PUBLICATION UPDATE

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Secured Transactions Under the Uniform Commercial Code

Publication 615 Release 130 March 2022

HIGHLIGHTS

Updated Chapters

- This release contains updates and revisions to several chapters to provide the current status of the law. The release includes discussion of important recent developments and adds new and revised material on several significant topics.

Chapter 7—The Super-Charged Floating Lien of Article 9. *Judgment creditors.* A debtor's rights to pledged shares of stock were properly transferred to a judgment lien creditor by way of garnishment, pursuant to a state statute that specifically allows for garnishment of secured collateral; however, those shares remained subject to the secured party's prior perfected security interest. See Bank of Hawaii v. DeYoung, 92 Haw 347 (2000), at § 7.02[6].

Floating liens—the general security agreement. "All other tangible and intangible property and assets" of the debtor was held insufficient to describe equity interests in a company; see Cheniere Energy, Inc. v. Parallax Enters., LLC, 585 S.W.3d 70, 78 (Tex. App. 2019), at § 7.03[2]. The use of UCC defined collateral terms, preceding the grant of a lien in "all personal property now owned or thereafter acquired," was sufficient under Colorado law to create a blanket lien notwithstanding the "super-generic" prohibition in § 9-108(c). See In re 3PL4PL, 619 B.R. 441, 457

(Bankr. D. Colo. 2020), at § 7.03[2].

Post-agreement waivers. A bank's security interest was not waived under equitable principles simply because the bank did not enforce its default rights prior to garnishment by a junior creditor. The Texas court held that a prior perfected security interest holder does not waive its senior interest by failing to exercise its elective remedies before a junior judgment creditor exercises foreclosure rights through garnishment. See Legacy Bank v. Fab Tech Drilling Equip., Inc., at § 7.03[4]. A bank did not waive its security interest in debtor's inventory for sales not in the ordinary course of business; see Bank of India v. Shrenuj USA, LLC, 2021 Wash. App. LEXIS 715 (Ct. App. Mar. 29, 2021), at § 7.03[4]. An implied authorization must unequivocally demonstrate an intent to waive the security interest; see Brooks v. Strategic Funding Source, Inc. (In re Brooks), 619 B.R. 669 (Bankr. C.D. Ill. 2020), at § 7.03[4].

Bankruptcy Code § 552. It is well settled that § 552(b) cuts off any security interest in accounts receivable arising post-petition; see In re Blackjewel L.L.C., 2020 Bankr. LEXIS 3413 (Bankr. S.D. W. Va. Dec. 7, 2020), at § 7.04[2][b]. Accounts receivable generated after commencement of the case were not proceeds, product, offspring, rents or profits of prepetition accounts receivable; see Fin. Oversight & Mgmt. Bd. v. Andalusian Glob. Designated Activity Co. (In re Fin. Oversight & Mgmt. Bd.), 385 F. Supp. 3d 138 (D.P.R. 2019), at § 7.04[2][b].

Editor's Note: To enhance clarity of presentation, Chapter 30, pertaining to leases of personal property, has been reorganized into two separate chapters. Chapter 30 discusses how to distinguish leases and security interests. Chapter 30A reviews how to file financing statements for leases and true leases under Article 2A.

Chapter 30—Leases of Personal Property: Distinguishing Leases and Security Interests. *Hybrid lease-purchase agreement.* An example of a hybrid lease-purchase agreement can be found in SASOF III (B) v. Nat'l Aero Stands LLC, 2021 U.S. Dist. LEXIS 75095 (W.D. Tex. Mar. 26, 2021), which involved a lease of an aircraft engine transportation stand with a mandatory purchase component if the stand was not returned by a certain date. See § 30.02[4].

Three-party transactions. A finance lease is the product of a three-party transaction. The supplier manufactures or supplies the goods pursuant to the lessee's specification, sales agreement or lease agreement between the supplier and the lessee. After the prospective finance lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor or an existing order, agreement or lease is assigned by the lessee to the lessor, and the lessor and the lessee then enter into a lease or sublease of the goods. See Vital Pharm., Inc. v. Balboa Capital Corp., 806 F. App'x 884 (11th Cir.

2020), at § 30.02[5].

