2018 BANKRUPTCY AT THE BEACH
COMMERCIAL LAW UPDATE

Professor John M. Czarnetzky
University of Mississippi School of Law

Commercial Cases Decided Under Alabama Law

Availability of Attorney's Fees for Breach of Article 4 Warranty

***Wells Fargo, N.A. v. Nat'l Bank of Comm.*, --- So.3d ----, 92 UCC Rep.Serv.2d 1213, 2017 WL 2822787 (Ala.).**

A collecting bank accepted a check that was not properly indorsed and presented it to the drawee bank for payment. One of the payees on the check sued both banks for conversion, and the drawee bank sought indemnification from the collecting bank for breach of presentment warranties. The UCC provides that the drawee bank is "entitled to compensation for expenses and loss of interest resulting from the breach" of the warranties, and thus the drawee bank was entitled to indemnity. However, although the drawee bank's successor prevailed on its claim for indemnity, it was not entitled to attorney fees under article 4. The Alabama commentary on article 4 leaves room for an argument for attorney's fees, but it is important to note that the commentary is not part of the statute and is not binding. Among other reasons, attorney's fees are not appropriate where, as here, the basis for the conversion suit was in part due to the independent actions of the drawee bank.

Article 2 Warranties.

***In re Lumber Liquidators Chinese-Manufactured Flooring Durability Marketing and Sales Practice Litigation*, 93 U.C.C. Rep Serv.2d 53, 2017 WL 2911681 (E.D. Va.).**

The buyers of flooring failed to provide sellers with notice under article 2 of the nonconformity of the flooring to the contract. Although the buyers had discovered the defects shortly after receiving the goods, they did not provide notice until after a year had passed. This notice was insufficient under Alabama law, and thus the buyers could not maintain suit for breach of warranties.

The court also noted that when the buyers did provide notice, it was through a demand letter to the counsel for the sellers. This seems to conflict with the purpose of the notice requirement, which is to give the parties an opportunity to remedy any problem. The buyers also argued that the seller knew about the problems through their own testing and quality control programs, and thus no notice was necessary. The court rejected that argument, noting that any knowledge the sellers had through their own testing did not in any way affect the requirement of notice.

Acceptance of Goods.

Summit Auto Sales, Inc. v. Draco, Inc., 93 UCC Rep.Serv.2d 825, 2017 WL 389669193 (N.D. Ala.).

The buyer of automobiles attempted to revoke its purchase of the automobiles. The purchaser had sold the vehicles to a customer who rejected them because they had previously been used as taxicabs. The buyer then sold them to another buyer. The court held that the first sale by the buyer was clearly inconsistent with continued ownership by the seller, and therefore the buyer had "accepted" the goods. However, the second sale did not necessarily constitute acceptance because sale after revocation is a permissible remedy for rejection.

Forum Selection Clauses and a "Battle of the Forms."

Micor Indus., Inc. v. Mazak Corp., 94 U.C.C. Rep. Serv.2d 1169, 2018 WL 804303 (N.D. Ala.).

In negotiating a sale of goods, he parties exchanged forms each of which contained its own forum selection clause. Under article 2, neither of the conflicting clauses would have become part of the contract. However, the buyer alleged that, after it mailed the purchase orders to the manufacturer, it signed and returned the manufacturer's sales order confirmations, a security agreement, and installation forms, all of which contained the manufacturer's terms and conditions of sale, including the forum selection clause. Under Alabama law, these actions constituted a modification of the terms of the original contract between the parties, and an adoption of the manufacturer's terms and conditions of sale, including the forum selection clause, as the only signed forms between the parties were the buyer's return, with the buyer's signature, of the manufacturer's forms.

Selected Non-Alabama Caselaw

Misindexed Financing Statement Provides Notice.

