacked constitutional standing to bring an infringement action against a third party.

BANKRUPTCY

In re Chuza Oil Co.,
639 B.R. 586 (10th Cir. BAP 2022)

Payments totaling $47,000 to an insider creditor on a subordinated note, and for the benefit of other insiders who had guaranteed the debt, were both avoidable preferences and constructively fraudulent transfers, even though the payments were made with funds provided by the insiders. Because the transactions substituted new unsubordinated debt for the paid subordinated debt, thereby diminishing the debtor's estate, the earmarking doctrine did not apply, the new value defense in § 547(c)(1) did not apply, and the debtor did not receive reasonably equivalent value in exchange for the payments.

In re George G. Sharp, Inc.,
2022 WL 1714178 (Bankr. S.D.N.Y. 2022)
Summary judgment would not be issued for either party on the trustee's claim to avoid allegedly preferential payments made to a vendor before delivery of the goods. Although the new value defense in § 547(c)(3) can include property or services provided under a contract separate from the one on which the preferential transfer was made, factual questions remained with respect to when goods were shipped, at the debtor's direction, to a third party, and whether new value was provided "to or for the benefit of the debtor." Although the trustee conceded that a contractually required prepayment is not "an antecedent debt owed by the debtor before such transfer was made," it was unclear from the facts whether the payments made, apparently in response to the vendor's demand for adequate assurance under § 2-609, were required under the debtor's contract with the vendor.

In re Reagor-Dykes Motors, LP,
2022 WL 2046144 (Bankr. N.D. Tex. 2022)
The Ponzi-scheme presumption of fraudulent intent did not apply to payments made by a car dealership to its floor-plan financier. Although the dealership engaged in systemic fraud (sales out of trust, fake flooring, double flooring, and check kiting), it did not operate as a Ponzi scheme, in which funds provided by later investors are used to pay earlier investors. Although the financier had a first-priority security interest in most of the dealership's assets, the financier was not entitled to summary judgment based on the argument that the payments were not made from the dealership's property. Even though the security agreement prohibited the commingling of assets, in the absence of proof that there was no commingling, there was no trust. Similarly, although a transfer of fully encumbered funds is not recoverable as a fraudulent transfer, because the payments came from commingled accounts and the financier had not yet traced its collateral, the financier was not entitled to summary judgment on that basis. Because it was not yet shown whether or to what extent the payments were made using the financier's collateral, summary judgment would also not be awarded on the trustee's preference action.

GUARANTEES & RELATED MATTERS

Osprin II, LLC v. TX 1111 Rusk GP LLC,
2022 WL 2541932 (Tex. Ct. App. 2022)
A guaranty of a nonrecourse bridge loan, which provided that "all obligations of the Guarantors under this Guaranty shall terminate" upon the completion of a project to restore a historic building, terminated when the project was competed even though the loan had not yet been repaid. The clause did not merely release the guarantor from future executory obligations while preserving matured obligations.

LENDING, CONTRACTING & COMMERCIAL LITIGATION

Adams v. Mt. Lebanon Operations, LLC,
2022 WL 1698012 (Pa. Super. Ct. 2022)
A trial court did not err in refusing, prior to discovery, to compel arbitration of a wrongful death claim brought by the daughter of a nursing home resident. Although the admission agreement signed by the daughter on her mother's behalf contained an arbitration clause, the agreement contained conflicting statements about the daughter's authority to contract for her mother, and it directed an authorized representative signing on behalf of a resident to attach a power of attorney, but no such documentation was attached.

Gerro v. BlockFi Lending LLC,
2022 WL 2128000 (Cal. Ct. App. 2022)
The trial court erred in staying a case brought in California by a debtor against his secured lender to cancel the loan agreement and obtain return of the Bitcoin collateral that the secured lender had sold. Although the security agreement chose Delaware law to govern and specified that all litigation must occur in Delaware, the agreement also included a waiver of a jury trial, and such a waiver is unenforceable in California. Because Delaware courts would likely honor the waiver, enforcement of the forum-selection clause would substantially diminish the rights of the debtor in way that violates public policy.