Time when lease is evaluated. Cases support the conclusion that the date of the transaction, rather than a future date, is the appropriate point in time to determine the parties' rights; see In re Clinton Nurseries, Inc., 2018 Bankr. LEXIS 1454 (Bankr. D. Conn. May 17, 2018), at § 30.02[6][b]. The focus should be on the reasonably predictable fair market value of a printer at the time the option is to be performed with reference to the facts and circumstances at the time the agreement was entered into; see Stanley v. Pawnee Leasing Corp., 86 N.E.3d 457 (Ind. Ct. App. 2017), at § 30.02[6][b].

Statutory criteria. Article applies to a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract; see Davies v. Conway, 2020 Ky. App. Unpub. LEXIS 21 (Ct. App. Jan. 10, 2020), at § 30.03[01].

Terminable at will leases. A number of courts have held that a lease terminable at will by the lessee is a true lease, and no further analysis or weighing of factors is necessary. A few have not stopped there and have analyzed other factors to determine whether the transaction was a true lease or a secured transaction. For a collection of cases, see § 30.03[1][a].

Option to purchase for nominal consideration. In one case, since an equipment lease was non-cancelable, and the equipment could be purchased at the end of the term for nominal value, the equipment lease was a per se disguised secured transaction and no further inquiry was needed. See In re ES2 Sports & Leisure, LLC, 519 B.R. 476, 481 (Bankr. M.D.N.C. 2014), at § 30.03[1][c]. Where a purchase option price was a stated to be the "fair market value" the lease was not a security interest; see In re Green Parts Int'l, Inc., 2019 Bankr. LEXIS 2436 (Bankr. N.D. Ga. Aug. 6, 2019), at § 30.03[1][c].

Length of term. One case used the residual value inquiry in an unusual way in a case involved the leasing of several trucks to the debtor. See In re Lasting Impressions Landscape Contractors, Inc., 579 B.R. 43 (Bankr. D. Md. 2017), at § 30.03[1][d].

Leases that are not automatically secured transactions. Some courts give the six factors listed in UCC § 1-203(c) considerable weight in deciding that the transaction was a true lease. See In re Johnson, 571 B.R. 167, 175 (Bankr. E.D.N.C. 2017), at § 30.03[2][0a]. But one court has said that UCC §1-203 lists six conditions that, alone, are not sufficient to distinguish between a lease and security agreement. See In re Lasting Impressions Landscape Contractors, Inc.), 579 B.R. 43, 52 (Bankr. D. Md. 2017), at § 30.03[2][0a].

Equity of lessee in property. In one case, the court's focus was on the economic reality of the transaction viewed from the perspective of the facts and circumstances which existed at the time the transaction was entered into; subsequent events were deemed not relevant to the inquiry. See Xerox Corp. v. Piranha Bus.

Cards, LLC, 2017 U.S. Dist. LEXIS 224822 (S.D. Miss. Jan. 17, 2017), at § 30.04[2].

TRAC leases. In re Lasting Impressions Landscape Contractors, Inc., 579 B.R. 43 (Bankr. D. Md. 2017), used the residual value inquiry in an unusual way in a case involved the leasing of several trucks to the debtor. See § 30.04[4]. In Royal T Energy, LLC v. ENGS Commer. Fin. Co. (In re Royal T Energy, LLC), 596 B.R. 525 (Bankr. E.D. Tex. 2019) the court found that the TRAC rider did not grant the debtor equity in the equipment; the TRAC rider simply shifts the risk that the actual value of the equipment at the end of the lease will be less than the estimated fair market value. See § 30.04[4].

Nature of lessor's business. The court in Vital Pharm., Inc. v. Balboa Capital Corp., 806 F. App'x 884 (11th Cir. 2020), did not let the "finance lease" character of the transaction influence its decision. While it is true that a finance lease, in some contexts, refers to a disguised security transaction, the California UCC is clear that in a context like this one, that is not the case. See § 30.04[6]. A finance lease was found to be a true lease and not a secured sale; the purchase option price was to be determined by mutual agreement if and when option was exercised. See Varilease Fin. v. Tpi Mex., 2017 Mich. Cir. LEXIS 1836, at § 30.04[6].

"Chameleon" leases. Some leases have become known as "chameleon" leases because they start out as true leases but at some point can become secured transactions. See, for example, Huntington Tech. Fin., Inc. v. Neff, 2020 U.S. Dist. LEXIS 50635 (D. Conn. Mar. 24, 2020), at § 30.04[11].

