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EXPLAINING THE 2022 UCC AMENDMENTS THROUGH ILLUSTRATIONS

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This summer, the American Law Institute and the Uniform Law Commission – the two sponsors of the Uniform Commercial Code ("UCC") – approved extensive amendments to the UCC. Those amendments touch every Article of the UCC except Article 6[1] and include a new Article 12 to deal with controllable electronic records.[2] The August issue of this newsletter included a chart that organized and listed the changes by subject matter. This article does something different. It seeks to explain some of the more notable changes through the use of illustrations. Each illustration begins with a fairly simple hypothetical scenario involving Bitcoin, then explains how the UCC – once the amendments are enacted and in effect – applies to the scenario, and concludes with advice to transactional lawyers.

To be clear, there is nothing in the amendments unique to Bitcoin. Quite the contrary, the analysis would apply equally to other cryptocurrencies and some of it would apply to other electronic assets as well. But limiting the scenarios to one type of property helps prevent this article from becoming too long and complicated, and Bitcoin was selected because most readers are likely to be familiar with it. Future articles in this newsletter might use the same format to explain how the 2022 UCC amendments affect transactions involving things other than cryptocurrencies.

BACKGROUND ON CURRENT LAW

Under the common law, money is negotiable. This means not only that it can be freely transferred but that the transferee generally takes free of claims to and ownership rights in the money. Even a thief, who acquires no property rights in stolen money, can transfer good title to the money to someone who accepts the money in good faith.[3] The UCC codifies one aspect of the negotiability of money in § 9-332(a), which provides that a transferee of money takes free of a security interest in the money unless the transferee acted in collusion with the debtor to violate the rights of the secured party.[4]

But cryptocurrencies are not money. Admittedly, there is a little uncertainty about this with respect to Bitcoin. The nation of El Salvador enacted legislation to make Bitcoin a medium of exchange as of September of 2021. In April of this year, the Central African Republic made Bitcoin legal tender in that country. Because the UCC currently defines "money" to include "a medium of exchange currently authorized or adopted by a domestic or foreign government,"[5] either or both of these actions might have caused Bitcoin to become money within the meaning of the UCC.[6] But such a conclusion would make it virtually impossible to perfect a security interest in Bitcoin as original collateral.[7] For this reason, and because the UCC is supposed to be interpreted to achieve its underlying purposes,[8] a draft commentary by the Permanent Editorial Board for the UCC concluded that the actions of foreign governments should not be deemed to affect how Bitcoin is treated under the UCC.[9] The PEB has decided not to issue that commentary because the 2022 UCC amendments resolve the issue statutorily, by excluding from the definition of "money" a cryptocurrency that exists before it is adopted by a government.[10] Nevertheless, the draft commentary is correct, and Bitcoin is not "money," at least for the purposes of Article 9's rules on how to perfect a security interest.

Of course, the UCC contains several rules designed to protect transferees of property other than money. A few of these rules allow some transferees of goods to acquire more rights to the goods than the transferor had, and thereby take free of the property interests of some others, although these rules do not apply to anyone who acquires goods directly or indirectly from a thief.[11] Other rules allow transferees of negotiable instruments[12] or securities[13] to take free of existing claims to or security interests in such property, and these rules do sometimes protect someone who acquires such property from a thief.[14] However, Bitcoin, like other cryptocurrencies, is not a good, negotiable instrument, or security. It currently falls under the term "general intangible,"[15] and there is no UCC rule that allows a transferee of a general intangible to take free of property rights to the general intangible.[16]

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This presents a potential problem for a lender relying on Bitcoin as collateral. If the borrower acquired the Bitcoin from a thief, or anyone down the chain of title from a thief, and the rightful owner came forward and proved its ownership, the lender would find that it never acquired a security interest in the Bitcoin because the borrower did not have rights in the Bitcoin. Perhaps more significantly, if a creditor has a perfected security interest in Bitcoin by filing a financing statement,[17] all subsequent transferees of the Bitcoin would take subject to that security interest.[18] If that creditor were able to identify the Bitcoin despite those transfers, a subsequent lender might find its own, later-created security interest was junior in priority. Moreover, there is little that the lender can do through the due diligence process to protect against this risk. To search for security interests granted by prior owners, one needs to know who those prior owners were. But the blockchain that records ownership of Bitcoin is not organized by name; it is instead effectively anonymous.[19] For these reasons, reliance on Bitcoin as collateral can be problematic.

These problems – the lack of a take-free rule for Bitcoin and other electronic assets and the concomitant difficulty of confirming ownership and ensuring priority of a security interest – were a principal reason why the UCC's sponsors created the Drafting Committee that prepared the 2022 UCC amendments. So, let's now explore what the 2022 UCC amendments do and how transactions involving Bitcoin will work once the amendments have been enacted and go into effect. The discussion that follows assumes that the amendments are in effect in all relevant jurisdictions, and thus there are no choice-of-law issues affecting the analysis.

THE RELEVANT 2022 UCC AMENDMENTS

A core aspect of the 2022 UCC amendments is the creation of a new category of personal property: a "controllable electronic record" ("CER"). A CER is defined functionally as a record in an electronic medium that can be subjected to "control."[20] This definition is not, by itself, very illuminating. The meaning comes from the further definition of "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 of the record;
- The exclusive power to transfer control of the record; and
- The ability readily to identify itself in any way (*e.g.*, by name, number, cryptographic key, office, or account number) as the person having these powers.[21]

Bitcoin, along with most other cryptocurrencies and non-fungible tokens, are CERs under these definitions.

A security interest in a CER may be perfected by filing a financing statement.[22] The law governing perfection by filing will be the law of the jurisdiction where the debtor is located,[23] which is the law that generally governs perfection by filing. Consequently, the place to file is the jurisdiction where the debtor is located.[24] The general rules on how to indicate the collateral in the financing statement will apply. Hence, an indication by collateral type (*e.g.*, "controllable electronic records" or "general intangibles"[25]) or an indication such as "all assets" will be sufficient.[26] Presumably, a more specific description (*e.g.*, "bitcoin" or "cryptocurrency") would also be effective. Alternatively, a security interest in a CER may be perfected by control. The principal method of control is to have all the powers mentioned above. Note, however, that even though control is defined to include some "exclusive" powers, control may, in fact, be shared.[27] Control also exists if a person in control – other than the debtor – acknowledges that it has control on behalf of the secured party.[28]

With respect to priority, new § 9-326A places a premium on control with a simple rule: a security interest in a CER perfected by control has priority over a conflicting security interest not perfected by control.[29] Section 12-104(e) does something more significant. It bestows on CERs a quality like the negotiability accorded to securities and negotiable instruments. Specifically, a "qualifying purchaser," which is defined as a purchaser that obtains control of a CER "for value, in good faith, and without notice of a claim of a property right in the CER,"[30] acquires its rights free of other property rights in the CER.[31] The filing of a financing statement is not, of itself, notice of a claim of a property right in a CER.[32]

Under this rule, a purchaser of Bitcoin that obtains control of the Bitcoin will generally take free of any security interest in the Bitcoin and free of all other claims to ownership of it. Because a secured party is a "purchaser" within the meaning of the UCC,[33] a secured party can become a "qualifying purchaser" for the purposes of this rule.

Scenario 1: Control through a Copy of the Public & Private Keys

On June 1, Bank makes a loan to Debtor and obtains a security interest in all of Debtor's Bitcoin. At the time, Debtor provides Bank the public and private keys to the Bitcoin but retains a copy of each. Is Bank's security interest in the Bitcoin perfected?

