

Banking and Finance Law Report

Posted at 1:48 PM on October 23, 2009 by Ken Rathburn

UCC Search Logic: Can Secured Creditors Be Too Careful?

It seems safe to assume that no lender would extend high-dollar credit without first having a deep knowledge of the party accepting the funds. Certainly, such deep knowledge would include the precise legal name of that borrower. Nevertheless, recent cases continue to demonstrate the prevalence of filing UCC-1 financing statements that may be deemed “seriously misleading” as to the name of the debtor and, therefore, ineffective to fix the secured creditor’s place in the chain of priority. All of this means that secured creditors should be cautious when preparing and filing UCC-1 financing statements, or else watch their claims in bankruptcy move further down the chain of priority. But, is there such a thing as being too cautious?

Revised Article 9 of the Uniform Commercial Code, specifically 9-503(a)(1), states that a financing statement sufficiently provides the name of the debtor “if the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the public record of the debtor’s jurisdiction of organization which shows the debtor to have been organized[.]” Instead of leaving it at that, however, 9-506 discusses the effect of errors or omissions in a filed financing statement. In short, 9-506(a) provides that errors or omissions are of no consequence unless they render the financing statement “seriously misleading,” and 9-506(c) provides that if a search in the filing office *using the filing office’s standard search logic* would disclose the financing statement, then it is not “seriously misleading,” even if it fails to provide the precise name of the debtor as required under 9-503(a).

Most filing offices use search logic that eliminates certain common words or abbreviations (such as “inc.,” “co.,” “Company,” and so forth). And, any other words are included in the search in a way that allows additional words to create problems. A recent example appears in the Nebraska bankruptcy case of EDM Corporation. In that case, the first-filing lender used the debtor name of “EDM Corporation d/b/a EDM Equipment.” The later-filing lender searched the debtor’s exact legal name of “EDM Corporation.” The filing office search logic eliminates the word “Corporation” and does a search only for the name “EDM.” Because of the filing office’s search logic, that search revealed only filings for “EDM” *with no other words included in the filing*. That search failed to disclose the first-filing lender’s financing statement because only a search for “EDM,” “d/b/a,” and “Equipment” would have revealed that filing. Thus, the first-filing lender had failed to file the exact public record name of the debtor (as required by 9-503(a)(1)) and the search logic failed to reveal that erroneous financing statement (as an available cure under 9-506(c)), so the first-filing lender lost its first priority lien position because its financing statement was “seriously misleading” under the law. The result of the EDM Corporation case seems harsh—the first-filing lender was trying to be extra cautious by using a belt-and-suspenders, cover-all-the-bases approach. This harshness is tempered only by the fact that the result preserves the purpose of Revised Article 9: to put the burden of proper notice on the filing party, not the searching party. If the law and/or the search logic were the opposite, the later-filing lender would have to review every filing containing the word “EDM,” when only “EDM Corporation” is the precise name of the debtor. This may be a small task to expect when it involves the name “EDM,” but it could be an arduous task if the name were “Smith.”

Regardless of its harshness, the EDM Corporation case and others like it clearly show that secured creditors must carefully check and review the debtor's name prior to filing. And even more, secured creditors could avoid most problems by simply running a search on the debtor's precise legal name *after* filing their UCC-1 financing statement. If doing so fails to reveal their recent filing, then that secured creditor knows there is a problem with their financing statement. Although running a post-filing search takes additional time and money, learning of the problem at that point is far better than learning of the problem once the debtor enters bankruptcy.

Trackbacks (0)

Comments (0)

Porter Wright Morris & Arthur LLP

Cincinnati 250 East Fifth Street

Suite 2200

Cincinnati, OH 45202-5118

Phone: 513-381-4700

Toll Free: 800-582-5813

Fax: 513-421-0991

Cleveland 925 Euclid Avenue

Suite 1700

Cleveland, OH 44115-1483

Phone: 216-443-9000

Toll Free: 800-824-1980

Fax: 216-443-9011

Columbus Huntington Center

41 South High Street

Columbus, OH 43215-6194

Phone: 614-227-2000

Toll Free: 800-533-2794

Fax: 614-227-2100

Dayton One Dayton Centre

Suite 1600

One South Main Street

Dayton, OH 45402-2028

Phone: 937-449-6810

Toll Free: 800-533-4434

Fax: 937-449-6820

Naples 9132 Strada Place

Third Floor

Naples, FL 34108-2683

Phone: 239-593-2900

Toll Free: 800-876-7962

Fax: 239-593-2990

Washington, D.C. 1919 Pennsylvania Avenue

NW, Suite 500

Washington, DC 20006-3434

Phone: 202-778-3000

Toll Free: 800-456-7962

Fax: 202-778-3063

