2023 BANKRUPTCY AT THE BEACH COMMERCIAL LAW UPDATE

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1. 2022 UCC Amendments.[1]

Beginning in 2019, the American Law Institute and the Uniform Law Commission (ULC) began considering amendments to the UCC to address "emerging technologies," including the lack of clarity in commercial rules for certain electronic transactions. The review committee received comments from the American Bar Association, as well as over 300 interested parties from academia, trade groups, government agencies, law firms, technology companies, and foreign law reform groups. In 2022, the ULC published its amendments, which include provisions addressing digital assets, tangible and electronic money, and block-chain technology. Upon adoption, the amendments would allow a state to regulate and facilitate modern commercial transactions. Among other things, a new Article 12 includes rules addressing transactions with digital assets like virtual currency, non-fungible tokens, and electronic promises to pay. Such digital assets will be referred to as "controllable electronic records" or "CERs".

Prior to the promulgation of Article 12, there has been a lack of clarity around certain legal issues surrounding digital assets, including as it relates to perfection and priority of security interests. New Article 12 establishes uniform rules to preserve uniformity of state commercial law, clarify rules for money in electronic form, and update UCC terminology for the digital age.

The primary amendments include:

- Digital Assets
    - Definition of CER: a record of information in electronic form that is susceptible to "control", which control is had when a person has a) the power to enjoy "substantially all the benefit" of the CER, b) the exclusive power to prevent others from enjoying "substantially all the benefit" of the CER, and c) the exclusive power to transfer control or to cause another person to obtain control of the CER.
        - If a record is not susceptible of control, it is outside the scope of Article 12. There are also certain specific assets that are excluded from the definition of CER because there are already commercial law rules that address such assets, including electronic chattel paper, electronic documents, investment

[1] *See* 2022 Amendments to UCC, Uniform Law Commission, https://www.uniformlaws.org/committees/community-home?communitykey=1457c422-ddb7-40b0-8c76-39a1991651ac#:~:text=The%202022%20amendments%20to%20the,intelligence%2C%20and%20other%20technological%20developments.

property, transferable records under the federal E-SIGN law or the Uniform Electronic Transactions Act, deposit accounts, and electronic money.

- Take-free rule: If a purchaser obtains control of a CER for value, in good faith, and without notice of a property claim to the CER, the purchaser takes the CER free of any competing property claim to the CER (subject to the applicability of other laws).

  - Article 12 does not replace other laws applicable to a CER. For example, copyright law may still affect intellectual property rights as they relate to CERs, including NFTs.[2]

- Security Interests: Article 12 is coordinated with existing Article 9. A CER is considered a general intangible, so financing statements that include general intangibles will cover CERs. Security interests in CERs can be perfected by a filing, but perfection by control will have priority. The transition rules for the 2022 amendments include a period for parties to retain priorities for a time after enactment in order to adjust the transaction to allow for control.

- Governing Law: Parties can choose which law applies to their transaction and incorporate such choice into their CER or the system in which the CER is recorded. Otherwise, governing law is the jurisdiction where the CER is "located" if a CER expressly provides its jurisdiction or is recorded in a particular jurisdiction. Otherwise, the law of the District of Columbia will apply if it has enacted the amendments (and if not, the substantive law rules of the Official Text of the amendments will apply). Normal debtor location rules apply for perfection of a security interest by filing a financing statement (but as noted above, priority may be dictated by control).

- Other Noted Changes

  - Chattel paper: The definition is modified to refer to a right to payment evidenced by records, rather than the records themselves.

  - Hybrid transactions: Hybrid transactions that involve a sale/lease of goods and a sale/lease of services are becoming increasingly common. The amendments incorporate the "predominant purpose" test.

  - Certain "writing" requirements are changed to "record" requirements to facilitate electronic commerce. Articles 3 and 9 still require an "instrument" to be in writing.

  - The definition of "signed" is expanded to allow for electronic signatures.