The answer, perhaps surprisingly, is yes. Section 12-105(a)(1)(B) specifies that, to have control of a CER, a person must have, among other things,[34] the *exclusive* powers to: (i) prevent others from availing themselves of substantially all the benefit from the CER; and (ii) transfer control of the CER to

another person. Because Debtor has retained a copy of the public and private keys, Debtor and Bank can each transfer the Bitcoin, and hence Bank's power appears not to be exclusive.

However, § 12-105(b) provides that, subject to subsection (c), a power is exclusive even if shared. This might strike some as a bit of Orwellian doublespeak but there were reasons why the language was drafted in this way. Subsection (c) creates a limitation on subsection (b), but that limitation applies only when a person's control powers can be exercised only with the cooperation of another person (who, in turn, either can act independently of the person asserting control or is the transferor).[35] In other words, subsection (c)'s limitation does not apply when more than one person has *independent* control powers. In short, control powers really need not always be exclusive; they merely must not be contingent on someone else. The upshot of this is that Bank's powers with respect to Debtor's Bitcoin are "exclusive" within the meaning of § 12-105, and Bank does have control.

If it seems awkward to treat a shared power as "exclusive," bear in mind that this is consistent with using a deposit account control agreement to perfect a security interest in a deposit account[36] or a securities account control agreement to perfect a security interest in a securities account.[37] In each of those methods of control, the debtor can be permitted to access and transfer the property prior to a contrary instruction from the secured party. Thus, what matters is the secured party's ability to benefit from and transfer the collateral, not the secured party's ability to prevent the debtor from doing those things prior to the secured party's exercise of its rights.

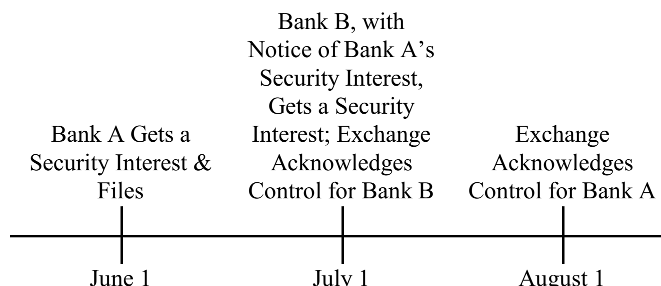
Note the implication of this analysis. Getting control of Bitcoin by having a copy of the public and private keys is a means to perfect but it is not a means of assuring priority. If Debtor had previously provided the public and private keys to someone else – a fact that almost no amount of due diligence could exclude as a possibility – that person would also have control and would have priority.[38] Moreover, Debtor could later transfer the Bitcoin to a qualifying purchaser who would take free of Bank's security interest. Thus, perfection in this manner is weak protection. It would be far better if Bank transferred the Bitcoin to its own wallet or to a third party who agreed to have control for Bank.

Scenario 2: Priority Between Two Secured Parties with Control

On June 1, Bank A makes a loan to Debtor secured by Debtor's Bitcoin that has been deposited with Exchange, which thereby acquired control. Exchange is *not* a securities intermediary. At that time, Bank A perfects the security interest by filing a proper financing statement in the appropriate office but does not obtain control.

On July 1, Bank B, with notice of Bank A's interest in the Bitcoin, makes a loan to Debtor secured by Debtor's Bitcoin and obtains Exchange's acknowledgment that Exchange has control on Bank B's behalf.

On August 1, Exchange acknowledges that it has control also on Bank A's behalf.



There is a subtle but nevertheless crucial preliminary question to address: who owns the Bitcoin, Debtor or Exchange? Put another way, does Debtor continue to own the Bitcoin, which is now in the custody of Exchange, or has Debtor transferred ownership of the Bitcoin to Exchange and received in return a contractual right to an equal number of Bitcoin on demand?

Bitcoin exchanges apparently operate in different ways, with some purporting to function as the custodian of the customer's Bitcoin and some acquiring ownership of the customer's Bitcoin. Celsius Network, which filed for bankruptcy on July 13, 2022, apparently provided Customers with two options: (i) a custodial account, under which the customer would purportedly remain the owner of the Bitcoin but would earn no income from Celsius, and (ii) an account through which the customer transferred Bitcoin to Celsius in return for a financing fee from Celsius and a right to an equal number of Bitcoin back on demand.[39] It seems highly unlikely that customers selecting the second option remain the owner of the Bitcoin they deposit with Celsius. But even the Bitcoin deposited into custodial accounts might not remain the property of the customer. If Celsius commingles Bitcoin from different customers, if it returns to custodial customers Bitcoin other than the Bitcoin that they deposited, and if it fails to maintain all the Bitcoin that it has contractually promised to maintain, the law might treat that relationship differently from what is provided in Celsius's Terms of Service.[40]

If Exchange owns the Bitcoin – which seems likely – then Debtor could not grant a security interest in the Bitcoin, only in Debtor's contractual rights against Exchange (*i.e.,* Debtor's right to receive Bitcoin from Exchange), which is a general intangible. Consequently, the collateral would not be a CER, control would not be a permissible method to perfect, and Article 12 would not apply. The only relevant perfection and

priority rules would be those applicable to general intangibles, which require filing to perfect and give priority to the first to file or perfect.

On the facts provided, and assuming Exchange is the owner of the Bitcoin, whether Bank A has a perfected security interest depends on how Bank A's security agreement and financing statement describe the collateral. If they describe the collateral as "Bitcoin on deposit with Exchange," that might be sufficient even though what Debtor owns is not the Bitcoin itself but a claim against Exchange.[41] For the remainder of this analysis, let us assume that is the case.

Bank B has a similar problem with respect to how its security agreement describes the collateral. But even if Bank B has a security interest, that interest is unperfected because Bank B has not filed a financing statement. Therefore, Bank A has priority under § 9-322(a)(2). Even if Bank B did perfect by filing, Bank A would have priority under § 9-322(a)(1), as the first to file or perfect.

If, instead, Debtor owns the Bitcoin, then Article 12 applies, as do the provisions of Article 9 applicable to CERs. Because Bank B knew of Bank A's security interest at the time it gave value and obtained control, Bank cannot be a qualifying purchaser of the Bitcoin. Nevertheless, on July 1, Bank B had perfection by control under § 12-105(e)(1), whereas Bank A had perfection only by filing. Consequently, beginning on July 1, Bank B had priority under § 9-326A.

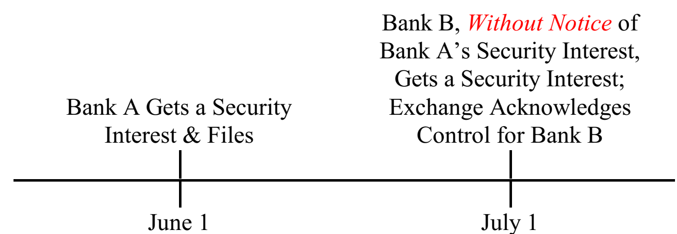
However, on August 1, Bank A acquired control in the same manner as Bank B had. Section 9-326A's simple rule – perfection by control beats perfection by some other method – no longer applies. The rule that now governs priority is the first-to-file-or-perfect rule of § 9-322(a)(1). Under that rule, Bank A's security interest became entitled to priority because Bank A's priority dates back to June 1, when Bank A filed a financing statement.[42]

The import of this scenario is that secured parties need to be wary of shared control under Article 12 because priority does not necessarily go to the first to obtain control. Secured parties can, however, protect themselves though contract. If a secured party obtains control under § 12-105(a) – by acquiring control directly – it should either refuse to grant anyone else control or insist that anyone to whom it grants control enter into a subordination agreement. If, as in this scenario, a secured party obtains control under § 12-105(e) – indirectly, by getting another person with control to acknowledge that it has control for the secured party's benefit – then it should insist that the other person both: (i) represent that it has not previously acknowledged control on behalf of anyone else; and (ii) agree not to grant control to anyone else without the secured party's prior consent.[43]

Scenario 3: The Meaning of "Take Free"

On June 1, Bank A makes a loan to Debtor secured by Debtor's Bitcoin that has been deposited with Exchange, which thereby acquired control. Exchange is *not* a securities intermediary. At that time, Bank A perfects the security interest by filing a proper financing statement in the appropriate office but does not obtain control.