***In re Feed Store, LLC*, 2018 Westlaw 1320168 (Bankr. N.D. W.Va) (West Virginia law)**.

A secured creditor properly filed a financing statement covering in all of the debtor's "inventory, chattel paper, accounts, equipment and general intangibles, together with all proceeds, accessions, additions, replacements and substitutions related thereto," but the financing statement was misfiled by the Secretary of State's office. The bankruptcy trustee argued that the article 9 provision which states that "failure of the filing office to index a record correctly does not affect the effectiveness of the filed record" deprived the trustee and thus the estate of an interest in property covered by the financing statement without proper constitutional notice.

The bankruptcy court rejected the trustee's argument. The provision on mifiling by the secretary of state puts the risk of misfiling on the subsequent searchers rather than the filers. The notice required by the constitution is "notice reasonably calculated under the circumstances" to provide notice, not perfect, actual notice. A filer who did all that was required had no additional duty to ensure proper indexing of the financing statement.

Extra Space in Debtor/Corporation Name Renders Financing Statement Seriously Misleading.

***SEC v. ISC, Inc.*, 2017 WL 3736796 (W.D. Wis.) (Wisconsin law).**

The secured creditor, Double Bubble, Ltd., filed a financing statement against the debtor. The financing statement listed the debtor's name as ISC, Inc., but it contained an extra space between the "c" and the period. A search of the financing statement records using the standard protocols of the filing office did not yield the financing statement filed by Double Bubble, Ltd.

Article 9 provides that a financing statement is effective unless it has an error that renders it "seriously misleading." In the case of debtor's names, a financing statement is seriously misleading if a search of the records under the debtor's proper name would not yield the financing statement with the error. Such were the facts in the case. Double Bubble argued that if the search were conducted in a reasonably diligent manner, say by dropping all punctuation in the debtor's name, the financing statement

would have been found. Moreover, had the search been done using the "hints" that the filing office provides, the financing statement would have been found.

The court rejected these arguments. The standard in article 9 is not "reasonable diligence," and the fact that the filing office provides hints and tips on searching does not alter in any way the statutory standard.

Rental Payments for Semis Are Proceeds of the Trucks.

***In re National Truck Funding LLC*, 2018 WL 543005 (Bankr. S.D. Miss.) (Nevada law).**

Rental payments made to the debtor for semitrucks leased to independent operators are "proceeds" of the trucks, and thus perfected security interests in the trucks continues in the rental payments. Under the UCC, the definition of "proceeds" includes "whatever is acquired upon the sale, lease, license, exchange or other disposition of collateral." The court reasoned that the leases of the trucks were "dispositions" of the trucks, and thus the rental payments received under the leases were received upon disposition of the trucks, and therefore proceeds.

As cash proceeds, the UCC provides that the security interest in proceeds, which continues, becomes unperfected after 21 days unless the proceeds are "identifiable." Because the question of whether the proceeds here are "identifiable" is a question of fact, summary judgment was not appropriate.

Court Has No Authority to Replace a Lost Stock Certificate.

***Huntington Nat'l Bank v. Bywood, Inc.*, 2017 WL 224153792 (Ct. App. Ohio) (Ohio law).**

A judgment creditor was attempting to execute a judgment against the stock owned by the judgment debtor. The debtor, however, had lost the stock certificate. The trial court granted the judgment creditor's motion to "issue" the stock that the debtor had misplaced, citing a provision of UCC article 8 which Article 8 provides that a creditor was entitled to aid from a court of competent jurisdiction in reaching a debtor's certificated security that could not readily be reached by other legal process.

The Ohio appellate court reversed that order. A court does not have the ability to "issue" securities. Only the corporation may issue its securities. Article 8 provides that a court may aid a judgment creditor in locating and executing against securities of the debtor, but in no way does this empower a court to issue securities.

Dealership With Voidable Title Passes Good Title to a Buyer

***Focarino v. Travelers Personal Ins. Co.*, 2017 WL 1456967 (Sup. Ct. N.J.) (New Jersey law).**

A car dealership obtained a Bentley automobile through a "transaction of purchase," whereby the dealership agreed to satisfy a third-party lien against the vehicle. The dealership fraudulently did not do so. At that point, the dealership held what article 2 calls "voidable title." Under article 2, a holder of "voidable title" can pass good title to a purchaser for value without notice of the fraud, and thus the buyer gets to keep the Bentley.