Blue Mountain Holdings Ltd. v. Bliss Nutraceticals, LLC,
2022 WL 2316386 (N.D. Ga. 2022)
A transaction structured as a credit sale of a trademark with a retained security interest securing the unpaid portion of the purchase price was instead a license because, until the full price was paid, the putative buyer would not receive legal title to the mark, could register the mark in a new jurisdiction only under the seller's name, could not license or transfer the mark without the seller's prior written consent, and was restricted with respect to how it could manufacture, distribute, and sell trademarked products. In addition, if the seller reasonably believed that any harm may be caused to the associated goodwill, it had the right to force the buyer to immediately modify or cease its use of the mark. The license was a "naked" license because, even though the agreements nominally gave the licensor the right to control the quality of the licensee's products, the licensor never exercised this contractual right in the three years since entering into the transaction, the agreement contained no formulas, ingredient lists, packaging instructions, sales procedures, or other requirements related to product quality, and the licensor was a holding company with no employees, and thus had no ability to monitor the quality of marked products. Consequently, the trademark had been abandoned as a matter of law.

In re TPC Group Inc.,
2022 WL 2498751 (Bankr. D. Del. 2022)
Syndicated loan documents permitted the holders of a majority of the loan to amend the loan agreement to subordinate the debt to a new loan made by the majority. Although the indenture required the approval of any adversely affected lender to an amendment "dealing with the application of proceeds of Collateral," that provision dealt with ratable distribution of proceeds received by the indenture trustee, not with subordination that prevented the trustee from receiving proceeds of collateral. Indeed, another clause in the indenture required only a two-thirds majority to consent to a release of collateral, and it would make no sense to require the consent of every adversely affected lender to subordination of the lien while requiring only two-thirds to consent to a more drastic release. Moreover, a clause in the supplement indenture required only a two-thirds majority to consent to an amendment that subordinated the lien securing the debt.

Financial Pacific Leasing Inc. v. RVI America Insurance Co.,
2022 WL 2718038 (W.D. Wash. 2022)
A residual value insurance policy, which protected an equipment lessor from the risk that railcars would have a value at the end of the lease term below their insured value, was ambiguous because it defined "appraised value" as both: (i) what would result from an arm's-length transaction between an informed and willing seller under no compulsion to sell and an informed and willing buyer under no compulsion to purchase; and (ii) "the expense necessary to construct an exact duplicate of a subject property."

Benbrook Economic Dev. Corp. v. National Bank of Texas,
2022 WL 1042926 (Tex. Ct. App. 2022)
Because the assignee of a promissory note, which had recorded an assignment of the deed of trust securing the note and had possession of the note, had allowed the original payee to receive periodic payments, full payment to the original payee might have satisfied the note and discharged the lien.

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COMMERCIAL LAW AMICUS INITIATIVE UPDATE

In June, the Commercial Law Amicus Initiative ("CLAI") won its fourth case when the Kentucky Supreme Court affirmed the decision of the Court of Appeals in *Versailles Farm Home and Garden, LLC v. Haynes,* 2022 WL 2253157 (Ky. 2022), albeit on different grounds. The issues in the case were whether a security interest can secure a later-incurred debt if the original security agreement lacks a future advances clause and, if so, what the priority of the security interest is. After concluding that the collateral did secure a subsequent loan, the Court of Appeals implied that the secured party, which was the first to file or perfect, had priority with respect to the later loan only because a secured party with a later-filed financing statement had not obtained or even asked to see the original security agreement that lacked a future-advances clause. The Kentucky Supreme Court, at the urging of CLAI, agreed that whether the later secured party had obtained or requested the first secured party's security agreement was irrelevant under the first-to-file-or-perfect rule of § 9-322(a)(1).

The decision brings CLAI's record as *amicus curiae* to a perfect 4-0. More information about CLAI's activities, including copies of its briefs, are available at CLAI's website: amicusinitiative.org.

