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## **PERFECTION AND THE IMPORTANCE OF A NAME**

### **(Under UCC Article 9)[i]**

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The pursuit of perfection in many aspects of our lives is not about money. And a good name cannot be bought. But when it comes to “perfection” of security interests and having the right name under Article 9 of the Uniform Commercial Code (“Article 9”), it is all about money and who gets it.

Perfection – the steps necessary for a creditor to establish rights to a pledged asset which are superior to the claims of other creditors – can be accomplished in a variety of ways depending on the type of asset, with the filing of a financing statement being the most common.<sup>[ii]</sup> In 1999, Article 9 was significantly revised (“Revised Article 9”) to require, among other things, more precision in preparing financing statements. Included with those changes was a rule – counterintuitive to many real estate practitioners – that impacted financing statements for collateral held in a trust. In those cases, the rule requires the name of the trust, not the name of the trustee of the trust, to be listed as the debtor.

Although many years have passed since Revised Article 9 was adopted in Hawaii,<sup>[iii]</sup> it appears that the special rules for trusts are still unfamiliar to many practitioners. This article explains some of those rules.

### **Properly Identifying the Debtor**

While a security interest may be valid even though it is unperfected, perfection is necessary to protect a creditor’s security interest from being subject to the rights of other creditors or transferees.<sup>[iv]</sup> “The requirement that a financing statement provide the debtor’s name is particularly important” because “[f]inancing statements are indexed under the name of the debtor, and those who wish to find financing statements search for them under the debtor’s name.”<sup>[v]</sup> The failure to properly identify a debtor can render a financing statement defective<sup>[vi]</sup> and a secured creditor unperfected, placing that creditor at the back of the line when it comes to payment from the proceeds of an asset.

Under the former Article 9, financing statements that substantially complied with Section 9-402(1) were sufficient, despite having minor errors or omissions, so long as those errors did not make the financing statement seriously misleading.<sup>[vii]</sup> Former Article 9 did not define “seriously misleading,” and so courts sought to apply the “reasonably diligent searcher” standard – “a standard that required the reviewing court to determine, on a case-by-case basis, whether a hypothetical reasonable searcher would have been able to discover the non-conforming financing statement despite the error in the debtor’s name” – to determine whether a financing statement was defective.<sup>[viii]</sup> That standard “created extensive litigation” and “contradictory decisions.”<sup>[ix]</sup>

Revised Article 9 changed the requirements for a financing statement, reducing former Section 9-402 to three general<sup>[x]</sup> requirements: (1) “the name of the debtor;”

(2) "the name of the secured party or a representative of the secured party;" and (3) "indicate[] the collateral covered by the financing statement."<sup>[xi]</sup> In an attempt to provide clarity with respect to a debtor that was a "registered organization," a "decedent's estate," and/or a "trust", Revised Article 9 introduced § 9-503 that provided specific and clear rules governing the sufficiency of the debtor's name.<sup>[xii]</sup> The "reasonable searcher" standard was replaced under Revised Article 9 with § 506, which provided a concrete rule for determining whether errors were seriously misleading by expressly providing that "a financing statement that fails sufficiently to provide the name of the debtor in accordance with Section 9-503(a) . . . [is] seriously misleading" and ineffective to perfect a security interest, unless the financing statement is found using the standard search logic of the filing office when the debtor's correct name is searched.

### **The Practical Application of Revised Article 9 to Trusts**

Revised Article 9 represented a significant shift. One object of the revision was to shift the responsibility for name accuracy of a financing statement by placing on the filer "the not too heavy burden of using the legal name of the debtor, thereby relieving the searcher from conducting numerous searches using every conceivable name variation of the debtor."<sup>[xiii]</sup>

Under former Article 9, the listing of the trustee's name, as the debtor, was usually sufficient, because the legal title to assets held in a trust were lodged in the trustee.<sup>[xiv]</sup> For example, if John Adams were the trustee of the "John Adams Revocable Living Trust", a typical financing statement listing John Adams, trustee, as the debtor would be sufficient. Significant problems arose under Section 9-402's general rule, however, when banks and trust companies were the trustees for many different trusts.<sup>[xv]</sup> Creditors of trusts with institutional trustees argued that the financing statements were insufficient because they were "seriously misleading" under the former Section 9-402(8).

