**2019 BANKRUPTCY AT THE BEACH COMMERCIAL LAW UPDATE**

**Professor John M. Czarnetzky**

**University of Mississippi School of Law**

**Commercial Cases Decided Under Alabama Law**

**True Lease v. Secured Transaction**

***Pipkin v. Sun State Oil, Inc.,* 96 UCC Rep.Serv.2d 1006, 2018 WL 4871132 (Ala.).**

In a case for conversion and trespass against the putative lessor of gasoline pumps. The Supreme Court of Alabama applied the article 1 test for a “true lease” versus a secured transaction to the agreement between the parties. The court held that the lease was indeed a secured transaction, and therefore the formalities of article 9 applied, and had not been followed.

The creditor, Sun State, asserted that the gasoline pumps were “trade fixtures,” that the agreement between the parties did not transfer any ownership rights in the pumps, and that therefore upon failure to perform the lease, the creditor had an absolute right to go and get the pumps from the property of the debtor, Pipkin.

The court began its opinion with the trade fixture argument. The trial court had held that the gasoline pumps were trade fixtures of Sun State, and therefore had never become part of the real property of Pipkin. When Pipkin did not pay under the lease, therefore, Sun State had a right to enter Pipkin’s property and retrieve the pumps.

The Alabama Supreme Court reversed the trial court. After an extensive discussion of the history and law of trade fixtures, the Court determined that the trade fixture doctrine applies only in the context of landlord-tenant law, and is an exception to the general rule that any fixtures attached to land by a tenant become part of the realty and therefore the property of the realty’s owner. The Court noted that Sun State is not the owner of Pipkin’s real estate, and there was no landlord-tenant relationship whatsoever between the parties. Therefore, the doctrine of trade fixtures simply does not apply to this case.

The Court then turned to whether the agreement between the parties was a true lease or a secured transaction. The analysis turned on the specifics of UCC: § 7-1-203 which contains a test for a “true lease” versus disguised sale. One criterion is whether the consideration that the lessee was to pay the lessor for the right to possession and use of the goods was an obligation for the term of the lease and was not subject to termination by the lessee. The agreement between the parties permitted Pipkin to terminate the agreement, but only with the seller’s consent. Moreover, the terms of the agreement provided that the Sun State could have objected to Pipkin’s termination of the agreement and could have required the Pipkin to pay the remainder of the consideration due under the agreement. The fact that the Sun State did not exercise that right did not transform the agreement into a lease.

Another indication that a lease is a disguised sale is a provision whereby the lessee becomes the owner of the property at the end of the lease for little or no additional consideration. Here, the agreement provided that Pipkin would become the owner of the pumps upon completion of all the requirements of the agreement. Again, the fact that Pipkin did not perform the agreement in full does not alter the agreement’s status as a sale agreement. Therefore, Sun State should have filed a financing statement with the state to perfect its security interest in the gasoline pumps. Not having done so renders Sun State an unsecured creditor with no property interest in the pumps.

**Article 2 Warranties and Definition of “Goods.”**

***Hanover Ins. Co. v. BASF Corp.*, 97 U.C.C. Rep Serv.2d 930, 2019 WL 220240 (N.D. Ala.).**

Insurer brought suit against the seller of stucco and sealant seller alleging a violation of the article 2 implied warranty of merchantability for a particular purpose. The stucco system and sealant had failed, and the issuer of a performance bond had paid $794,485 as a result. The insurer sought reimbursement from the manufacturer under the article 2 theory. The court held that the stucco and sealant were not “goods” for purposes of the UCC, and thus the article 2 implied warranty did not apply.

A “good” for purposes of the UCC is “anything that is moveable at the time it is identified to the contract for sale. Although goods can include such items that become affixed to realty, in order to retain their status as “goods,” such items must be severable from the real property in such a fashion that there is no material harm to the realty.

In this case, the insurer itself alleged that that the stucco and waterproofing were to provide a “watertight” seal for the building, that the system was integral to the building, and that removal of the stucco and waterproofing would render the realty exposed to the elements in a way that would harm the realty. Given these allegations by the insurer, the stucco and waterproofing were not “goods,” and the article 2 warranties did not apply.

**Does Purchase of Receivables Also Transfer Right to Arbitration?**

***Lester v. Portfolio Recovery Assocs., LLC.*, 96 UCC Rep.Serv.2d 226, 2018 WL 3374107 (N.D. Ala.)(Utah law).**

A purchaser of credit card receivables (the “assignee”) sought to enforce an arbitration provision of the original credit agreement between the account debtor and the original creditor. The assignee asserted that it had stepped into the shoes of the original creditor for all purposes when it had purchased the credit card receivables pursuant to a bill of sale.