[2] For a recent case addressing the applicability of intellectual property law to NFTs, *see Hermès International v. Rothschild*, No. 22-cv-384 (JSR), 2023 WL 1458126 (S.D.N.Y. Feb. 2, 2023) (denying cross-motions for summary judgment). The jury subsequently returned a verdict in favor of the plaintiff.

- “Authenticate” is replaced by “sign” in Article 9 in light of this definition change, which eliminates the need for “authenticate.”

<u>Negotiable Instruments</u>

2. *Western & Lake Check Cashers, LLC v. Propane Pete, LLC*, --- N.E.3d ---, 2023 WL 3471391 (Ill. App. Ct. May 16, 2023).

<u>Background</u>: Defendant Propane Pete issued a paper check to Jones, who electronically deposited the check into his bank account and then took the check to plaintiff Check Cashers and cashed the check. Check Cashers' bank sought payment from Propane Pete's bank for the check, but Propane Pete's bank returned the check without payment because it had already paid the check when it was electronically deposited. Check Cashers then demanded payment from Propane Pete, and when Propane Pete refused to make payment, sued. The trial court found in favor of Check Cashers, entering judgment for the amount of the check plus certain fees and costs, and Propane Pete appealed.

<u>UCC Application</u>: The appellate court considered three dispositive issues: 1) whether Check Cashers was a holder in due course of the check; 2) if so, whether Propane Pete's obligation to pay the check was discharged under the UCC due to prior payment; and 3) if not, whether Propane Pete was responsible for the fees and costs included in the judgment. The court determined that based on the applicable burden, Check Cashers was initially a holder in due course because it had possession of the endorsed check and presented it for payment. Such possession of the check was *prima facie* evidence of its holder in due course status. The burden then shifted to Propane Pete to establish a defense that would nullify Check Cashers' status, but Propane Pete did not present evidence of any defenses, such as whether Check Cashers had any notice of irregularity when it made payment on the check. With respect to the issue of discharge, Propane Pete argued that the applicable UCC sections provided that liability on the check is discharged once payment is made. However, the court found that Propane Pete's argument overlooked Section 3-306, which provides an exception when the party is a holder in due course. Accordingly, Propane Pete's prior payment on the check did not discharge its obligation vis-à-vis Check Cashers. With respect to the issue of fees, Check Cashers argued that it was entitled to fees and court costs because of the warranties that extended to it as a holder in due course. After consideration of the applicable statutes, the court determined that Check Cashers' claim for fees was proper against Jones, as the warrantor, but not against Propane Pete. Finally, the court noted the inequities of the situation, but said “our hands are tied. Any revision to the Code, which is sorely needed considering the technological advancements in banking that the Check 21 Act addresses, must come from the legislature, not the courts.”

3. *VFS Leasing Co. v. Markel American Insurance Company*, No. 8:21-cv-1297-TPB-JSS, 2022 WL 3924277 (M.D. Fla. Aug. 31, 2022).

<u>Background</u>: The plaintiff VFS leased eighteen-wheelers to a non-party, Time Definite Leasing, LLC (“TDL”). VFS required TDL to purchase insurance for the eighteen-wheelers and name VFS as an additional insured and loss payee, and TDL did so. Five of the leased eighteen-wheelers were damaged, and TDL submitted claims to the defendant insurer Markel. Markel made payment on the claims, sending two checks to TDL, payable to both VFS and TDL as copayees, but VFS was

not made aware of the checks. TDL cashed the checks, keeping all proceeds, and then subsequently filed bankruptcy.

VFS then sued Markel in state court, and the case was removed to federal court. The single claim was for breach of contract, with VFS arguing that Markel had breached its insurance contracts by failing to pay the amount of the claims. Markel asserted that it satisfied its contractual obligations by sending the checks to TDL, and any claim VFS may have was against TDL and/or the bank that improperly cashed the two-party checks.