Section 9-503(a)(3) of Revised Article 9 was specifically crafted to avoid this confusion.<sup>[xvi]</sup> In particular, when "the debtor is a trust or a trustee acting with respect to property held in trust," Section 9-503(a)(3) of Revised Article 9 specifically requires that the financing statement:

(A) **Provide . . . the name specified for the trust in its organic documents** or, if no name is specified, provides the name of the settlor and additional information sufficient to distinguish the debtor from other trusts having one or more of the same settlors; and

(B) Indicate . . . in the debtor's name or otherwise, that the debtor is a trust or is a trustee acting with respect to property held in trust[.]

Financing statements failing to comply with this rule are *per se* "seriously misleading"<sup>[xvii]</sup> under the bright-line rule established under Section 9-506(b) of Revised Article 9, which was conjointly enacted. So under Revised Article 9, a proper financing statement would need to list as the debtor in the example above "John A. Adams Revocable Living Trust," not "John A. Adams, Trustee."

### **Conclusion**

A financing statement listing the trustee's name as the debtor may, which was previously sufficient, is now "seriously misleading" under the provisions of Sections

9-503 and 9-506 of Revised Article 9. The security interest in the collateral identified in the financing statement would be unperfected, even though the trustee is the legal owner of the pledged collateral.

The UCC provides certainty, but lawyers working with the UCC need to be familiar with its requirements to properly protect their clients.

[i] This article appeared in *Ka Nu Hou*, the newsletter of the Real Property & Financial Services Section of the HSBA, October 2010.

[ii] A financing statement is not always effective to perfect a security interest, and even if effective as a general matter can be subordinate to perfection accomplished by another means such as possession or control with respect to certain collateral. A discussion of these issues is beyond the scope of this article.

[iii] The Revised Article 9 was adopted in Hawaii and codified in 2000 as Hawaii Revised Statutes, Chapter 490.

[iv] See 79 C.J.S. *Secured Transactions* § 48.

[v] UCC § 9-503 (1999) cmt. 2.

[vi] See UCC Revised Article 9, § 9-506.

[vii] See UCC § 9-402(8) (1995).

[viii] *In re John's Bean Farm of Homestead, Inc.*, 378 B.R. 385 (Bankr. S.D. Fl. 2007).

[ix] *Id.*

[x] Additional information is required for financing statements concerning "as-extracted collateral or timber to be cut, or which is filed as a fixture filing and covers goods that are or are to become fixtures." See § 9-502(b).

[xi] UCC § 9-502 (1999).

[xii] See UCC § 9-503 (1999).

[xiii] See *Pankratz Implement Co. v. Citizens Nat'l Bank*, 130 P.3d 57, 68 (Kan. 2006); see also *In re Kinderknecht*, 308 B.R. 71, 75 (B.A.P. 10th Cir. 2004); see also *In re John's Bean Farm of Homestead*, 378 B.R. 385 (Bankr. S.D. Fl. 2007); see also *In re Tyringham Holdings, Inc. v. Suna Bros. Inc.*, 354 B.R. 363 (Bankr. E.D. Va. 2006).

[xiv] See 76 Am. Jur. 2D *Trusts* § 253 (2010).

[xv] See Emory Ireland, *Financing Statements Under Revised UCC Article 9*, Wisconsin Lawyer, Vol. 74, No. 8, August 2001, available at [http://www.wisbar.org/am/template.cfm?section=wisconsin\\_lawyer&template=/cm/contentdisplay.cfm&contentid=50189](http://www.wisbar.org/am/template.cfm?section=wisconsin_lawyer&template=/cm/contentdisplay.cfm&contentid=50189).

[xvi] See note 14, *supra*.

[\[xvii\]](#) Unless the financing statement is found using the standard search logic of the filing office when the debtor's correct name is searched. See UCC § 9-506(c).