If you are aware of a case that you think CLAI should participate in as amicus curiae, please contact any of CLAI's officers:

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A Summary of the 2022 Amendments to the Uniform Commercial Code		
Subject	**Sections Amended or Added**	**Change Made**
Controllable Electronic Records – Definition	§§ 12-102(a)(1), 12-105	Defines a controllable electronic record ("CER") as a record in electronic form that is susceptible to a specified method of control. Note, it is imperative to distinguish between a *record* (*i.e.*, the CER itself) and any *rights evidenced* by the record. Some CERs (*e.g.*, cryptocurrencies and non-fungible tokens) have intrinsic value in the sense that people are willing to pay for the CER itself. Other CERs evidence ownership of a tangible or intangible asset or right, and ownership of that asset or right might or might not be transferred when the CER is transferred.
Controllable Electronic Records – Transfer of Rights Generally	§ 12-104(c), (d)	Provides that a purchaser of a CER acquires all rights in the CER that the transferor had or had power to transfer. In most cases, whether a transfer of a CER transfers rights to property represented by the CER is left to law outside the UCC.
Controllable Electronic Records – Choice of Law	§§ 1-301(c)(9), 9-306B, 12-107(c), (d)	Provides that perfection by control and priority are governed by the law of the CER's jurisdiction. A waterfall of rules is provided to determine what the CER's jurisdiction is: (i) the jurisdiction expressly designated as the CER's jurisdiction in the record; (ii) the jurisdiction expressly designated as the CER's jurisdiction in the rules of the system in which the record is recorded; (iii) the jurisdiction whose law is selected to govern in the CER; (iv) the jurisdiction whose law is selected to govern the rules of the system; (v) the District of Columbia. Perfection by filing is governed by the law of the jurisdiction where the debtor is located.
Controllable Electronic Records – Perfection	§§ 9-107A(a), 9-312(a), 9-314(a), (b), 12-105	Provides that a security interest in a CER may be perfected by filing or control. To have control of a CER, a person must have: • The power to avail itself of substantially all the benefit from the record; • The exclusive power to prevent others from availing themselves of substantially all the benefit from the record; • The exclusive power to transfer control of the record; and • The ability readily to identify itself (by name, number, cryptographic key, account number, or otherwise) as the person having these powers.
Controllable Electronic Records – Priority	§§ 9-326A, 12-102(a)(2), (4), 12-104(e), (f), (g), (h)	Provides that a security interest perfected by control has priority over a security interest held by a secured party that does not have control. Provides that a "qualifying purchaser" (which can include a secured party) takes free of a claim of a property right in the CER. To be a qualifying purchaser, a purchaser must obtain control of the CER for value, in good faith, and without notice of a claim of a property right in the CER. The filing of a financing statement is not notice of a claim of a property right in a CER.
Controllable Accounts & Controllable Payment Intangibles – Definitions	§ 9-102(a)(27A), (27B)	Creates two new classifications of collateral, defined respectively as: (i) an account evidenced by a CER; and (ii) a payment intangible evidenced by a CER. Hence, controllable accounts are a subset of accounts (not of CERs) and controllable payment intangibles are a subset of payment intangibles (not of CERs).

A Summary of the 2022 Amendments to the Uniform Commercial Code		
Subject	**Sections Amended or Added**	**Change Made**
Controllable Accounts & Controllable Payment Intangibles – Transfer of Rights Generally	§ 12-104(a), (d)	Provides that the transfer of a CER evidencing a controllable account or controllable payment intangible transfers with it the underlying account or payment intangible. As noted above, transfers of other CERs do not necessarily have this effect; whether a transferee of other CERs acquires the property represented by the CERs is left to law outside the UCC.
Controllable Accounts & Controllable Payment Intangibles – Choice of Law	§§ 9-306B, 12-107(b), (c), (d)	Same as for CERs, except that: (i) the agreement with the account debtor may specify what jurisdiction law governs; and (ii) automatic perfection for a sale of controllable payment intangibles is governed by the law of the jurisdiction where the debtor is located.
Controllable Accounts & Controllable Payment Intangibles – Perfection	§§ 9-107A(b), 9-312(a), 9-314(a), (b), 12-105	Same as for CERs, except that there is automatic perfection for a sale of controllable payment intangibles.
Controllable Accounts & Controllable Payment Intangibles – Priority	§§ 9-326A, 12-102(a)(2), (4), 12-104(e), (f), (g), (h)	Same as for CERs.
Chattel Paper – Definition	§ 9-102(a)(3), (11), (31), (47), (79)	Redefines chattel paper more accurately as a right to payment, rather than as a collection of writings or records. Eliminates the defined terms "electronic chattel paper" and "tangible chattel paper." Clarifies that if the account debtor's monetary obligation covers not only a lease of goods but also other property and services relating to the leased goods, then chattel paper is created only if the predominant purpose of the transaction is to create a lease of goods. Alters the relationship between instruments and chattel paper. The definition of "instrument" now excludes "writings that evidence chattel paper." As a result, a receivable cannot be both an instrument and chattel paper. Instead, the term chattel paper now takes precedence.
Chattel Paper – Choice of Law	§ 9-306A	Provides that if chattel paper is evidenced by authoritative electronic records or by both authoritative electronic records and authoritative tangible records, the law of the chattel paper's jurisdiction governs: (i) perfection by control and possession; and (ii) priority. A waterfall of rules is provided to determine what the chattel paper's jurisdiction is: (i) the jurisdiction expressly designated as the chattel paper's jurisdiction in the record; (ii) the jurisdiction expressly designated as the chattel paper's jurisdiction in the rules of the system in which the record is recorded; (iii) the jurisdiction whose law is selected to govern in the chattel paper; (iv) the jurisdiction whose law is selected to govern the rules of the system; (v) the debtor's location. For chattel paper evidenced only by authoritative tangible copies, perfection by possession and priority are governed by the law of the location of the authoritative tangible copies. For all types of chattel paper, perfection by filing continues to be governed by the law of the jurisdiction where the debtor is located.