UCC Application: On consideration of the parties' cross-motions for summary judgment, the court considered a "somewhat regularly occurring legal issue"—whether cashing a two-party check by one copayee, without the knowledge, involvement, or endorsement of the other copayee, discharges the party that issued the check from its liability on the check and any underlying contractual obligation. The court noted a split of authority from UCC jurisdictions, and no Florida state court opinion directly addressing the issue. The two approaches are as follows:

1. The first approach, which would favor the defendant insurer, holds: "[W]hen a party with a contractual obligation to pay delivers a two-party check to one of the two copayees, and the copayee cashes the check without the knowledge, involvement, or endorsement of the other copayee, that party cannot be held liable on its contractual obligation because the law deems the obligation discharged when the check is delivered and cashed by the copayee, or at least suspended until the check is property paid or dishonored[.]"

2. The second approach, which would favor the plaintiff, holds: "[T]he cashing of a two-party check by one copayee, without the knowledge, involvement, or endorsement of the other copayee, does *not* discharge the party that issued the check from its liability on the check or on an underlying contractual obligation. The unpaid copayee is therefore entitled to bring an action for breach of contract against the party with the contractual obligation to pay, or a suit on the check itself under the theory that the check is lost, or under both theories."

The court considered various provisions of Article 3, including the meanings of "acceptance," "dishonor," "presentment," and "payment or acceptance by mistake," as well as provisions on the "effect of instrument on obligation for which taken" and "enforcement of lost, destroyed, or stolen instrument." The court noted that the language of Fla. Stat. § 673.1101(4), regarding the identification of person to whom instrument is payable, specifies that "[i]f an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them." The court found that this provision supported the second approach noted above, such that the defendant insurer was not discharged of its obligations under the insurance contract. Judgment was entered in favor of the plaintiff.

Banks

4. *Azure College, Inc. v. Bank of America, N.A.*, No. 21-CV-62270-RAR, 2022 WL 4291084 (S.D. Fla. Sept. 16, 2022).

Background: Plaintiff Azure College opened an account with defendant Bank of America. Only the president of Azure College was an authorized signer on the account. Over a period of 9 days, six ACH debits were initiated by a third-party defendant, who was a payroll company. The payroll company had been contacted by someone impersonating Azure College's president, who said that the College was interested in obtaining payroll services and who provided the account and routing numbers for the College's account. The payroll company transmitted this information to its bank, Valley National Bank, who effectuated the six debits totaling $259,800. Bank of America paid this amount out of Azure College's account. Azure College noticed the unauthorized transactions a few days later and reported them to Bank of America. Only one transaction was recredited, as it had been coded as a consumer transaction. Azure College sued Bank of America to recover the remaining five transactions, arguing that the bank was liable under section 670.204 of the Florida UCC and also under a breach of contract theory in connection with the deposit agreement.

UCC Application: On consideration of a motion for summary judgment, the court found that section 670.204 is not applicable to ACH transactions. That section requires a bank to refund unauthorized payment orders. However, the bank and customer can agree that payment orders will be verified by a security procedure, and if such procedures are commercially reasonable and the bank accepts a payment order in good faith, the bank does not have to refund unauthorized payment orders. A "payment order" is defined as a transaction where "the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender." In this case, either the payroll company or Valley National Bank was the sender, but not Azure College who did not initiate the transactions. According, the transactions were not "payment orders" that fell under section 670.204. Instead, they were "debit transfers", whereby the instruction to pay is given by the person receiving the payment. The Official Comments make clear that the intention of the drafters was that debit transactions not be covered by the statute.

5. *Rodriguez v. Branch Banking & Trust Company*, 46 F.4th 1247 (11th Cir. 2022).

