

# The Banking Law Journal

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# A Recent Case Highlights the Importance of Precision in Drafting and Maintaining UCC Financing Statements

*Cindy J. Chernuchin\**

*This article discusses a case that underscores the importance under Article 9 of the Uniform Commercial Code of providing both (i) a reasonable identification of the collateral covered and (ii) the exact name of the debtor on a financing statement and serves as a reminder of the pitfalls and best practices when preparing and maintaining financing statements.*

For the filing of a financing statement to perfect a security interest<sup>1</sup> granted by a registered organization,<sup>2</sup> the financing statement must:

- (i) Be authorized by the debtor;
- (ii) Provide an indication of the collateral covered;
- (iii) Provide the name of the debtor indicated on its most recently filed public organic record;<sup>3</sup>

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<sup>1</sup> A financing statement can perfect a security interest in all personal property as original collateral other than (i) money, deposit accounts and letter of credit rights (UCC § 9-312(b)) and (ii) property subject to preemptive legal rules outside of the UCC (e.g., United States (“U.S.”) registered copyrights and certain aircraft, vessels and vehicles) (UCC § 9-311). All UCC Section references used in this article are references to the UCC as effective in New York on the date of this article.

<sup>2</sup> UCC § 9-102(a)(71) defines “registered organization” as an organization organized solely under the law of a single state or the U.S. by the filing of a public organic record with, the issuance of a public organic record by, or the enactment of legislation by, the state or the U.S. UCC § 9-102(a)(77) defines “state” as a state of the U.S., the District of Columbia, Puerto Rico, the U.S. Virgin Islands, and any other territory or insular possession subject to the jurisdiction of the U.S.

<sup>3</sup> UCC § 9-102(a)(68) defines “public organic record” as (i) a record consisting of the record initially filed with or issued by a state or the U.S. to form or organize an organization and any amendment or restatement of such initial record, (ii) an organic record of a business trust consisting of the record initially filed with the state and any amendment or restatement of such initial record, if the statute of the state governing business trusts requires that the record be filed with the state and (iii) a record consisting of legislation enacted by the legislature of a state or the

- (iv) Provide the name of the secured party or its representative; and
- (v) Be filed with the central filing office of the debtor's jurisdiction of organization.<sup>4</sup>

A secured creditor that fails to properly perfect its security interest may be treated as having an unsecured claim in its debtor's bankruptcy proceeding. A recent U.S. Court of Appeals for the First Circuit (the "First Circuit")<sup>5</sup> decision underscores the importance under Article 9 of the Uniform Commercial Code (the "UCC") of providing both (i) a reasonable identification of the collateral covered and (ii) the exact name of the debtor on a financing statement. This article discusses this case and serves as a reminder of the pitfalls and best practices when preparing and maintaining financing statements.

## THE FACTS

In *In re Financial Oversight and Management Board for Puerto Rico v. Puerto Rico AAA Portfolio Bond Fund*<sup>6</sup> ("*In re Financial*"), the First Circuit confirmed that (i) a financing statement that incorporates a collateral description by reference to an extrinsic document without indicating the location of the extrinsic document on the financing statement does not "indicate the collateral covered" and is therefore not effective to perfect a security interest in collateral and (ii) it is critical to use and maintain the debtor's correct name on a financing statement.

*In re Financial* involved approximately \$2.9 billion of debt (i) issued in 2008 by a retirement and benefit system (the "System") created in 1951 by an Act of the Commonwealth (the "1951 Enabling Act")<sup>7</sup> and designated as the Employees Retirement System of the Government of the Commonwealth of Puerto Rico ("ERS"), (ii) owed to certain bondholders (the "Bondholders") and (iii) secured by a security interest in favor of the Bondholders in, among other things, all of the System's revenues (the "Pledged Property"). In 2008, two

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Congress of the United States which forms or organizes an organization and any amendment or restatement of such legislation or the name of such organization.

<sup>4</sup> There are two exceptions to this rule: financing statements that (i) are related to real property (i.e., fixture filings (other than for a debtor that is a transmitting utility) and (ii) cover as-extracted collateral or timber to be cut. For these types of collateral, it is best to file both in the central filing office and in the office where a mortgage would be filed.

<sup>5</sup> The First Circuit is a federal court with appellate jurisdiction over the district courts in the Districts of Maine, Massachusetts, New Hampshire, Puerto Rico, and Rhode Island.

<sup>6</sup> 914 F. 3d 694 (2019).

<sup>7</sup> Law No. 447 of May 15, 1951, 1951 P.R. Laws 1298.

financing statements were properly filed with the Puerto Rico Department of State to perfect the lien on the Pledged Property (the “Initial Financing Statements”). The Initial Financing Statements provided that the name of the debtor was ERS and described the collateral as the “Pledged Property described in the security agreement attached as Exhibit A hereto and by reference made a part thereof.” The security agreement was part of the Initial Financing Statements; however, the Security Agreement did not define “Pledged Property” but instead cross-referenced the relevant publicly filed bond resolution (the “Bond Resolution”) for such definition. The Bond Resolution was not attached to the Initial Financing Statements and the location of the Bond Resolution was not included on the Initial Financing Statements.