A Summary of the 2022 Amendments to the Uniform Commercial Code		
Subject	**Sections Amended or Added**	**Change Made**
Chattel Paper – Perfection	§§ 9-105, 9-314A	Replaces the separate rules for perfection by possession of tangible chattel paper and perfection by control of electronic chattel paper with a single rule under which a security interest in chattel paper can be perfected by taking possession of all the authoritative tangible copies and obtaining control of all the authoritative electronic copies. This avoids the problems that can arise when: (i) there are both authoritative tangible records that evidence the right to payment and authoritative electronic records that evidence the right to payment; or (ii) tangible chattel paper is converted to electronic chattel paper, or vice-versa. Modifies the safe harbor for control to be consistent with control of CERs under § 12-105. It differs from the general rule discussed above, which is based on a "single authoritative copy" of an electronic record or records, and hence is unavailable when the chattel paper is maintained on a blockchain or other distributed ledger. To obtain control under the safe harbor: (i) a person must be able to identify each electronic copy as authoritative or non-authoritative; (ii) the chattel paper, a record associated with the chattel paper, or the system in which the chattel paper is recorded enables the person to identify itself as the person to which each authoritative electronic copy has been assigned; and (iii) the person must have the exclusive powers to: (A) prevent others from adding or changing an identified assignee of each authoritative electronic copy; and (B) to transfer control of each authoritative copy. If it is established that a person has those powers, subsection (f) provides a presumption of exclusivity. Perfection by filing remains available.
Chattel Paper – Priority	§ 9-330	Consistent with the new unitary rule for perfection of a security interest in chattel paper by possession and control of all authoritative records evidencing the chattel paper, provides that a purchaser's priority over a perfected security interest applies only if the purchaser takes possession of each authoritative tangible record and obtains control of each authoritative electronic record.
Commercial Tort Claims – Attachment	§ 9-204(c)	Clarifies and makes explicit that subsection (b) does not prevent a security interest from attaching to commercial tort claims as proceeds of other collateral or, through an after-acquired property clause, to proceeds of commercial tort claims. This clarification corrects and rejects two lines of cases erroneously ruling to the contrary.
Instruments – Temporary Perfection	§§ 9-102(a)(47), 9-312(g)	Because the definition of "instrument" now excludes "writings that evidence chattel paper," § 9-312(g) (which itself is not amended) no longer applies to maintain perfection for 20 days if a promissory note (or other writing) that evidences chattel paper is returned to the debtor for collection or some other legitimate reason.

