



AMERICAN **BAR** ASSOCIATION

Real Property, Trust and
Estate Law Section

Spring 2020
Volume 5 Number 1

OPINIONS MATTERS

The Newsletter of the Committee on Legal Opinions in Real Estate Transactions

Sufficiency of Collateral Description in U.C.C. Perfection by Filing Opinions: Incorporation by Reference

Lawyers are often asked to provide Uniform Commercial Code (U.C.C.) perfection opinions in commercial real estate finance transactions. These opinions have been addressed in detail in the recent report, “Uniform Commercial Code Opinions in Real Estate Finance Transactions,” prepared by a Joint Drafting Committee of the ABA Section of Real Property, Trust and Estate Law Committee on Legal Opinions in Real Estate Transactions and other legal organizations.¹ Among subjects discussed in the U.C.C. Opinions Report is that of the sufficiency of the description

1. *Uniform Commercial Code Opinions in Real Estate Finance Transactions*, 53 REAL PROP. TR. & EST. L.J. 163 (2018/2019) (the “U.C.C. Opinions Report”). See https://www.americanbar.org/content/dam/aba/publications/real_property_trust_and_estate_law_journal/v53/ucc-real-estate-finance-report-v53-02.pdf.]

of personal property collateral in the financing statement on which a perfection opinion is based.²

Recent cases have considered the legal sufficiency of the collateral description when the financing statement incorporates by reference a description of collateral contained in an unattached, unfiled document, such as the security agreement to which the financing statement relates.³ Despite some uncertainty resulting from these cases, it is possible to conclude that incorporation by reference can in certain circumstances create a legally sufficient description of the collateral in a financing statement. Given the litigation over legal sufficiency through incorporation by reference, opinion preparers should be mindful of the potential uncertainty and be sure that the financing statement being reviewed for the applicable perfection opinion has adequately addressed this uncertainty.

The creation and attachment of a security interest are prerequisites to perfection, and therefore prerequisites to an opinion on perfection.⁴ For both creation and attachment of the security interest, the opinion preparer must determine that the description of the collateral is legally sufficient. The U.C.C. Opinions Report discusses this concept at length in the context of both the security agreement and the financing statement,⁵ but the U.C.C. Opinions Report does not address the specific issue of a description of collateral in a financing statement incorporated by reference through an unattached, unfiled document.

The law under Article 9 for the requirements in describing the collateral is straightforward.⁶ A security agreement requires a “description of the collateral.”⁷ The U.C.C. looks to Section 9-108 for what is sufficient for that purpose. Section 9-108(a) provides that a description of property is generally sufficient, whether or not it is specific, if it reasonably identifies what is described.⁸ The security agreement may use categories of collateral as its description, but not a “supergeneric” description such as “all the debtor’s assets.”⁹ On the other hand, under revised Article 9, a financing statement is required only to “indicate” the covered collateral.¹⁰ The U.C.C. looks to

2. *U.C.C. Opinions Report* at 172.

3. See, Brent C. Shaffer, *Collateral Descriptions in Financing Statements – The (Almost) \$7.6 Million Mistake*, 16 DEL. BANKER 30 (Winter 2020).

4. *U.C.C. Opinions Report* at 146. See also TriBar Opinion Committee, *Special Report of the TriBar Opinion Committee: U.C.C. Security Interest Opinions – Revised Article 9*, 58 BUS. LAW. 1451 (2003).

5. *U.C.C. Opinions Report* at 172, 174.

6. See Thomas M. Quinn, 8 QUINN’S UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST §§ 9504[A][2], [A][2][a] at 696-699 (rev. 2d ed. 2011).

7. U.C.C. § 9-203(b)(3)(A).

8. U.C.C. § 9-108(a).

9. U.C.C. § 9-108(c).

10. U.C.C. § 9-502(a)(3).

Section 9-504 for what is sufficient for that purpose.¹¹ That section of the U.C.C. provides two avenues for a legally sufficient indication. One is the use of a generic description such as “all assets” or “all personal property.”¹² The second approach is to comply with U.C.C. Section 9-108, which includes description by any method (excluding a supergeneric description) by which the identity of the collateral is objectively determinable.¹³

The reason for the different treatment of the description of the collateral in the security agreement and the financing statement is that the financing statement is only a notice document. Unlike a security agreement, a financing statement is intended to inform third parties that all or certain assets of the debtor may be subject to security interests and to provide enough information about the parties to the security interest to allow the third party to inquire about details of that security interest and the collateral to which it is subject.¹⁴

Courts have reviewed financing statements identifying the collateral by incorporation by reference to an external document in various jurisdictions and, in some instances found such an approach to be insufficient at least where the financing statement does not describe the collateral covered by it. A financing statement that describes the collateral covered as an unattached “general business security agreement” with no mention of personal property, assets or collateral as described or defined in that security agreement at best identifies the existence of a security agreement, but fails to indicate the collateral covered.¹⁵ In *In Re Financial Oversight & Mgmt. Bd. Puerto Rico*,¹⁶ the First Circuit Court of Appeals upheld the bankruptcy court’s ruling that some of the financing statements involved in the subject financing did not perfect the applicable security interests, “as they lacked a sufficient description of collateral.”¹⁷ Although the security agreement was attached to the filed financing statements, the security agreement itself did not expressly describe the collateral. Rather, the security agreement only made reference to an unattached, unfiled document where the description could be found. The court does not say that incorporation by reference can never satisfy the U.C.C. requirements, but just not under the facts on the record.¹⁸ In other words, here the court found the financing statements did not describe the collateral, even by type, did not indicate where the description could be

found, and did not attach and file the document where the description could be found. Thus, the court noted that the facts undercut key goals of the U.C.C. and the filing system, and stated the financing statements did not give “fair notice . . . of a security interest” to other creditors.¹⁹