The court, applying Utah law, disagreed with the assignee. The bill of sale provided that the assignee had purchased “receivables” represented by the account debtor’s “account.” There was no mention of the right to arbitrate contained in the agreement. While it is true that under article 9 that the rights of an assignee of accounts receivable were subject to all terms of the original agreement between the account debtor and the original creditor, there was no evidence of an intent to transfer the right to arbitrate. Thus, the assignee only received a transfer of the right to collect the receivable, and potentially other rights surrounding the collection, but not the right to compel arbitration.

# Selected Non-Alabama Caselaw

**Inoperable Helicopter a Good in Which Buyer Had Special Property Interest.**

***In re Phoenix Heliparts, Inc.,*** **95 UCC Rep.Serv.2d 1038, 2018 WL 2107796 (9th Cir. BAP) (Arizona law)**.

In the bankruptcy case of a helicopter refurbisher, the issue was whether an inoperable helicopter was property of the debtor’s estate or not. The helicopter in question once had been fully operational, but it no longer was when the debtor received it prepetition in order to refurbish it and render it operational again. The issue in the case was whether the helicopter was a “good” pursuant to article 2 of the UCC in which the buyer obtained a special property interest prepetition, or was the helicopter merely a “future good” in which the buyer had no property interest. The court held that it was a “good” under the UCC.

A good need not be complete in order to be a “good.” Indeed, this case was NOT one of a good being manufactured from scratch. Rather, the helicopter existed but could not fly. The parties had made no agreement regarding identification of the helicopter to the contract, so the court, applying the default rule, held that the helicopter was identified to the contract when under the contract the make, model, serial number and flying hours were all set forth in the contract. As a good identified to the contract, the buyer obtained a special property interest at the time of the contract, which was before the seller’s bankruptcy filing.

**Charity Does Not Have Standing to Claim Conversion of Checks It Never Possessed.**

***Alzheimer’s Fdn. of Am. v. Alzheimer’s Disease & Related Disorders Assn., Inc.,* 95 UCC Rep.Serv.2d 950, 2018 WL 2084169 (S.D.N.Y.) (New York or Illinois law).**

The defendant, the “Association,” received checks from donors made out to the plaintiff, the “Foundation.” The Association deposited the checks in the Association’s bank account, and never forwarded the funds to the Association. The Association sued the Foundation on multiple counts, including conversion under article 3 of the UCC.

The Foundation acknowledged that it never possessed, either actually or constructively, the checks in question. The court noted that it was a longstanding rule that a check has no valid inception until delivered. Therefore, a payee has no property interest in a check until it receives possession of it, either actually or constructively. Because the Foundation admitted that it never had any form of possession, the Foundation had no property interest in the check, and thus suffered no damages when the proceeds of the checks were kept by the Association.

**Perfection of A Security Interest In Uncertificated Securities.**

***In re Jaghab,* 95 UCC Rep.Serv.2d 826, 2018 WL 1831775 (Bankr. E.D.N.Y.).**

A creditor took a security interest in the debtor’s shares in a corporation in order to secure a promissory note. The bankruptcy court held that the creditor failed to perfect its security interest in the shares, and thus was an unperfected secured creditor whose interest in the stock was avoidable under §544 of the Bankruptcy Code.

The stock was not represented by stock certificates. A security interest in such uncertificated securities – which are characterized as “investment property” under article 9 of the UCC -- can be perfected either by an article 9 filing with the state or by “control.” The creditor never made a UCC filing, leaving only control as a possibility. Such “control” exists where the debtor delivers the investment property to the creditor, or where the debtor agrees by contract to be bound by the directions of the creditor with regard to the investment property. There was no delivery because the corporation in question did not have a ledger book for recording the transfer of stock, so there was no evidence of such a transfer. There was no agreement between the debtor and creditor regarding the stock. Thus, there being no evidence that the creditor “controlled” the investment property, there was no perfected security interest in the stock at the time the debtor filed their bankruptcy case.

**Repossession Was Pursuant to “Judicial Process” Where Sheriff Not Present.**

***Carter v. First Nat’l Bank of Crossett,* 95 UCC Rep.Serv.2d 1189, 2018 WL 242004(Ct. App. Ark.) (Arkansas law).**

Article 9 permits a secured creditor to exercise self help to repossess collateral of the secured creditor if it can do so without a breach of the peace. If that condition cannot be met, then the creditor must proceed by “judicial process.”

In the case, the creditor obtained a court order directing the sheriff to take possession of the creditor’s collateral, which was logging equipment. After obtaining the court order, the creditor took possession of the collateral at a time the debtor was not present and without the sheriff being present. An “unnamed third party” had broken the lock on the premises permitting access to the collateral for the creditor.