Background: The plaintiffs/appellants Rodriguez and his family and businesses lost more than $850,000 when an employee of defendant/appellee BB&T changed the password to their accounts and transferred out the funds. The plaintiffs asserted claims against BB&T and the thieves for breach of contract and a statutory demand for repayment under Florida law, as well as certain tort claims. At the summary judgment stage, the trial court considered the breach of contract claims and found that BB&T had not breached any contractual duties owed to the plaintiffs. Ultimately, the trial court dismissed the tort claims and granted summary judgment on the remaining claims in favor of BB&T. While the appeal was pending, BB&T located additional documents relevant to the case. Because the additional evidence implicated potential genuine disputes of material facts, the only question the Eleventh Circuit considered on appeal was whether the Florida UCC's statute of limitations of one year for making a demand for a refund of a fraudulent wire transfer could by modified by agreement of the parties. The agreements at issue were the Commercial Bank Services agreement that governed the commercial bank accounts at issue and the Treasury Management Agreement that one of the plaintiffs had executed. Both documents limited the

period to demand a refund to 30 days of the monthly statement date, or 10 days from the regular statement date if no monthly statement was received.

UCC Application: The Eleventh Circuit reviewed the applicable provisions of Article 4A of Florida's UCC. Section 670.501(a) provides that the rights and obligations of parties to a funds transfer may be varied by agreement unless otherwise provided by statute. Section 670.204(a) requires a bank receiving a payment order to determine whether the payment is "verified" based on security procedures previously agreed-upon by the bank and the customer. The security procedures must be commercially reasonable. If the bank accepts a payment order that is not verified, the bank must refund the payment and pay the customer interest on the refunded amount. The customer has a "reasonable time" to report a fraudulent payment, which time cannot exceed 90 days and may be fixed by agreement. However, pursuant to Section 670.202(2), the bank's obligation to refund the payment cannot be varied by agreement. Finally, Section 670.505 provides that the customer must notify the bank of the customer's objection to the payment without one year after the customer received notification of the payment being made.

Based on these provisions, the Court found that the parties could not modify the time to demand repayment in light of Section 670.202(2)'s prohibition. The only remedy for the bank if the customer fails to notify the bank of a fraudulent transfer within a "reasonable time" is that the customer loses its right to interest on that transfer. The Court noted that "Florida made a policy choice about who should bear the risk of a fraudulent transfer: the bank or the account holder. It chose the bank. Indeed, the commentary expressly says so: 'There is no intention to impose a duty on the customer that might result in shifting loss from the unauthorized order to the customer'". This policy choice "makes sense", as banks are in the best position to protect, and to create security for, their deposits. If the banks were able to modify the time period, there would be no way to say how short of a refund period was too short.

Statute of Frauds

6. *Nutrien AG Solutions, Inc. v. Simmons*, No. 2:19-CV-614-WKW, 2022 WL 3230421 (M.D. Ala. Aug. 10, 2022).

Background: The defendant Simmons, who had three decades of experience as a farmer in Ohio, moved to Alabama to farm soybeans. He entered into an agreement with the plaintiff Nutrien for the purchase of soybean seeds, chemicals, and fertilizer for 1,100 acres. The written agreement set forth the payment terms, including the timing of payment and the finance charges. Simmons alleged that Nutrien's agent, Smith, recommended Simmons purchase and plant "long season" or "full season" soybean seeds, telling him that those were the only soybeans farmers planted in Alabama and that the weather conditions in November would be dry enough to ensure a successful crop. Simmons purchased the "long season" beans, but that November had more rain than usual and most of Simmons' crop was destroyed. Simmons therefore did not have enough money to repay Nutrien for the seeds, chemicals, and fertilizer, and Nutrien sued Simmons to recover the amounts due. In response, Simmons alleged that he was not liable either at all or at least in the amounts stated due to three side agreements he had entered into with Smith:

1) Simmons alleged that Smith assured Simmons that if he could not harvest the "long season" soybeans because of too much rain, Simmons would not have to pay Nutrien for the invoiced seeds. Simmons produced a writing of notes memorializing his conversations with Smith, which Simmons had handed to Smith and which Smith returned to Simmons with Smith's name written on the top. Simmons did not see Smith sign the paper.

2) Simmons alleged that Smith orally agreed to match the prices that Simmons could have obtained from his Ohio suppliers. Nutrien had not honored the alleged price-match agreement, and instead invoiced Simmons at a higher price.