It is important to note, however, that the financing statements in question were analyzed under the U.C.C. in effect at the time of their filing in 2008, which, in Puerto Rico, was former Article 9 and not revised Article 9. Revised Article 9 was not enacted until 2013 in Puerto Rico. Former Article 9 required that a financing statement “contain” a description of the collateral, not that it must “indicate” what collateral is covered.²⁰ As illustrated by the First Circuit case, the semantic difference is critical to the analysis of a description through incorporation by reference. It is interesting that some of the blog reports on this decision do not point out that the decision was made on the basis of former Article 9, which was revised in part precisely to simplify the requirements of a financing statement as a notice filing.²¹ It is not clear how the First Circuit would have reviewed these financing statements under revised Article 9; however, it is possible the court would have ruled the same way given that the security agreement referred to in the financing statement did not itself identify the collateral, an important factor in the court’s analysis.

Some would argue that under current version of Article 9, on the other hand, the change to “indicates the collateral” in revised Article demonstrates that currently “notice” for purposes of a financing statement is notice that there is a security interest in some sort of collateral (that could be sufficiently described in an extrinsic document), not actual notice of the exact collateral in which a security interest is granted.

Most recently, for example, the Seventh Circuit Court of Appeals reversed the bankruptcy court’s holding that the subject financing statement did not have a legally sufficient description of the collateral as the collateral had been identified only by reference to an unattached, unfiled security agreement. In *In Re I80*,²² the court analyzed whether incorporation by reference sufficiently “indicates” the collateral under revised Article 9. In this case, the financing statement purported to cover all collateral described in a security agreement expressly identified in the financing statement by parties and date.²³ The court looked to U.C.C. Section 9-108. and found that the financing statement would be sufficient “so long as the identity of the collateral

11. U.C.C. § 9-504.

12. U.C.C. § 9-504(2).

13. U.C.C. § 9-504(l); U.C.C. § 9-108(b)(6).

14. Thomas M. Quinn, 8 QUINN’S UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST § 9504[A][2][a] at 698 (rev. 2d ed. 2011). Note that former Article 9, before the 2000 revisions, had a different standard, which could result in different conclusions when looking at incorporation by reference.

15. *In re Lynch*, 313 B.R. 798, 801 (Bankr. W.D. Wis. 2004).

16. 914 F.3d. 694 (1st Cir. 2019).

17. *Id.* at 703.

18. *Id.* at 710.

19. *Id.* at 711

20. *See* n. 15 *supra*.

21. Thomas M. Quinn, 8 QUINN’S UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST § 9504[A][2][a] at 698 (rev. 2d ed. 2011).

22. *In re I80 Equip., LLC*, 938 F. 3d 866 (7th Cir. 2019).

23. *Id.* at 869.

is objectively determinable.”²⁴ Concerning its review of the applicable sections of the U.C.C., the court noted that a “plain reading of the text [of the U.C.C.] allows a party to ‘indicate’ collateral in a financing statement by pointing or directing attention to a description of that collateral in the parties’ security agreement.”²⁵ By this decision, the Seventh Circuit has provided a clear basis to accept that a description of collateral only by reference to a document that contains such a description satisfies the requirement of U.C.C. Section 9-502.

Opinion givers generally are averse to risk-taking. Accordingly, when preparing an opinion on perfection by filing a financing statement that describes the subject collateral by reference to an unattached, unfiled extrinsic document, the opinion giver should carefully consider the legal sufficiency of the description and indication of collateral as interpreted under the applicable case law governing the opinion. Some opinion preparers will follow the approach in the U.C.C. Opinions Report and include an assumption and an exclusion on the sufficiency of the description of the collateral, thereby avoiding an uncertain or reasoned analysis of the sufficiency under applicable law.²⁶ For example, the Illustrative Opinion Letter attached to the U.C.C. Opinions Report contains the following assumption: “The description of the Collateral is accurate and reasonably identifies the Collateral.”²⁷ The Illustrative Opinion Letter also contains an express statement that no opinion is given with respect to “the accuracy or sufficiency of any description of collateral or other property.”²⁸ On the other hand, assumptions generally deal with factual matters, not legal conclusions. When, for example, the opinion giver is opining as the creation or attachment of a security interest, in addition to perfection, it may require verification of the legal (as opposed to factual) sufficiency of the collateral description in a security agreement as well.²⁹ Considering the arguable conflicting case law and the tension between analyzing a collateral description from a legal standpoint and analyzing it from a factual standpoint, opinion givers should carefully consider the sufficiency of the description of the collateral in a financing statement as a legal matter when giving a perfection by filing opinion, particularly where the description incorporates by reference an extrinsic document.

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24. *Id.* at 874.

25. *Id.* at 871-872.

26. *U.C.C. Opinions Report* at 173.

27. Illustrative Opinion Letter para 2.1(h) in *U.C.C. Opinions Report* at 216.

28. *Id.* para. 4.6(u) at 242.

29. *U.C.C. Opinions Report* at 172-173.

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