On July 1, Bank B, *without notice* of Bank A's interest in the Bitcoin, makes a loan to Debtor secured by Debtor's Bitcoin and obtains Exchange's acknowledgment that Exchange has control on Bank B's behalf.



The analysis of this scenario begins with the same question as does the analysis of Scenario 2: who owns the Bitcoin, Debtor or Exchange? If Exchange does, then the analysis is the same as in Scenario 2 because notice is irrelevant to perfection or priority of security interests in general intangibles.

Assuming, however, that Debtor owns the Bitcoin, then Article 12 applies. The next issue to resolve is whether Bank B is a "qualifying purchaser" of the Bitcoin. For that to be true, Bank B must not have had *notice* of Bank A's security interest,[44] which is different from merely not knowing of the security interest.[45] As noted above, the mere fact that Bank A filed a financing statement does not provide notice.[46] However, if Bank B had searched and found Bank A's filed financing statement, Bank B would likely have notice of Bank A's security interest, and would certainly have notice if the financing statement included a statement that Bank A really does have a security interest in the Bitcoin.[47] Thus, the definition of "qualifying purchaser" in § 12-104(h) might create an incentive not to search.

If Bank B did have notice of Bank A's security interest in the Bitcoin at the time Bank B gave value and obtained control, then Bank B is not a qualifying purchaser and does not get the benefit of § 12-104(e)'s take-free rule. Nevertheless, Bank B has priority over Bank A under § 9-326A because Bank B's security interest in the Bitcoin is perfected by control whereas Bank A's security interest is perfected by filing.

If Bank B did not have notice of Bank A's security interest in the Bitcoin, and assuming Bank B gave value and acted in good faith, then Bank B is a qualifying purchaser.

Consequently, Bank B, took free of Bank A's security interest under § 12-104(e). Superficially, the take-free rule of § 12-104(e) seems to create a conflict with the priority rule of § 9-326A. In other words, Bank B *has priority* under § 9-326A but *took free* under § 12-104(e).[48] These statements appear to differ.

However, take-free rules that protect a *buyer* operate differently from take-free rules that protect a *non-buyer purchaser*, such as a lessee, licensee, or a secured party with a security interest that secures an obligation. That is because such a non-buyer purchaser acquires only a limited interest in the property purchased, and takes free only to the extent of the interest purchased.[49] Indeed, § 12-104(e) makes this point expressly. It does not state that a qualifying purchaser acquires *the CER* free of a claim of a property right in the CER, it states that a qualifying purchaser acquires "its rights" in the CER free of such a claim.[50]

Put succinctly, in the relatively rare situation in which a non-buyer secured party benefits from a "take free" rule,[51] the rule operates in the same manner as a priority rule. Consequently, there really is no conflict in this scenario between § 9-326A and § 12-104(e); Bank B's security interest has priority over Bank A's security interest. Moreover, in the unlikely event that § 12-104(e) were deemed to conflict with § 9-326A, then under § 12-103, Article 9 and its priority rule governs over Article 12's take-free rule.

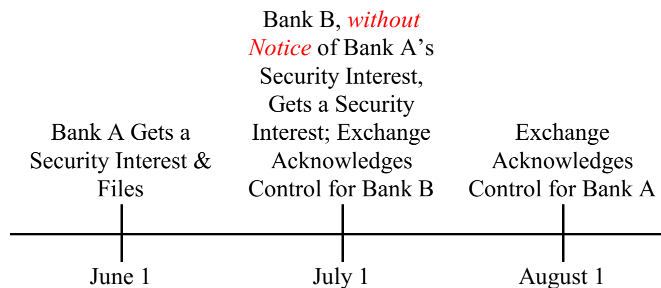
So, the end result is, regardless of whether Bank B is a qualifying purchaser, that Bank B's security interest has priority over Bank A's, but Bank A's security interest survives, at least until Bank B does something further to enforce its rights, such as by conducting a disposition or acceptance of the collateral. This scenario shows the relative weakness of perfecting a security interest in Bitcoin by filing a financing statement.

Scenario 4: Priority Between Two Secured Parties with Changing Perfection Methods

On June 1, Bank A makes a loan to Debtor secured by Debtor's Bitcoin that has been deposited with Exchange, which thereby acquired control. Exchange is *not* a securities intermediary. At that time, Bank A perfects the security interest by filing a proper financing statement in the appropriate office but does not obtain control.

On July 1, Bank B, *without notice* of Bank A's interest in the Bitcoin, makes a loan to Debtor secured by Debtor's Bitcoin and obtains Exchange's acknowledgment that Exchange has control on Bank B's behalf.

On August 1, Exchange acknowledges that it has control also on Bank A's behalf.



Having fun yet? If you're paying attention, this one should be easy because the analysis begins the same as the analysis of Scenario 3, and then deals with one subsequent fact: Bank A subsequently acquired control of the Bitcoin. That additional fact was explored in the discussion of Scenario 2. So, you might try to resolve this one before reading further.

Pursuant to the conclusion reached in the discussion of Scenario 3, regardless of whether Bank B is a qualifying purchaser, on July 1, Bank B had perfection by control under § 12-105(e)(1), whereas Bank A had perfection by filing. Consequently, under § 9-326A, Bank B had priority on July 1.

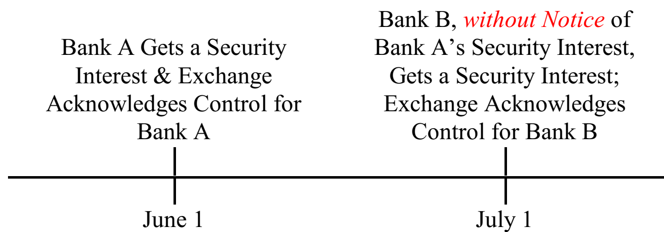
But, as in Scenario 2, on August 1, Bank A acquired control in the same manner as Bank B had. Section 9-326A (perfection by control beats perfection by some other method) no longer applies. Instead, Bank A's security interest became entitled to priority under the first-to-file-or-perfect rule of § 9-322(a)(1).

This scenario, like Scenario 2 (in which Bank B had notice of Bank A's security interest) shows the weakness of control through an intermediary. It also shows that, when perfecting in that manner, it is prudent either to search for filed financing statements (because someone who had a financing statement could obtain priority by later getting control) or get a commitment from the intermediary not to acknowledge control for anyone else.

Scenario 5: The Limits of Article 12

On June 1, Bank A makes a loan to Debtor secured by Debtor's Bitcoin that has been deposited with Exchange, which thereby acquired control. Exchange is *not* a securities intermediary. At that time, Exchange acknowledges that it has control on Bank A's behalf.