A Summary of the 2022 Amendments to the Uniform Commercial Code		
Subject	**Sections Amended or Added**	**Change Made**
Money – Definition	§ 1-201(b)(24), 9-102(a)(31A), (54A), (79A)	Expands the Article 1 definition to include "electronic money," but also limits the term so that it does not include an electronic record that is a medium of exchange recorded and transferable in a system that existed and operated before the medium of exchange was authorized or adopted by a government. Hence, a government electronic currency can be money but privately created cryptocurrencies, such as bitcoin and ethereum, are not money.
Money – Perfection	§§ 9-105A, 9-312(b)(4), 9-314(a), (b)	Provides that a security interest in electronic money as original collateral can be perfected only by control. Control of electronic money is defined consistently with control of a CER (discussed above).
Money – Priority	§§ 9-332(b), 12-102(a)(1).	Provides that a transferee of electronic money takes free of a security interest if the transferee obtains control of the money without acting in collusion with the debtor in violating the rights of the secured party. Electronic money is excluded from the definition of "controllable electronic record," and therefore Article 12 does not apply to electronic money. Consequently, there is no rule providing for transferees to take free of a claim of ownership other than a security interest.
Electronic Documents of Title – Perfection by Control	§ 7-106(c), (f)	Creates a new safe harbor for control modeled on control of CERs under § 12-105. It differs from the safe harbor in subsection (b), which is based on a "single authoritative copy" of an electronic document of title and hence is unavailable when the document is maintained on a blockchain or other distributed ledger. To obtain control: (i) a person must be able to identify each electronic copy as authoritative or non-authoritative; (ii) the document, a record associated with the document, or the system in which the document is recorded enables the person to identify itself as the person to which each authoritative electronic copy has been issued or transferred; and (iii) the person must have the exclusive powers to: (A) prevent others from adding or changing an identified person to which each authoritative electronic copy has been issued or transferred; and (B) to transfer control of each authoritative copy. If it is established that a person has received those powers, subsection (f) provides a presumption of exclusivity.
Control through Another Person – Permitted	§§ 7-106(g), 8-106(d)(3), 9-104(a)(4), 9-105(g), 9-105A(e), 9-107A(a), (b), 12-105(e)	Permits a person/purchaser/secured party to have control of electronic documents, security entitlements, deposit accounts, chattel paper, electronic money, controllable accounts, controllable payment intangibles, and CERs if someone else with control, other than the transferor, acknowledges that it has control on behalf of the person.
Control through Another Person – No Duty to Acknowledge	§§ 7-106(h), 8-106(h), 9-107B(a), 12-105(f)	Provides that a person who has control of an electronic document, security entitlement, deposit account, chattel paper, electronic money, or CER is not required to acknowledge that it has or will obtain control on behalf of another person. It is unclear if this rule applies to controllable accounts or controllable payment intangibles.

A Summary of the 2022 Amendments to the Uniform Commercial Code		
Subject	**Sections Amended or Added**	**Change Made**
Control through Another Person – Duties	§§ 7-106(i), 8-106(i), 9-107B(b), 12-105(g)	Provides that a person who agrees to have control of an electronic document, security entitlement, deposit account, chattel paper, electronic money, or CER on behalf of someone else has no duties other than those agreed to or created under law outside the UCC. It is unclear if this rule applies to controllable accounts or controllable payment intangibles.
Shared Control	§§ 7-106(d)(2), (e), 9-105(d)(2), (e), 9-105A(b)(2), (c), 12-105(b)(2), (c)	Allows for control of electronic documents, chattel paper, electronic money, controllable accounts, controllable payment intangibles, and CERs to be shared, thereby authorizing multi-signature agreements. However, if Party A can exercise a control power only with the cooperation of Party B but Party B either can exercise the control power without Party A or is the transferor, then Party A does not have control.
Secured Party's Duties – Relinquish Control	§ 9-208(b)(3), (6), (7), (8)	Provides that when there is no outstanding secured obligation and no commitment to make advances, the secured party (other than a buyer of a controllable account or controllable payment intangible) having control of an electronic record evidencing chattel paper, an electronic document, electronic money, or a CER must, within 10 days after receiving the debtor's demand therefor, transfer control to the debtor or a person designated by the debtor.
Secured Party's Duties – Unknown Debtors & Obligors	§§ 9-605(b), 9-628(f)	Provides an exception to the general rule that a secured party does not owe a duty to and does not incur liability to a debtor or obligor unless the secured party knows that person is a debtor or obligor and how to contact that person. Under the exception, a secured party owes a duty to such a person if, at the later of the time the security interest attaches to a CER, controllable account, or controllable payment intangible or the time the secured party obtains control of such collateral, the secured party knows that the name or address of the person is not provided by the collateral, a record attached to or logically associated with the collateral, or the system in which the collateral is recorded. The exception reflects the policy that a secured party should not be free to avoid statutory duties if it knows at the outset of the transaction that it will not have the information necessary to fulfill those duties.
Assignor & Assignee	§ 9-102(a)(7A), (7B)	Codifies PEB Commentary No. 21 (March 11, 2020) by: (i) defining "assignee" to include both a secured party with a security interest that secures an obligation and a buyer of an account, chattel paper, payment intangible, or promissory note; and (ii) defining "assignor" as the counter-party in such transactions. This overrules judicial decisions interpreting too narrowly those terms in Part 4 of Article 9.
Buyers and Lessees of Goods Take Free of Future Advances	§ 9-323(b), (d)	Expands the rules that allow buyers and lessees of goods to take free of some future advances to cover buyers in ordinary course of business and lessees in ordinary course of business. Such buyers and lessee take free of most security interests entirely, but when they do not (because, for example, the security interest was not created by the seller or lessor), they should nevertheless take free of advances made without knowledge of the sale or lease or more than 45 days after that transaction.