3) Simmons alleged that Smith orally agreed that Simmons could be part of a program whereby Simmons' obligations would be interest-free for six months. While Nutrien did have a zero-interest program, Simmons was provided with and did not complete the required application to be part of that program.

UCC Application: On consideration of Nutrien's motion for summary judgment, the court considered Nutrien's claim for breach of contract. The court found that there was no genuine issue of material fact with respect to the first three elements of that claim (valid contract, plaintiff's performance, and defendant's nonperformance). The parties had entered into the agreement for Nutrien to provide agricultural goods and services to Simmons, such goods and services had been provided, and Simmons had not paid Nutrien after receipt of invoices. The fourth element (damages) was in dispute based on the alleged side agreements.

With respect to the first side agreement, the court noted that such agreement was subject to the statute of frauds and therefore only enforceable if it expressed consideration and was "in writing and subscribed by the party to be charged therewith or some other person by him thereunto lawfully authorized in writing." Ala. Code § 8-9-2(7). The Alabama Supreme Court had previously explained that in order for an oral contract to be taken out of the operation of the statute of frauds, all essential elements must be stated over the signature of the party to be charged. The court found that there was no consideration evidenced on the note pad, as there were no indications of what Simmons would provide Nutrien in exchange for the alleged agreement to forgive the debt. Additionally, the alleged signature of Smith did not reference Nutrien or otherwise indicate that he was acting as Nutrien's representative. There was no evidence that Smith had any actual authority to agree to forgive Simmons' debt on behalf of Nutrien, and implied or apparent authority is not sufficient for purposes of the statute of frauds. Simmons also argued that, while the writing may not have satisfied Alabama's general statute of frauds, it did satisfy the Alabama UCC's statute of frauds at Ala. Code § 7-2-201, which requires "some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker." The court found that the UCC statute of frauds did not apply because the alleged agreement was the forbearance of a debt, not the sale of goods, as the soybean seeds had already been sold to Simmons. Even if the UCC did apply, the agreement would still fail for lack of consideration.

With respect to the second and third side agreements, the court noted that under Alabama law, a purchaser cannot disregard the express terms of a written contract and rely on a claim of fraud based on reliance on a statement contrary to such terms. Reliance on a contrary statement must be

reasonable under the circumstances. The court found that Simmons's reliance on Smith's statements about price-matching and participation in the zero-interest program was not reasonable in light of the explicit terms of the contract, and Simmons's level of education (which included an undergraduate degree and multiple graduate degrees, including in law and economics).

Simmons also argued that he had been overcharged because he was sold goods based on 1,100 acres. Ultimately, Simmons only had 927 tillable acres. However, prior to entering into the agreement, Simmons believed he had 1,250 acres, and it was only a couple of years after Simmons contracted with Nutrien that he had his fields measured and learned he had 927 acres. Accordingly, the court did not limit damages based on any overcharging, and entered summary judgment in favor of Nutrien.

<u>Sale of Goods</u>

7. *Santana Equestrian Private Financial, LLC v. Richtmyer*, 349 So. 3d 441 (Fla. Dist. Ct. App. 2022).

<u>Background</u>: Richtmyer entrusted her competitive jumping horse to her former fiancé, a merchant of competitive jumping horses, who then sold or entrusted the horse to another merchant of competitive jumping horses. The former fiancé instructed the merchant to sell the horse. The horse was subsequently transferred to a second merchant, who sold the horse to Santana. Richtmyer sued Santana to get the horse back, apparently asserting that the horse was fraudulently sold.