On July 1, Bank B, *without notice* of Bank A's interest in the Bitcoin, makes a loan to Debtor secured by Debtor's Bitcoin and obtains Exchange's acknowledgment that Exchange also has control on Bank B's behalf.



Assuming debtor remains the owner of the Bitcoin,[52] this scenario differs from Scenario 2 solely in the manner in which Bank A initially perfected its security interest.

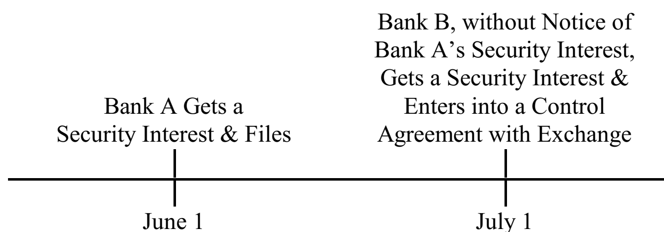
Bank B might be a qualifying purchaser under § 12-102(a)(2) that seemingly "took free" of Bank A's property rights in the Bitcoin under § 12-104(e). However, the answer under Article 9 is different. Section 9-326A does not apply because both security interests are perfected by control. Instead, under the first-to-file-or-perfect rule of § 9-322(a)(1), Bank A's security interest has priority.

Now there is a conflict between Article 12 and Article 9. Pursuant to § 12-103, Article 9 controls, and thus Bank A's security interest has priority. To protect itself, Bank B needed to inquire of Exchange whether it had already acknowledged control for someone else. Exchange has no duty to provide such information. § 12-105(f). But silence is sometimes very telling.

Scenario 6: *Priority under Article 8*

On June 1, Bank A makes a loan to Debtor secured by Debtor's rights in Bitcoin that has been deposited with Exchange, which *is a securities intermediary*. At that time, Bank A perfects the security interest by filing a proper financing statement in the appropriate office but does not obtain control.

On July 1, Bank B, without notice of Bank A's interest, makes a loan to Debtor secured by Debtor's rights in the Bitcoin and enters into a control agreement with Exchange.[53]



In this scenario and the next, we explore what happens when Bitcoin is held by a securities intermediary.

Amendments to Article 8 make it clear that a CER such as Bitcoin qualifies as a financial asset only if the securities intermediary has expressly agreed with the customer to treat the CER as a financial asset.[54] Few Bitcoin exchanges have agreements containing such a term, but at least one currently does,[55] and more might in the future. Assuming Exchange has expressly agreed to treat the Bitcoin as a financial asset, then Exchange holds a "securities account."[56] Consequently, Debtor owns a securities entitlement, not Bitcoin. Because CERs are defined to exclude all investment property,[57] Debtor does not own a CER and, hence, Article 12 does not apply. The relative rights of Bank A and Bank B are therefore determined under the rules of Articles 8 and 9.

Bank B cannot be a "protected purchaser" under § 8-303(a) because that term is limited to a purchaser of a certificated or uncertificated security, and Bitcoin is not a security within the meaning of the U.C.C.[58] Nevertheless, Bank B's security interest has priority under § 9-328(1), which provides that a security interest perfected by control has priority over a security interest perfected other than by control.

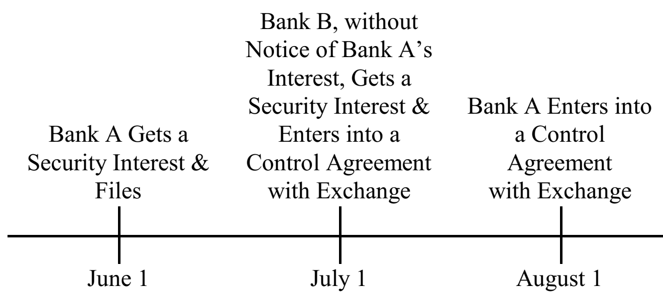
The lesson of this scenario is not new. When dealing with investment property, perfection by control is better than perfection by filing. Notice also, that the result is essentially the same as under Scenario 3, in which the Bitcoin was intermediated but not with a securities intermediary. Thus, whether Exchange has agreed to treat the Bitcoin as a financial asset or not does not matter if one secured party perfects by filing and another perfects by control. The secured party perfected by control will win. That said, there is one notable difference between this scenario and Scenario 3. When the Bitcoin is intermediated with a securities intermediary, Debtor's rights become a security entitlement, not a general intangible or CER. Consequently, the description of the collateral in the security agreement (and the indication of collateral in the financing statement) should refer to investment property, the securities account, or the security entitlement.

Scenario 7: Priority under Article 8 Between Two Secured Parties with Changing Perfection Methods

On June 1, Bank A makes a loan to Debtor, obtains a security interest in all of Debtor's personal property, and perfects the security interest by filing a proper financing statement in the appropriate office. At the time, Debtor owns Bitcoin that has been deposited with Exchange, which *is a securities intermediary*.

On July 1, Bank B, without notice of Bank A's security interest, makes a loan to Debtor secured by Debtor's rights in the Bitcoin and enters into a control agreement with Exchange

On August 1, Bank A enters into a control agreement with Exchange.



This scenario builds upon Scenario 6 by adding the fact that Bank A subsequently obtained control of the securities entitlement. The priority of the perfected security interests of Bank A and Bank B in Debtor's securities entitlement is determined under § 9-328, which unlike new § 9-326A, includes rules for multiple security interests perfected by control. Pursuant to § 9-328(2), Bank B's security interest has priority because Bank B was the first to obtain control.

Thus, in comparing this scenario to Scenarios 2 and 4, we see that the priority of two or more security interests in a CER, all perfected by control, is treated differently from the priority of two or more security interests in investment property perfected by control. With investment property, the first to obtain control wins. With a CER, such as Bitcoin, priority goes to the first to file or perfect, which might not be the first to have control.

Lenders might regard the rules applicable to investment property as more desirable, with the result that they might start insisting that their borrowers use a Bitcoin exchange that agrees to treat the customers' property as a financial asset. This avoids not only the possible application of the first-to-file-or-perfect rule of § 9-322(a)(1), but also the question explored in the analysis of Scenario 2 about whether intermediating Bitcoin results in the debtor owning a general intangible, for which perfection by control is not possible.

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Notes:

1. In 1989, the ULC and ALI recommended that Article 6 be either repealed or revised. To date, 48 states, the District of Columbia, and the U.S. Virgin Islands have repealed Article 6. California has enacted the alternative, revised version. Maryland has retained the pre-1989 version.

2. The 2022 Amendments also include a new Article A that contains transition rules that deal with the effect of the amendments on pre-effective date transactions.

3. *See, e g.*, City of Portland v. Berry 739 P.2d 1041 (Or. Ct. App. 1987) (a person who acquires stolen money in good faith and for valuable consideration obtains good title and prevails over the victim of the theft).

4. *See* U.C.C § 9-332(a). Although the current text of § 9-332(a) does not include an express requirement that the transferee receive possession of the money, obtaining possession is arguably implicit in the word "transferee." The 2022 Amendments remove any doubt about this by adding an express requirement that the transferee receive possession of the money in order to take free of a security interest in the money.

5. *See* U.C.C. § 1-201(b)(24).

6. In addition, the draft PEB Commentary noted that the Marshall Islands has adopted a blockchain-based currency as its legal tender. This action does not address Bitcoin, but it could make that blockchain-based currency "money" within the current UCC definition.