In 2013, the 1951 Enabling Act was amended (as amended, the “Enabling Act”)<sup>8</sup> and the name of the System designated in the Enabling Act remained the same. Because Puerto Rico recognizes both Spanish and English as official statutory languages, an English translation of the Enabling Act was published in 2014 (the “English Translation”). The opening of the English Translation referred to the System as the Retirement Employees System of the Government of the Commonwealth of Puerto Rico (“RES”), but all other references to the System in the English Translation continued to refer to the System as ERS.

In December 2015 and January 2016, amendments to the Initial Financing Statements were filed (the “Financing Statement Amendments”; and together with the Initial Financing Statements, the “Financing Statements”) to amend the collateral description to include the definition of Pledged Property that was set forth in the Bond Resolution. The Financing Statement Amendments did not change the name of the System to RES as indicated in the opening of the English Translation.

The Financial Oversight and Management Board for Puerto Rico (the “Oversight Board”) filed suit in district court on July 21, 2017 on behalf of the System, seeking declaratory judgments on issues related to the perfection of the Bondholders’ security interest in the Pledged Property. The district court ruled in favor of the System, holding that the Bondholders were unsecured creditors of ERS because the Initial Financing Statements were not effective to perfect the Bondholders’ security interest in the Pledged Property because defining the Pledged Property by cross-referencing the definition thereof provided in the Bond Resolution is not sufficient to indicate the collateral if the Bond Resolution is not attached to the Initial Financing Statements and the location

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<sup>8</sup> Codified as amended at P.R. Laws Ann. Tit. 3, §§ 761 et seq.

of the Bond Resolution is not specified in the Initial Financing Statements. The Bondholders appealed, claiming that they had a perfected security interest in the Pledged Property.

### THE FIRST CIRCUIT'S DECISION

The First Circuit affirmed the district court's holding that the Initial Financing Statements did not perfect the Bondholders' lien on the Pledged Property<sup>9</sup> but held that the Financing Statements were effective to perfect the Bondholders' lien on the Pledged Property as of the date of the filing of the Financing Statement Amendments because the Financing Statement Amendments (a) indicated the collateral covered and (b) provided the name of the System indicated on its public organic record as set forth in the English Translation even though it did not provide the name set forth in the opening of the English Translation. It is important to note that the facts with respect to the name of the debtor on the Financing Statements in *In re Financial* are very unusual because (i) the Spanish name of the debtor in the Enabling Act was the same as its name in the 1951 Enabling Act and the English Translation (other than in the opening of the English Translation), (ii) the RES name referred to in the opening of the English Translation "varie[d] from every other formal version both before and after its presentation"<sup>10</sup> and (iii) a search under the ERS name revealed the Financing Statements.

This decision highlights the importance of meticulous attention to detail in the preparation and maintenance of financing statements. Best practice is to:

- 1) Indicate the collateral covered (i) by listing the applicable UCC Article 9 collateral categories in Box 4 of the financing statement or (ii) if all UCC Article 9 collateral categories are applicable (or if debtor consents), as "all assets."
- 2) Avoid using attachments to financing statements or, if an attachment is used, be certain to (i) identify the collateral in Box 4 of the financing statement by listing the applicable Article 9 collateral categories and then providing "as more specifically described on Exhibit A attached hereto" and (ii) search the applicable UCC records a few days after you file to confirm that any attachment used was filed with the financing statement.<sup>11</sup>

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<sup>9</sup> The parties agreed that the name of the debtor set forth on the Initial Financing Statements was correct.

<sup>10</sup> See *In re Financial*, p. 13.

<sup>11</sup> Recently, the Pennsylvania Department of State Bureau of Corporations and Charitable

- 3) Provide on the financing statement, the exact name of the debtor as set forth on the debtor's most recently filed public organic record (punctuation and spacing counts). If there is any confusion as to the debtor's name, file against each possible variation of the debtor's name.
- 4) Confirm every four months that the debtor's public organic record was not amended or restated to either change the debtor's name or jurisdiction of organization.

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Organizations (the "Bureau") mistakenly separated and discarded the attachments to financing statements mailed to it during the period of March 1 through April 3, 2019. Due to this error, the attachments were not scanned and all such financing statements were filed without attachments (if any). While the Bureau is reaching out to filers so that the Bureau can fix this error by updating such filed records, this error highlights the importance of indicating the collateral in Box 4 of the financing statement and searching the records after you file to confirm that the relevant financing statement (together with any attachments) was properly filed.