A Summary of the 2022 Amendments to the Uniform Commercial Code		
Subject	**Sections Amended or Added**	**Change Made**
Conspicuousness	§ 1-201(b)(10)	Removes the "safe harbor" for contrasting type, which was inconsistent with the general rule. An extensive new comment provides further guidance. Relevant primarily to disclaimers of implied warranties under Articles 2 and 2A.
Scope of Article 2	§§ 2-102, 2-106(5),	Codifies a two-tiered test for the scope of Article 2 that combines the widely used predominant purpose test with the less widely used bifurcation approach. If the sale-of-goods aspects of a hybrid transaction predominate, then Article 2 applies. If the other aspects of the transaction (*i.e.*, services, real property, software or other intangible property, or even a lease of other goods) predominate, then the provisions of Article 2 that relate primarily to the goods, but not to the transaction as a whole, apply.
Scope of Article 2A	§§ 2A-102, 2A-103(1)(h.1)	Codifies a two-tiered test for the scope of Article 2A. If the lease-of-goods aspects of a hybrid transaction predominate, then Article 2A applies. If the other aspects of the transaction (*i.e.*, services, real property, software or other intangible property, or even a sale of other goods) predominate, then the provisions of Article 2A that relate primarily to the goods, but not to the transaction as a whole, apply.
Negotiable Instruments	§ 3-104(a)	Clarifies that neither a choice-of-law clause nor a choice-of-forum clause prevents a writing from being a negotiable instrument.
Remote Deposit Capture	§§ 3-105, 3-604	Clarifies that: (i) an instrument is "issued" if a drawer sends an image of and information describing an item but never delivers the item; and (ii) destruction of the writing in such a process does not discharge the obligation of a person to pay a check.
Payment Orders	§ 4A-104	Clarifies when an instruction sent pursuant to a so-called "smart contract" constitutes a payment order.
Security Procedures	§§ 4A-201, 4A-202	Clarifies that: (i) a security procedure in connection with a payment order for a funds transfer may impose obligations on the receiving bank, the customer, or both; (ii) a security procedure may require the use of symbols, sounds, or biometrics; and (iii) a requirement that a payment order be sent from a known email address, IP address, or phone number is not by itself a security procedure.

A Summary of the 2022 Amendments to the Uniform Commercial Code		
Subject	**Sections Amended or Added**	**Change Made**
Medium Neutrality – Sign & Authenticate	§§ 1-201(b)(37), 1-306 5-104, 5-116(a), 7-102(a)(11), 9-102(a)(4)(A), (7), (66), 9-104(a)(2), 9-203(b)(3)(A), 9-208(b)(1), (4), (5), 9-209(b), 9-210(a)(2), (3), (4), (c), (d), (e), 9-312(e), 9-313(c)(1), (2), 9-324(b)(2), (d)(2), 9-334(f)(1), 9-341, 9-404(a)(2), 9-406(a), 9-509(a), 9-513(b)(2), (c), 9-608(a)(1)(C), 9-611(a)(1), (b), (c)(3), (e)(2), 9-615(a)(3)(A), (4), 9-616(a)(2), 9-619(a), 9-620(a)(2), (b)(1), (c)(1), (2), (f)(2), 9-621(a)(1), 9-624(a), (b), (c)	Modifies the definition of "sign" to apply to both tangible and electronic records. References to "authenticate" and "authenticated" are replaced with "sign" and "signed."
Medium Neutrality – Writing & Record	§§ 2-201(1), (2), 2-202, 2-203, 2-205, 2-209, 2A-107, 2A-201(1)(b), (2), (5)(a), 2A-202, 2A-203, 2A-205, 2A-208, 4A-103(1), 4A-202(b), (c), 4A-203(a)(1), 4A-207(c)(2), 4A-208(b)(2), 4A-210(a), 4A-211(a), 4A-305(c), (d), 7-102(a)(10), 8-102(a)(6), 9-616(a)(1), (b)(1)(A), (c)	Most references to "writing" and "written" are replaced with references to "record" and "in a record."