7. If Bitcoin is money under the current UCC, the only ways to perfect would be to intermediate the Bitcoin with a securities intermediary, *see infra* notes 54-58 and accompanying text, or to take possession, *see* U.C.C. § 9-312(b)(3). Of course, it is not possible to take possession of an intangible asset, such as Bitcoin.

8. *See* U.C.C. § 1-103(a).

9. Specifically, the comment concluded that because money in intangible form would not be susceptible of being possessed, the general perfection-by-filing rule in § 9-310(a) applies to a security interest in intangible money. *See* Draft PEB Commentary [on] Perfection of a Security Interest in Intangible Money and Related Choice-of-law Rules (Aug. 5, 2021).

10. *See* U.C.C. § 1-201(b)(24) (2022) (citations with this date are to the UCC as amended).

11. *See* U.C.C. §§ 2-403(1), (3), 9-320(a), (b), (d), 9-321(c), 9-323(d), (f). *See also* U.C.C. §§ 1-201(b)(9) (defining "buyer in ordinary course of business"), 2A-103(1)(o) (defining "lessee in ordinary course of business"). There are similar protections for security entitlements. *See* UCC §§ 8-502, 8-510.

12. *See* U.C.C. § 3-306. *See also* UCC § 3-302 (defining "holder in due course").

13. *See* U.C.C. § 8-303(b) (protected purchaser takes free of adverse claims to a security). *See also* U.C.C. §§ 8-102(a)(1), 8-303(a) (defining, respectively, "adverse claim" and "protected purchaser").

14. Section 3-306, which allows a holder in due course to take free of adverse claims to the instrument, protects someone who acquired an instrument from a thief only if the instrument was originally issued in bearer form or is indorsed in blank so that it becomes payable to bearer. *See* U.C.C. § 3-205(b) (when indorsed in blank, an instrument becomes payable to bearer). If, instead, an instrument was issued to the order of a specified person, stolen from that person, and then that person's signature

was forged, the result would be different. The thief/forger would not be a person entitled to enforce the instrument. If the thief/forger sold the instrument to an unsuspecting buyer, the buyer would also not be a person entitled to enforce because the original payee did not indorse the note. The thief's forgery of the payee's name is not the payee's indorsement. *See* § 3-403. Instead, the thief has converted the note under the first sentence of § 3-420(a) and the buyer has converted the note under the second sentence of § 3-420(a).

15. *See* U.C.C. § 9-102(a)(42).

16. A perfected security interest in the general intangible has priority over an earlier-attached but unperfected security interest in the general intangible, *see* § 9-322(a)(2), but that priority rule is not a take-free rule.

17. Under current law, the only ways to perfect a security interest in Bitcoin are to file a financing statement in the jurisdiction where the debtor is located or to deposit the Bitcoin with a securities intermediary who agrees to treat the Bitcoin as a financial asset, and then perfect the security interest in the debtor's securities account or security entitlements by either filing a financing statement or obtaining control. The process of intermediating the Bitcoin and treating it as a financial asset is discussed *infra* notes 54-48 and accompanying text.

18. Even if the security interest in the Bitcoin is unperfected, a transferee of the Bitcoin who is not a secured party might take subject to the security interest. That is because Article 9 generally provides that a security interest continues in collateral notwithstanding a transfer of the collateral by the debtor, § 9-315(a)(1), and that, unless some provision of the Code states otherwise, a security agreement is effective against purchasers of the collateral, § 9-201(a). Although § 9-317(b) allows buyers of many types of property to take free of an *unperfected* security interest, that rule does not apply to general intangibles, such as Bitcoin. The 2022 Amendments expand the scope of § 9-317 to protect buyers of controllable electronic records, controllable accounts and controllable payment intangibles. *See* U.C.C. § 9-317(h), (i) (2022).

19. Tracing ownership of other personal property – such as goods – can also be difficult. But when the property is valuable, the person offering it as collateral will usually have some record of purchasing the property, and that record is likely to identify the former owner by name

20. *See* U.C.C. § 12-102(a)(1) (2022).

21. *See* U.C.C. § 12-105(a) (2022).

22. *See* U.C.C. § 9-312(a) (2022).

23. *See* U.C.C. § 9-306B(b)(1) (2022).

24. *See* U.C.C. § 9-301(1).

25. CERs are a sub-category of general intangibles.

26. *See* U.C.C. §§ 9-108(b), 9-504.

27. *See* U.C.C. § 12-105(b)(2), (c) (2022).

28. *See* U.C.C. § 12-105(e) (2022).

29. *See* U.C.C. § 9-326A (2022).

30. *See* U.C.C. § 12-102(a)(2) (2022).

31. *See* U.C.C. § 12-104(e) (2022).

32. *See* U.C.C. § 12-104(h) (2022).

33. *See* U.C.C. § 1-201(b)(29), (30).

34. The person in control must also have the power to avail itself of substantially all the benefit from the electronic record, and the CER, a record attached to or logically associated with the CER, or a system in which the CER record is recorded must enable the person readily to identify itself in any way, including by name, identifying number, cryptographic key, office, or account number, as having the requisite powers. *See* U.C.C. § 12-105(a) (2022).

35. *See* U.C.C. § 12-105(c)(1) (2022).

36. *See* U.C.C. § 9-104(a)(2), (b).

37. *See* U.C.C. §§ 8-106(d)(2), (f), 9-106(a).

38. *See* U.C.C. § 9-322(a)(1), discussed *infra* note 42 and accompanying text.

39. *See* Celsius Network Terms of Use. Apparently, the vast majority of customers (approximately 96%) selected the second option.

40. *See* Adam J. Levitin, *Not Your Keys, Not Your Coins: Unpriced Credit Risk in Cryptocurrency*, 101 TEX. L. REV. at *20-24 (2022) (forthcoming; available at SSRN). *See also* U.S. DEP'T OF TREAS, CRYPTO-ASSETS: IMPLICATIONS FOR CONSUMERS, INVESTORS, AND BUSINESSES, at 38 (2022) (noting that customers of a cryptocurrency exchange might be treated as unsecured creditors, presumably because the exchange might be the owner of the cryptocurrency deposited by customers).

41. Alternatively, if Debtor had transacted with Bank A before depositing the Bitcoin with Exchange, Bank A initially would have had a perfected security interest in the Bitcoin, Debtor's rights against Exchange would be proceeds of the Bitcoin, *see* U.C.C. § 9-102(a)(64), and Bank A would now have a perfected security interest in those rights, *see* U.C.C. § 9-315(c), (d)(1). In addition, Bank A's security interest in the Bitcoin would continue unless Bank A consented to the transfer to Exchange free of its security interest, *see* U.C.C. § 9-315(a)(1), or Exchange was a qualifying purchaser of the Bitcoin, *see* U.C.C. §§ 12-102(a)(2), 12-104(e).

42. *See* U.C.C. § 9-322(a)(1) (priority dates from the earlier of filing or perfection "if there is no period thereafter when there is neither filing nor perfection").

43. Of course, such contractual terms would not, if breached, prevent a loss of priority. They would, however, provide a claim against the person for that breach.

44. *See* U.C.C. § 12-102(a)(2) (2022).

45. *See* U.C.C. § 1-202.

46. *See* § 12-104(h). *See also* § 9-331(c) (similarly providing that filing a financing statement does not constitute notice of a claim so as to prevent a transferee from becoming a holder in due course of an instrument, a holder of a negotiable document of title that has been duly negotiated, or a protected purchaser of a security).