The court upheld the repossession. The creditor had obtained judicial process before taking possession of the collateral. The debtor was not present at the repossession, so the presence of the sheriff was not necessary. Furthermore, the question of breach of the peace only arises when the creditor does not proceed by judicial process as the creditor did here. Finally, the court noted that because it was proceeding by court order, the creditor would have been within its rights to break the lock itself, so who actually broke the lock did not matter.

***Sears Home Appliance Showrooms, LLC v. Charlotte Outlet Store, LLC*, 96 UCC Rep.Serv.2d 77, 2018 WL 3068459 (N.D. Ill.) (Illinois law).**

A franchisee asserted that its franchisor failed to use best efforts to supply appliances, lawn and garden equipment pursuant to the franchise agreement under article 2 of the UCC. The agreement was that the franchisee would facilitate the sale of the franchisor’s goods. The franchisee had the right to use the franchisor’s trademarks and to receive the goods to pass on to customers. However, the title to the goods remained always with the franchisor.

The court held that the agreement was predominately one to provide services, not goods, and therefore was not governed by the UCC. Though the purpose of the contract ultimately was to sell goods, the agreement between the parties essentially detailed the services that the parties would provide in achieving those sales, rather than a contract solely concerning the sale of goods. The main thrust of the agreements was not about the nature or logistics of sales of affiliate-owned goods, but rather was about the franchisees’ use of the franchisor’s trademarks and copyrights, their operation of the stores, their obligations around insurance, record-keeping, and information systems, and the establishment of the exchange of fees and payment.

**Owner of Farmland Was Not a “Buyer” of Seed and Chemicals He Accepted on Behalf of Person Farming the Land.**

***Jamison v. Coddington*, 96 UCC Serv.2d 354, 2018 WL 3912134 (Ct. App. Iowa) (Iowa law).**

An owner of farmland had rented the land to another farmer to raise crops. The landowner accepted some seed and chemicals which the tenant farmer applied to the land. The seller was not paid for the seed and chemicals, and sued the landowner. Article 2 of the UCC contains an exception to the statute of frauds for goods accepted, and as this was an oral contract, the seller argued that article 2 applied to the case.

The court rejected the seller’s argument and held that article 2 did not apply. Specifically, the court rejected the argument that the tenant was either the partner or the employee of the landowner. This was an important argument because the article 2 exception to the SOF is for goods accepted by the buyer. Because there was not sufficient evidence to establish that acceptance by the landowner was either the same as acceptance by the buyer (partners) or actually by the true buyer (agency), the necessary element for the exception to the SOF was not met.

**Purchase of Assets at a Foreclosure Sale Does Not Preclude Claim of Successor Liability**

***Wells Fargo Vendor Financial Services, LLC v. Nationwide Learning, LLC,* 96 UCC Serv.2d 649, 2018 WL 3945936 (Ct. App. Kan.) (Kansas law).**

A purchaser of printers at a properly conducted foreclosure sale was then sued on a successor liability theory for the original debtor’s breach of lease agreements concerning the printers. The buyer asserted that the purchase of the printers at a foreclosure sale insulated it from successor liability. The court rejected the buyer’s argument and held that a successor liability suit could proceed.

Article 9 provides that a properly conducted foreclosure sale discharges the security interest being foreclosed upon, as well as any subordinate security interests. Article 1 of the UCC specifically provides that principles of equity and law supplement the UCC unless specifically displaced by the UCC. Successor liability is an equitable doctrine that is not specifically displaced by any provision of the UCC. Therefore, successor liability, which is concerned with whether or not a debt is extinguished (not the enforcement of a lien as in article 9) is not affected by a foreclosure sale.

**Father’s Sweetheart Sale of Tractors to Son Did Not Extinguish Security Interest**

***Security Nat’l Bank of Sioux City v. Welte,* 97 UCC Serv.2d 310, 2018 WL 6120206 (Ct. App. Iowa) (Iowa law).**

A farmer sold some tractors to his son for less than a quarter of the equity that the farmer had in the tractors. At the time of the sale, the tractors were subject to a validly perfected security interest of the bank. The security agreement with the bank provided that the debtor could not “consume, assign or transfer any Collateral without prior written consent of Secured Party.” Nevertheless, the farmer testified that he regularly bought and sold machinery without seeking the bank’s permission, and the son argued that this created an implied course of dealing allowing the father to dispose of collateral free of the creditor’s security interest, as contemplated by Article 9.

The court rejected the famer’s argument. Even if such a course of dealing were recognized which could alter the terms of the written security agreement, the sweetheart deal the farmer made with his son did not comply with that course of dealing. Therefore, the sale to the son was in violation of the security agreement even as amended by the purported course of dealing in which the bank had allegedly acquiesced.