<u>UCC Application</u>: In reversing the trial court's grant of replevin in favor of Richtmyer, the appellate court considered the UCC's application of protections to buyers of goods in certain circumstances, noting:

> [U]nder the UCC, if goods are entrusted to a merchant who deals in goods of that kind and ultimately the goods are sold to a good faith buyer in the ordinary course of business, then the entruster's intent, intervening sales, and the merchant's fraudulent actions are irrelevant. "The buyer in the ordinary course of business obtains good title by virtue of [section 672.403(a)]." "The purpose of this section of the Uniform Commercial Code is to protect the buyer in the ordinary course of business and thus to eliminate the impediments to the free flow of commerce."

(internal citations omitted). The evidence in the record established that Santana bought the horse from a known merchant and that the circumstances and terms of the sale were typical of the industry. Santana was thus a buyer in the ordinary course of business and entitled to protection under the applicable UCC statutes.

<u>Warranties</u>

8. *Trophia v. Camping World, Inc.*, No. 8:22-cv-00128-CEH-AEP, 2022 WL 2918116 (M.D. Fla. July 25, 2022).

<u>Background</u>: The plaintiff Trophia purchased a mat from defendant Camping World to use at campsites and outside of his RV. The mat came with an informational insert that, among other things, represented that the mat had "tight weaving & reinforced stitching for long lasting

durability"; that the material was coated and "weather & fade resistant"; and that it dries quickly. On the same day Trophia purchased the mat, he travelled to a campsite with his husband and placed the mat outside at the exit of the RV. It rained, and approximately 30 minutes after the rain stopped, Trophia exited the RV, stepped on the mat, slipped, and fractured his right femur. Trophia and his husband sued Camping World for, among other things, breach of express warranty and the implied warranty of merchantability.

UCC Application: On consideration of Camping World's motion to dismiss, the court considered Florida's adoption of the UCC. For a breach of express warranty claim, the plaintiff must allege a) the sale of goods, b) the express warranty, c) breach of the warranty, d) notice to the seller of the breach, and e) the buyer sustained injuries as a result of the breach. Camping World contended that the third and fifth elements were not met, asserting that the informational insert did not represent that the mat could be used as an entry/exit mat and that the size of and material used in the mat are "clearly different than anything that would commonly be regarded as an entrance mat." The court found that Camping World's arguments relied on factual assertions that lacked support and were outside the bounds of consideration for a Rule 12(b)(6) motion (e.g., what materials were appropriate for an outdoor mat). Camping World's arguments for dismissal of the implied warranty claim also relied on its assertions that the mat was not being used in its intended manner, as is required for a breach of implied warranty claim, and the court rejected the defendant's argument for the same reason.

Security Interests

9. *Versailles Farm Home & Garden, LLC v. Haynes*, 647 S.W.3d 205 (Ky. 2022).

Background: At issue in this case were future advances and two competing security interests. In 2012, Haynes and Farmers Tobacco Warehouse ("Farmers") entered into a security agreement regarding Haynes' 2012 tobacco crop, and Farmers filed a UCC-1 financing statement. The agreement did not explicitly provide for future advances, but Farmers would make advances from time to time. The notes evidencing such advances were secured by reference to the original security agreement. In 2013, Haynes and Farmers entered into a second security agreement for Haynes' 2013 tobacco crop. Farmers made advances to Haynes from time to time, and again the notes evidencing the advances indicated that they were secured by reference to the 2013 security agreement. Later that year, Versailles Farm extended a loan to Haynes and the parties entered into a security agreement for the 2013 tobacco crop. Versailles Farm filed a UCC-1 financing statement and provided Farmers with notice of its perfected security interest. Versailles Farm did not receive any proceeds from the sale of the 2013 tobacco crop, and sued Haynes after he defaulted on his loan obligations.

Through discovery in the case, Versailles Farm discovered that Farmers had kept the sale proceeds from the 2013 tobacco crop, as well as some related insurance proceeds. Versailles Farm joined Farmers as a defendant and asserted a claim for conversion, arguing that because the 2013 security agreement did not contain a future advances clause, Versailles Farm had the superior security interest under the Kentucky UCC. The trial court granted summary judgment in favor of Farmers, finding that a future advances clause did not have to be explicitly provided for by the security agreement if it was established by the parties' course of dealing. Versailles Farm appealed.