47. Although the mere filing of a financing statement does not provide *notice* of a security interest, searching and finding a financing statement that goes beyond merely indicating the collateral – and states that a purchase would violate the filer's rights – gives the searcher *knowledge* that such a purchase would violate the filer's rights. *See* § 9-330 cmt. 6 ("a purchaser of chattel paper who has seen a financing statement covering the chattel paper or who knows that the chattel paper is encumbered with a security interest, does not have knowledge that its purchase violates the secured party's rights. However, if a purchaser sees a statement in a financing statement to the effect that a purchase of chattel paper from the debtor would violate the rights of the filed secured party, the purchaser would have such knowledge."). The statutory text and official comments are conspicuously silent about whether searching and finding a financing statement that simply indicates the collateral provides *notice* of the security interest.

In all likelihood, finding such a financing does not provide *knowledge* of a security interest in the collateral indicated – after all, a filer might not have a security interest in the collateral indicated in a financing statement for a variety of reasons (permissible pre-filing, unauthorized filing, failure to terminate after the secured obligation is satisfied, overly broad indication of collateral) – but does provide *notice* of a security interest. *See* § 1-202(a)(3) (a person has "notice" of a fact if, from all the facts and circumstances known to the person at that time, the person "has reason to know" that the fact exists).

48. The distinction between having priority and taking free can matter for at least two reasons. First, as the discussion below of Scenario 4 shows, priorities can shift over time, but that is likely to be true only if the security interests remain attached. Second, it affects to whom a secured party must send notification of an intended disposition or acceptance of the collateral.

49. *See* U.C.C. §§ 8-302(b) (a purchaser of a limited interest acquires rights only to the extent of the interest purchased); 9-321(b), (c) (a licensee in ordinary course of business takes "its rights" free and a lessee in ordinary course of business takes "its leasehold interest" free).

50. This somewhat non-intuitive point is made most clearly in § 9-331 comment 2:

> In some provisions, this Article distinguishes between claimants that take collateral free of a security interest (in the sense that the security interest no longer encumbers the collateral) and those that take an interest in the collateral that is senior to a surviving security interest. See, e.g., Section 9-317. Whether a holder or purchaser referred to in this section takes free or is senior to a security interest depends on whether the purchaser is a buyer of the collateral or takes a security interest in it.

51. *See* U.C.C. § 8-303(b) (a "protected purchaser" of a security – a term which can include a secured party – takes free of claims to the security).

52. If Exchange became the owner of the Bitcoin, so that Debtor owns a general intangible (Debtor's rights under its agreement with Exchange), not a CER, then Bank A's security interest would not be perfected by Exchange's purported control on behalf of Bank A.

53. Control of a CER can be achieved by having a person in control acknowledge that it has control for someone else. § 12-105(e) (2022). While a purchaser can obtain control of investment property by having a person in control acknowledge that it has control for the purchaser, *see* § 8-106(d)(3), a securities intermediary apparently has control of a securities entitlement only if it has an interest in the securities entitlement. *See* § 8-106(e). So, unless Exchange has a security interest in Debtor's securities entitlement, Bank A can obtain control under § 8-106(d)(1) (by becoming the entitlement holder) or (d)(2) (by entering into a control agreement with Exchange), but not under § 8-106(d)(3). This is the reason that Scenarios 6 and 7 refer to the banks entering into control agreements with Exchange, rather than merely having Exchange acknowledge that it had control on behalf of one or both banks.

54. *See* U.C.C. §§ 8-102(a)(9)(iii), 8-103(h) (2022).

55. The Coinbase User Agreement is one of the few agreements, perhaps the only agreement, used by a Bitcoin exchange that purports to treat a customer's Bitcoin as a financial asset under Article 8. *See* Coinbase User Agreement § 2.7.2 (July 1, 2022) (available here).

56. *See* U.C.C. § 8-501(a). This agreement will mean that Exchange qualifies as a "securities intermediary." *See* U.C.C. § 8-102(a)(14).

57. *See* U.C.C. § 12-102(a)(1) (2022). *See also* U.C.C. § 9-102(a)(49) (defining investment property to include securities entitlements).

58. In contrast, a stablecoin might be a security. *See* Adam J. Levitin, *Not Your Keys, Not Your Coins: Unpriced Credit Risk in Cryptocurrency*, *supra* note 40, at *38-40.

Recent Cases

SECURED TRANSACTIONS

Scope Issues

Lateral Recovery, LLC v. Queen Funding, LLC, 2022 WL 2829913 (S.D.N.Y. 2022)

Merchants that purportedly sold their future receivables stated a claim for violation of RICO against the putative buyer by alleging that the transactions were disguised usurious loans with an effective annual interest rate ranging from 100% to 300%, and that the buyer committed wire fraud by falsely stating that: (1) the transactions were not loans, (2) the required daily payment was a good-faith estimate of the merchant's receivables, (3) the daily payment was for the merchant's convenience, and (4) the automated ACH program is labor intensive, requiring the buyer to charge an exorbitant fee. The complaint adequately alleged that the transactions were loans. Although the agreements contained a reconciliation provision for adjusting the amount of the daily payment, that provision was a sham because adjustment was within the sole discretion of the putative buyer. Moreover, other terms shielded the buyer from the risk that the purchased receivables might be uncollectible, and without such risk the transactions were, in economic substance, loans.

Perfection Issues

1944 Beach Boulevard, LLC v. Live Oak Banking Co., 2022 WL 3650803 (Fla. 2022)

Florida's UCC registry does not use standard search logic in responding to a search request because it does not return a list of likely matches when a search is conducted. Instead, the registry returns the entire index of filed financing statements, placing the recipient on a page of the 20 entries most closely matching the name searched but allowing the recipient to move navigate forwards and backwards through the entire index. Consequently, a filed financing statement that uses an incorrect name for the debtor, as determined by § 9-503, is seriously misleading and ineffective to perfect.

Carmel Financing, LLC v. Schoenmann, 2022 WL 3599561 (N.D. Cal. 2022)

A lender with a deed of trust on real property did not have a perfected security interest in the insurance proceeds payable after a fire damaged the property. Pursuant to a non-uniform provision in California's § 9-312(b), a security interest in an insurance policy may be perfected only by giving written notice of the security interest to the insurer. Although the insurance broker had sent to the insurer a form (which the insurer apparently ignored) identifying the lender as a new "additional insured," replacing the prior mortgagee, that form did not mention a security interest and therefore was insufficient.

Priority Issues

Mingtel Inc. v. Comerica Bank, 2022 WL 3040636 (Tex. Ct. App. 2022)

Transactions pursuant to which a manufacturer delivered goods to an intermediary, which held the goods on behalf of a broadcaster (that advertised and sold the goods), and then shipped the goods to the broadcaster's customers, was an Article 9 consignment to the intermediary. There was sufficient evidence to support the trial court's conclusion that the intermediary was "not generally known by its creditors to be substantially engaged in selling the goods of others." Because the manufacturer had not filed a financing statement to perfect its security interest, the bank with a perfected security interest in the intermediary's assets had priority.

Enforcement Issues

The Central Trust Bank v. Branch, 2022 WL 4226368 (Mo. 2022)

The trial court erred in ruling that bank's notification of disposition, which described the disposition as a private sale, was insufficient. The disposition was a dealers-only auction, which is a private sale. The trial court also erred in ruling that bank did not send a required explanation of deficiency following disposition of the collateral. Although the debtors did not receive the explanation, which had been sent by certified mail and returned to the bank, § 9-616 requires only that the explanation be sent, not that it be received. While a secured party *might* be required to take additional steps upon learning that the debtor did not receive a required notification or notice, § 9-616 does not refer to a post-sale explanation as a notification or notice, and because the explanation does not inform the debtor of any rights that are expiring, the interests that might support requiring further efforts upon learning that a notification or notice was not received do not apply.