Recent State Legislation Amending the State's Version of the UCC				
State	**Legislation**	**Description**	**Date Enacted**	**Effective Date**
Arkansas	2021 Ark. Laws Act 1078	Added Chapter 11 to the state's commercial code. Modeled on selected provisions of a draft version of UCC Article 12 produced by the Committee on the UCC and Emerging Technologies, the act defines "virtual currency" and provides that a good faith purchaser that acquires control of virtual currency takes free of any adverse claim.	4/30/21	7/28/21
Idaho	2022 Idaho Laws ch. 284	Enacted the "Digital Assets Act," which, among other things: (i) defines digital assets to include virtual currency; (ii) provides that a security interest in virtual currency perfected by possession or control has priority over a security interest not perfected by possession or control; and (iii) provides that a good faith purchaser takes free of a claim of a property right to the currency.	3/28/22	7/1/22
Indiana	2022 Ind. Legis. Serv. P.L. 110-2022	Amended the state's UCC Article 9 and added a new Chapter 11 to the state's UCC, modeled on a preliminary draft the amendments and new Article 12 produced by the Committee on the UCC and Emerging Technologies. The act addresses "controllable electronic records," "controllable accounts," and "controllable payment intangibles." It defines "control," and provides that a good faith purchaser that acquires control of such property takes free of any adverse claim.	3/15/22	7/1/22
Iowa	H. 2445	Amended the state's UCC Article 9 and added a new Chapter 14 to the state's UCC, modeled on a preliminary draft the amendments and new Article 12 produced by the Committee on the UCC and Emerging Technologies. The act addresses "controllable electronic records," "controllable accounts," and "controllable payment intangibles." It defines "control," and provides that a good faith purchaser that acquires control of such property takes free of any adverse claim.	6/13/22	7/1/22
New Hampshire	2022 N.H. Laws ch. 281	Amended the state's UCC to adopt the 2022 amendments, based on the draft presented at the 2022 ULC Annual Meeting.	6/28/22	1/1/23
Texas	2021 Tex. Sess. Law Serv. ch. 739	Amended the state's UCC Article 9 and added Chapter 12 to the state's UCC. The act: (i) defines "virtual currency"; (ii) provides for a security interest in virtual currency to be perfected by "control," the definition of which is taken from a draft of UCC Article 12 produced by the Committee on the UCC and Emerging Technologies; and (iii) provides that a good faith purchaser that acquires control takes free of a claim of a property right to the currency.	6/15/21	9/1/21
Utah	2022 Utah Laws ch. 448	Enacted the Digital Asset Management Act, which: (i) defines "digital assets"; (ii) defines "control" of a digital asset; and (iii) specifies that an owner may demonstrate ownership through control.	3/24/22	5/4/22

Recent State Legislation Amending the State's Version of the UCC				
State	**Legislation**	**Description**	**Date Enacted**	**Effective Date**
Wyoming	2021 Wy. Laws ch. 91 & 2020 Wy. Laws ch. 103	Collectively, these laws provide that: (i) a security interest in virtual currency may be perfected by possession, which is defined as the ability to exclude others from the use of property, and includes use of a private key, a multi-signature arrangement exclusive to the secured party or a smart contract; (ii) a security interest in digital securities may be perfected by control; (iii) a security interest in virtual currency or digital securities perfected by possession or control, respectively, has priority over a security interest not perfected by possession or control; and (iv) a transferee of a digital asset takes free of any security interest perfected by filing two years after the transferee takes the digital asset for value and without actual notice of an adverse claim.	4/5/21 & 3/13/20	7/1/21 & 3/13/20

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