<u>UCC Application</u>: In considering the impact of the lack of a future advances clause in the 2013 security agreement, the court considered the Official Comment to the definition of "security agreement", which states:

> The definition of "security agreement" is substantially the same as under the former Section 9-105—an agreement that creates or provides for a security interest. However, the term frequently was used colloquially in former Article 9 to refer to the document or writing that contained a debtor's security agreement. This article eliminates that usage, reserving the term for the more precise meaning specified in the definition."

The court further noted that the definition of "agreement" specified that its meaning was different than the term "contract", such that the parties' agreement "means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance [or] course of dealing[.]" Interpreting all applicable UCC sections together, the court agreed with the trial court that there was not requirement that a future advance clause be specifically included in the security agreement. The only required inclusions in the security agreement are authentication by the debtor and a description of the collateral. Accordingly, the court found that the evidence established that Haynes and Farmers had entered into a security agreement that granted Farmers a security interest in the 2013 tobacco crop, that the parties' course of dealing and course of performance supplemented the security agreement with respect to future advances, and that such future advances were therefore part of the parties' bargain and secured by the previously granted security interest.

10. *In re Main Street Business Funding, LLC*, 642 B.R. 141 (Bankr. D. Del. 2022).

<u>Background</u>: Creditor Lane asserted a perfected security interest in certain collateral of the debtor, and filed a motion seeking an order directing the chapter 7 trustee to pay him proceeds received by the trustee in connection with a court-approved litigation settlement. Specifically, Lane purchased a promissory note from the debtor and the debtor signed a security agreement granting liens in favor of Lane. The collateral included all tangible and intangible personal property of the debtor, and proceeds thereof. Prior to the petition date, the debtor had commenced litigation to recover damages for a purported scheme against him. The litigation was settled and the settlement was approved by the bankruptcy court. Lane argued that the liens granted to him covered the causes of action asserted in the litigation that was settled and that he was therefore entitled to the proceeds to repay his secured claim. The trustee countered that Lane's liens could not attach to the causes of action at issue because they did not exist at the time the security agreement was executed.

<u>UCC Application</u>: The bankruptcy court considered two issues: 1) whether the litigation sounded in contract or tort, and 2) whether the collateral description in the security agreement was specific enough to include the proceeds of the litigation.

With respect to the first issue, the debtor was a factoring company and the defendant in the litigation had been engaged as a consultant to the debtor. The debtor asserted through the litigation that the defendant had engaged in a fraudulent scheme to cause the debtor to take out an unauthorized loan by fraudulently e-signing documents and using those funds to benefit parties

affiliated with the defendant and not the debtor. The litigation included claims for fraudulent misrepresentation, conversion, civil conspiracy, unjust enrichment, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and legal malpractice. Considering the "gist of the action" doctrine under Pennsylvania law, the court reviewed each of the counts asserted in the litigation and found that only the unjust enrichment counts sounded in breach of contract. Therefore, the complaint as a whole was a commercial tort claim and Lane's lien on the debtor's contracts and any proceeds thereof did not reach the litigation settlement proceeds.

With respect to the second issue, the collateral description in the security agreement did not mention the litigation specifically, the term "commercial tort claim," or any other term that might have referred to the litigation. Under the Pennsylvania UCC, security interests in commercial tort claims must be specifically identified or described. Further, proceeds of commercial tort claims are excluded from the after-acquired general intangible clause. Therefore, Lane could not rely on such clause to extend his lien to the settlement proceeds.

11. *Worthy Lending LLC v. New Style Contractors, Inc.*, 201 N.E.3d 783 (N.Y. Ct. App. 2022).