Amerifactors Financial Group, LLC v. University of Chicago, 2022 WL 3081897 (N.D. Ill. 2022)

A factor that bought the accounts of a contractor failed to state a claim against the university whose agreement with the contractor permitted the university to make payment jointly to the contractor and its subcontractors if the university learned that the contractor had not paid the subcontractors on time, even though the university had signed an acknowledgment that "there are no disputes, claims of offset, . . . or any other matters" that allegedly reduced the obligation to pay the full amount owed. There was no breach of contract claim because there was no contract between the factor and the university (the signed acknowledgment did not create one) and there was no allegation that the university had breached its contract with the contractor. The factor had no claim under § 9-607 because it was seeking the full amount of the invoices, which the contractor did not have the right to receive.

Liability Issues

Firestone Financial, LLC v. WA Gym Downers Grove, LLC, 2022 WL 4094161 (N.D. Ill. 2022)
A debtor that operated fitness centers was not excused, based on the doctrine of frustration of purpose, of its liability to an equipment financier due to a gubernatorial order requiring all fitness centers to close during the early stages of the pandemic. The agreements between the parties did not limit how the equipment was to be used and permitted substantial changes to the debtor's business activities with the financier's consent. Even if the debtor's ability to provide low-cost, 24-hour gym access free from government interference was a basic assumption underlying the agreements, there was still no frustration of purpose because the financier deferred all required loan payments during the period that the debtor was required to be shut down. The fact that other pandemic-related restrictions might have made the debtor's business unprofitable once the debtor was permitted to reopen is not sufficient to provide relief for frustration of purpose. The financier was therefore entitled to replevy the equipment due to the debtor's default.

BANKRUPTCY

Claims & Expenses

In re Firestar Diamond, Inc., 2022 WL 4002268 (Bankr. S.D.N.Y. 2022)
The claims of banks with security interests in the accounts of entities that prepetition had sold goods to, and were affiliated with, the debtor, were subject to disallowance under Bankruptcy Code § 502(d) because the affiliates had not repaid avoidable transfers they had received. It did not matter that the debtor had been instructed, prepetition, to make payment directly to the banks. The claims belonged to or had been transferred by the affiliates; there was no direct agreement between the debtor and the banks.

Discharge, Dischargeability & Dismissal

In re Forrest, 2022 WL 3908803 (11th Cir. 2022)
The debt incurred by a produce buyer, who subsequently transferred asserts in the ordinary course of business and thereby failed to preserve property subject to a PACA trust, was not nondischargeable under Bankruptcy Code § 523(a)(4). While PACA does create a statutory trust, it does not impose a duty to segregate trust assets or to refrain from using trust assets for non-trust purposes, and therefore PACA-related debts do not fall within § 523(a)(4).

Avoidance Powers

Briar Capital Working Fund Capital, LLC v. Remmert, 2022 WL 4137840 (S.D. Tex. 2022)
A secured creditor that received an assignment of the debtor's preference action in exchange for withdrawing its objection to the debtor's plan of reorganization lacked standing to pursue the preference action. Although Bankruptcy Code § 1123(b)(3)(B) allows a reorganization plan to authorize a party other than the debtor or a trustee to exercise avoidance powers, that party must be a representative of the estate. Because the assignment granted the secured creditor the right to retain all proceeds of the avoidance action, the secured creditor was not a representative of the estate. A sale of a preference action is not permissible.

In re Silver State Holdings, 2022 WL 3755778 (5th Cir. 2022)
The discharge of a junior lien that occurred when the sole owner of the debtor formed a new company, purchased a senior lien, and then conducted a foreclosure, could be avoided as a constructively fraudulent transfer to an insider creditor while insolvent. The transfer was made by the debtor, within the meaning of the Texas Fraudulent Transfer Act, even though it was made by the foreclosure trustee. The transfer was an asset of the debtor because the value of the property, as determined partly by a sale that occurred two months after the foreclosure, exceeded the total debt secured by liens on the property.

In re Bayou Steel BD Holdings, LLC, 2022 WL 3079861 (Bankr. D. Del. 2022)
The trustee could not avoid the debtors' prepetition grant of a security interest in return for a $33 million loan as a constructively fraudulent transfer because the debtors received reasonably equivalent value: the loaned funds. Even if there was a lack of good faith, that could not affect the reasonable equivalence of the exchange. The trustee could also not avoid the transfer as an actually fraudulent transfer. Although lender was an insider that, nine months before the loan was made, had received a $30 million distribution from the debtors, the loan was subordinated to an existing bank loan, no payments were required until maturity, and thus the loan exposed the lender to substantial risk of nonpayment. Even if the cash infusion was necessitated by the earlier distribution, there were no facts to suggest that the lender was required to lend the additional funds to the debtors, let alone on an unsecured basis.

Other Bankruptcy Matters

In re Falcon V, LLC,
2022 WL 3274174 (5th Cir. 2022)
The debtor's contract with the issuer of irrevocable performance bonds was not an executory contract, and hence was not assumed pursuant to a term in the debtor's confirmed plan of reorganization that assumed all executory contracts. In multiparty arrangements, the executory nature of a contract must be determined by looking at whether each party owes a material unperformed obligation to anyone, not merely at reciprocal obligations flowing between the debtor and a creditor. In this case, the debtor had material obligations to pay premiums to the issuer and to indemnify the issuer for any payments that the issuer made under the bonds, and the issuer had material obligations to the bond beneficiaries. However, the contract was nevertheless not executory because, at the time of the petition, the issuer's failure to perform would not have been a material breach that excused the debtor from performing its obligations because the bonds were irrevocable.

LENDING, CONTRACTING & COMMERCIAL LITIGATION

Great Western Dairy, LLV v. MWI Veterinary Supply Co.,
2022 WL 3597186 (D. Colo. 2022)
A dairy farm's negligence claim against a supplier that both sold feed additives to the dairy farm and licensed for free a delivery system for the additives was not barred by a limitation of liability provision in an application the dairy farm completed for credit to purchase the additives. The application referred only to the terms of sale for the feed additives, not to the license of the delivery system. However, the negligence claim was barred by the economic loss doctrine because the supplier's error in setting the delivery system in meter mode, rather than in weight mode, which caused the system to overdose cattle with vitamin D, was a breach of the parties' licensing agreement.

Pharmacy Corp. of America v. Askari,
2022 WL 3697342 (3d Cir. 2022)
The seller of a business had no claim for breach of contract against the buyer for the way it calculated the purchase price. The agreement provided for a price based on earnings minus debt, and the fact that the buyer loaned funds to the business after taking control but before the date that the price was to be established properly lowered the price to $1. Although the seller was entitled to vote on specified major decisions, including the granting of any security interest, the seller had no right to vote on the loan because the buyer already had a security interest and, even though the loan increased the secured obligation, the loan did not create a new lien.