Bank Customer Duty to Review Checks Paid by Bank.

***Levy, Baldante, Finney & Rubenstein P.C. v. Wells Fargo, N.A.*, 2018 WL 847756 (Pa. Sup. Ct.). (Pennsylvania law).**

Under article 4, a bank customer must, with reasonable promptness, review its bank statement to determine whether there has been some unauthorized alteration of the check. The commentary to article 4, however, makes clear that this duty does not extend to reviewing bank statements for unauthorized indorsements.

These rules are subject, however, to the general rule that such provisions may be altered by the contract between the parties. In this case, the customer was a law firm, and its agreement with the bank contained a provision requiring the law firm to review its bank statement and report to the bank within 30 days several matters, including not paying the proper amount to the correct person, which would necessarily include unauthorized indorsements. One of the law firm's partners stole over $300,000 from the law firm's IOLTA account through fraudulently indorsed checks written to third parties.

Thus, the court enforced the agreement between the bank and its law firm, absolving the bank of any responsibility for the improper checks. The court rejected the law firm's argument that because the account at issue was an IOLTA account, the bank had heightened responsibilities to its customer. The court noted that the although article 4 does not require it, the bank indeed did provide greater information in its statement to the law firm than it does for other accounts.

Security Interest Extinguished When Motor Vehicle Crushed.

***In re Hill*, 2018 WL 1075860 (Bankr. N.D. Ill.).**

The City of Chicago impounded the debtor's vehicle for unpaid parking tickets, and it was eventually crushed. The debtor and the creditor which had a security interest in the vehicle both received notice of the impoundment. The creditor filed a proof of claim in the debtor's bankruptcy claiming secured status.

The bankruptcy court denied secured status to the claim, holding that the secured creditor's claim became unsecured at the time the car was crushed. Thus, the creditor was a general unsecured creditor in the debtor's bankruptcy case. Moreover, since there were no insurance payments received on the vehicle, there were no proceeds to attach.

Art Gallery Was BIOC from Art Dealer Entrusted With Painting

***Gallin v. Hamada*, 283 F.Supp.3d 189 (S.D.N.Y.) (New York law).**

An art gallery traded a painting for another painting and $450,000 from an art dealer. When the art dealer then faced financial difficulties, a childhood friend of the dealer asserted a claim against the painting that the art gallery had received from the dealer. The friend claimed that there was an oral agreement between him and the seller that the friend had a one-third ownership interest in the painting, and that the friend had entrusted the painting to the dealer in order to sell. The art gallery claimed that it was a buyer in the ordinary course, in good faith, from a dealer of paintings, and thus it took free of any claims of third parties.

Article 2 provides that a good entrusted to a merchant dealing in goods of the same sort is sold free and clear of any claims to a buyer in the ordinary course who acts in good faith. There was no doubt that the seller was a merchant involved in selling paintings, so the only way he could prevail was to attack the BIOC status. The friend attempted to do so by pointing to several "red flags," the most important of which was that the buyer "surely" knew of the financial problems facing the seller. The court rejected this and all other purported "red flags," upholding the buyer in the ordinary course status.

Security Interest in Liquor License Not Properly Perfected

***In re TAM of Alleghany, LLC,* 575 B.R. 131 (Bankr. W.D. Pa. 2017).**

In the transfer of a bar, a secured creditor made a fixture filing in the local recorder of deeds which claimed the bar's liquor license as collateral. The bankruptcy trustee claimed that the filing was not sufficient to perfect a security interest in the license. The bankruptcy court agreed with the trustee.

A liquor license is a general intangible, and thus a security interest in it is perfected by filing in the secretary of state's office, which was not done here. While the fixture filing may have perfected a security interest in some of the fixtures of the bar, it was not effective to perfect an interest in the license. The bankruptcy trustee, with the status of a hypothetical lien creditor, defeats an unperfected security interest.