Background: Defendant New Style Contractors, Inc. hired Checkmate Communications LLC as a subcontractor. Plaintiff Worthy Lending LLC extended a loan to Checkmate that was secured by certain of Checkmate's assets, including "all right, title and interest of Checkmate in and to its accounts". These accounts included accounts receivable under the invoices issued to Checkmate's customers, including New Style. The security agreement allowed Worthy to send payment direction letters to the account debtors. Worthy filed its UCC-1 financing statement and sent a payment direction letter to New Style. The letter included language stating that payment to anyone other than Worthy would not discharge New Style's obligations. After Checkmate defaulted on its obligations and filed for bankruptcy, Worthy sued New Style asserting claims under Section 9-607 for amounts allegedly paid on the accounts to Checkmate instead of Worthy. The trial court dismissed Worthy's complaint on the grounds that Section 9-607 was not applicable, as that section dealt with assignments and the agreement at issue was a security interest, not an assignment.

UCC Application: On appeal, the court considered the application of Section 9-406 of New York's UCC, particularly whether the term "assignee" includes the holder of a presently exercisable security interest in an assignor's receivables. The court concluded that the answer was yes, holding: "Under UCC 9-406, a security interest is an assignment and the UCC is purposefully structured to permit a debtor to grant creditors security interests in a debtor's receivables so that the secured creditor can direct account debtors to pay it directly." An account debtor is required to pay the secured creditor upon receipt of a payment demand letter in order to have its obligation discharged, and if there is a question as to the validity of the secured creditor's interest, the account debtor is entitled to seek proof and withhold payment temporarily. Worthy was entitled to enforce its rights to collect Checkmate's accounts receivable, and if New Style paid Checkmate after receiving the payment direction letter, New Style may be forced to pay double as a statutory consequence for failing to adhere to the letter.

12. *Novi Footwear International Co. Ltd. v. Earth OpCo LLC*, --- F. Supp. 3d ---, 2022 WL 16578820 (D. Mass. Nov. 1, 2022).

Background: The court described the dispute at issue as follows: "What began as a breach of contract dispute over the sale of footwear products has, with the intervention of defendant Earth Opco LLC's (Earth) secured lender, morphed into a tug-of-war between the lender and the seller over whose interest in the products takes priority." Plaintiff Novi is a Hong Kong-based manufacturer and exporter of footwear products to private label owners. Earth was one of those owners. Earth and Novi agreed that title to the footwear would pass to Earth once Novi received full payment for the footwear it delivered, and that Novi retained the right to resell the footwear to a third party prior to receiving payment. Subsequently, lender Second Avenue extended credit to Earth in exchange for a lien on all of Earth's personal property assets and filed a UCC-1 financing statement.

A few months later, Earth began to make partial payments on Novi's invoices. Eventually, Novi stopped shipping footwear to Earth and refused to fulfill future orders until the parties agreed to a definitive payment plan. A few months after that, Second Avenue notified Earth that it was in default of their agreements. In order to resolve its issues with Novi, Earth entered into a letter agreement with Novi regarding a payment plan, which agreement the court called "a poster child for imprecise contract drafting." Among other things, it did not consistently describe Novi's interest in footwear after it was delivered to Earth, on the one hand stating that Novi retained title for a longer period of time and on the other hand stating that Earth took title upon receipt of the invoice for the footwear.

As may be expected, Earth did not maintain the payment plan and instead began liquidating its inventory at discounted prices. Novi filed suit, seeking, among other things, a preliminary injunction to prevent Earth from liquidating the footwear. Second Avenue intervened and requested that the preliminary injunction be dissolved based on its superior interest in the footwear.

UCC Application: On consideration of a motion for summary judgment, the court considered which party had the superior interest in the footwear. Second Avenue had a perfected security interest in the inventory, and Nori had some sort of continuing interest in the footwear after delivery and before payment. Under the Massachusetts UCC, a perfected security interest has priority over an unperfected security interest. While Nori had a "quasi-security interest", Nori had failed to perfect it. The record established that Second Avenue, on the other hand, had perfected its security interest and therefore had priority. This was true even though Earth had not paid for the footwear. Accordingly, the court granted summary judgment in favor of Second Avenue, and the preliminary injunction was dissolved.