Rafuse v. Advanced Concepts and Technologies Int'l, LLC,
2022 WL 3030792 (W.D. Tex. 2022)
An individual who, pursuant to a purchase agreement, sold his 50% membership interest in a limited liability company to the company in return for a $2 million note, and who simultaneously entered into a pledge agreement under which he accepted responsibility for half of any liability arising from post-sale adjustments to pre-sale contracts or taxes, had no liability for any portion of the $448,000 that the company paid to settle claims asserted by the federal government for adjustments to pre-sale contracts. When the company paid the note, the individual and the company executed an accord and satisfaction that discharged their obligations under the purchase agreement and note. Although the accord and satisfaction did not expressly mention the pledge agreement, the pledge agreement by its own terms terminated when the company fully paid and performed its obligations under the purchase agreement. Moreover, the accord and satisfaction contained a merger clause by which it "supercedes [sic] and replaces all prior . . . agreements" between the parties.

Tiptop Restoration, Inc. v. Zokaeem,
2022 WL 3907903 (Cal. Ct. App. 2022)
A lawyer who received insurance proceeds on behalf of a client for water damage to the client's inventory and lost business, and then used some of the proceeds to pay for the lawyer's services to the client and remitted the remainder to the client, was not liable for conversion, negligence, or breach of fiduciary duty to the company that provided emergency services to the client. Even though the company's services provided the underlying basis for much of the insurance claim, the company did not have a lien on the insurance claim or insurance proceeds, merely a contractual right to payment from the client. The company's expectation of payment from the insurance proceeds, but no agreement to that effect, did not create a fiduciary relationship.

Garcia v. Federal Home Loan Mortgage Corp.,
2022 WL 4007984 (N.D. Tex. 2022)
A clause in a home equity loan providing for the borrower to pay the lender's attorney's fees incurred in connection with "a legal proceeding that might significantly affect Lender's interest in the Property and/or rights under this Security Instrument (such as a proceeding in bankruptcy, probate, for condemnation or forfeiture, for enforcement of a lien which may attain priority over this Security Instrument or to enforce laws or regulations)" did not cover attorney's fees incurred when the borrower sued the lender for violating the State Constitution because none of the types of proceedings listed in the clause were brought by the borrower against the lender and the proceedings did not involve a contest to the merits of the underlying loan.

Spinal Technologies, LLC v. Mazor Robotics Inc., 2022 WL 3867742 (W.D.N.Y. 2022)

A disclaimer of the implied warranty of merchantability on page five of an eight-page contract for the sale of goods, which was in all capital letters and under the bolded heading "Warranties and Limitations" but not itself in bold, a contrasting typeface, a different color, or a larger size than surrounding text, was conspicuous. Consequently, the buyer of surgical guidance equipment could not state a claim for breach of the implied warranty. While the buyer did claim that the seller had breached an express warranty by delivering defective goods that repeatedly needed repairs, because the contract limited the remedy for breach of warranty to repair or replacement of the goods, and the buyer had not alleged that the seller had failed to repair or offer a replacement, the buyer had no claim for the amounts paid. Because the buyer retained the goods for 2½ years, it was too late as a matter of law to reject or revoke acceptance of the goods. Although there were multiple repairs during that time, the buyer did not allege any failure to repair and did not generally allege repeated repairs for the same defect.

Citibank v. Brigade Capital Management, LP, 2022 WL 4102227 (2d Cir. 2022)

Lenders that received more than $500 million in mistaken principal payments from a bank acting as administrative agent on an unmatured term loan – payments from the agent's own funds – were obligated to return the payments. The lenders were not entitled to the "discharge-for-value" defense to the agent's unjust enrichment claim because they had constructive notice of the mistake. Constructive notice exists whenever a person has reasonable grounds for suspecting an error and, through reasonable inquiry, would have discovered the mistake. The lenders had reasonable grounds for suspecting error because: (i) they received a prepayment of principal without the contractually mandated prior notification; (ii) the payment, which totaled almost $1 billion, purportedly came from a debtor that the lenders believed was insolvent; (iii) the loan was trading at 20¢ to 30¢ on the dollar, and could have been retired far more cheaply through open-market purchases than by paying the loan in full; and (iv) only four days earlier the debtor had offered to exchange notes to avoid acceleration of the loan, an offer that would make no sense if it were going to repay the loan in full. Even if the lenders were reasonable in believing that there was no mistake, in part because the amount paid was precisely the amount of the debt outstanding, that would not relieve them of the duty to inquire.

1701 Commerce Acq., LLC v. Macquarie US Trading, LLC, 2022 WL 3904976 (Tex. Ct. App. 2022)

A lender properly declared a default, and therefore was entitled to $1 million in default-rate interest, due to the prepayment of a subordinate, mezzanine loan without the lender's consent. Although the mezzanine loan had been accelerated due to default, the agreements for both loans refer to a "prepayment" as something that could occur after acceleration, after default, or during foreclosure. Although the borrower was not the entity that paid the mezzanine loan, the loan agreement defined "default" to include "if any prepayment or refinancing of a [subordinate debt] shall occur without the prior written consent of Lender," and thus it did not matter who made the prepayment. The lender did not violate the duty of good faith by declaring a default because, when a contract gives a party sole discretion to implement a contractual term, that negates the duty of good faith and the party may exercise the discretion in any way that does not deprive the other party of the fruits of a contract or make the performance it was promised illusory. Here, there was no suggestion that the borrower would be deprived of the fruits of the loan agreement and the lender had performed by providing the promised financing. It did not matter that the loan agreement referred in other places to "sole and absolute" discretion whereas in the term relating to prepayment it referred to "sole" and "final and conclusive" discretion. The different words meant the same thing. However, the lender was not entitled to recover for the attorney's fees that the lender incurred in defending against the debtor's claim. Although the loan agreement provided for recovery of costs and attorney's fees "incurred by Lender in connection with . . . the prosecuting or defending of any action or proceeding or other litigation or otherwise, in each case against, under[,] or affecting Borrower, any other Borrower Party[,] or any Affiliate of Borrower," that language was not sufficiently clear to cover fees incurred in inter-party disputes, as opposed to disputes with third parties.

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COMMERCIAL LAW AMICUS INITIATIVE UPDATE

In August, the Commercial Law Amicus Initiative ("CLAI") achieved another victory when the Florida Supreme Court issued its decision in *1944 Beach Boulevard, LLC v. Live Oak Banking Co.*, 2022 WL 3650803 (Fla. 2022), a case involving U.C.C. § 9-506(c) and whether Florida's filing office uses standard search logic.

Florida's search system is unusual in that it does not sift through filed financing statements and select those that are most relevant. Instead, the response to every search is the entire index of filed financing statements, arranged alphabetically by debtor name. The searcher is simply placed electronically at a particular location in that index, but then permitted to scroll forwards and backwards through the entire index, page by page. The parties assumed that the system employed search logic but acknowledged that not everything in the index should be deemed to be responsive to a search request. Instead, they argued about how far forwards or backwards a searcher should be expected to review the results.

CLAI argued, and the court agreed, that there was no search logic. In so doing, CLAI pointed out that:

• If the 20 filings on the initial page (or the 60 total filings on the initial page, the preceding page, and the subsequent page) were treated as disclosed pursuant to search logic, then to protect its priority a searcher would need to get the filer of each such financing statement either to file a termination statement or to enter into a subordination agreement, something that none of those filers would have a duty to do.

• The index is not static. As financing statements are filed and terminated, the index will change. Thus, the financing statements listed on the initial page of the search results (or on the initial and the two adjoining pages) will change. Consequently, the effectiveness of a previously filed financing statement that gives an incorrect name for the debtor could change for reasons outside the parties' control, having nothing to do with the parties or the transaction, and without any notice to anyone.

The decision brings CLAI's record as *amicus curiae* to a perfect 5-0. 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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