"Functional" approach in bankruptcy. Some bankruptcy courts have taken what has been termed a "functional approach" in deciding whether to treat a lease as a secured claim or a true lease that requires either assumption or rejection. Under the functional approach, which bankruptcy courts sometimes also use to determine whether a contract is "executory" or not, it is the consequences of the classification for the estate, not the form of the contract, which courts examine. See In re Byers, 621 B.R. 943 (Bankr. S.D. Ala. 2020), at § 30.04[12].

Chapter 30A—Leases of Personal Property: Filing Financing Statements for Leases and True Leases Under Article 2A. *Fixture filings.* It is now well settled that, as between a landlord and his tenant, the term "trade fixtures" means such articles as may be annexed to the realty by the tenant to enable the tenant to properly or efficiently to carry on the trade, contemplated by the tenancy contract, and which can be removed without material or permanent injury to the freehold. See In re CoreTech Indus., LLC, 2019 Bankr. LEXIS 3933 (Bankr. N.D. Tex. Dec. 31, 2019), at § 30A.01[5]. In determining whether an item is a fixture, courts consider whether the removal of the

item will cause irreparable or serious physical injury or damage to the freehold; see Nisselson v. Bank of the W. (In re Cocoa Servs., L.L.C.), 2018 Bankr. LEXIS 1132 (Bankr. S.D.N.Y. Apr. 13, 2018), at § 30A.01[5]. It would make little sense for the law to allow creditors to perfect a security interest in personal property destined to become a fixture, if such security interest would terminate upon the personal property actually becoming a fixture. See In re Carr, 2017 Bankr. LEXIS 4142 (Bankr. D.D.C. Dec. 1, 2017), at § 30A.01[5].

Definition of lease. The issue of what constitutes the "lease contract" sometimes arises in disputes over which statute of limitations governs the dispute. If an agreement is considered part of the "lease contract," the statute of limitations in Article 2A may govern that dispute even if it does not concern traditional lease terms. See Jair United Inc. v. Inertial Airline Servs., 20132013 U.S. Dist. LEXIS 112302 (W.D. Ky. 2013), at § 30A.02[2][b].

Formation of leases—statute of frauds. For a recent case that dealt with the statute of frauds in the context of equipment and services provided for oil and gas wells, see Midwest Compressor Sys. LLC v. Highland Imperial, Inc., 2021 Tex. App. LEXIS 4968 (Tex. App. 2021), at § 30A.02[3][a]. A company could not invoke the statute of frauds and argue that there was no agreement to rent equipment when it accepted delivery of the equipment. See Wilda v. JLG Indus., 470 F. Supp. 3d 770 (N.D. Ill. 2020), at § 30A.02[3][a].

Usage of trade. A written lease cannot be contradicted by usage of trade; see Serv. Pump & Supply Co. v. Sun Indus., 2019 U.S. Dist. LEXIS 84228 (W.D. W. Va 2019), at § 30A.02[3][b].

Warranties. Express and implied warranties under the Texas UCC are applied to leases the same as they are applied to sales of goods; see C&M Oilfield Rentals v. Location Illuminator Techs., 2020 U.S. Dist. LEXIS 205562 (W.D. Tex. 2020), at § 30A.02[4][a][0i]. The warranty against "infringement or the like" is usually construed as protecting against claims of infringement of intellectual property rights such as trademark, copyright, and patent. See, e.g., BIC Corp. v. Chi. Imp., Inc., 2021 U.S. Dist. LEXIS 95109 (N.D. Ill. 2021), at § 30A.02[4][b].

Disclaimers. The court in US Foods, Inc. v. White Oak Manor-Charlotte, Inc., 2021 U.S. Dist. LEXIS 124930 (W.D. N.C. 2021), enforced a disclaimer stating that the lessor "makes no representation as to the condition of the Equipment." The court concluded that this phrase "makes plain that there are no warranties promised." See § 30A.02[4][c][ii]. In Griffitts & Coder Custom Chopping v. CNH Indus. Am. LLC, 438 F. Supp. 3d 1206 (D. Kan. 2020), the warranty disclaimer was provided inside a box, in bold type, and entirely in capital letters. Most of the document was in lower case type. The court found that,

viewing the document as a whole, the disclaimer was written in a way that draws the reader's attention to it. See § 30A.02[4][c][ii].

Transfers of interests under lease contracts. Claims against the assignor of lease were actionable against the assignee in Blue Ridge Bank, Inc. v. City of Fairmont, 240 W. Va. 123, 807 S.E.2d 794 (2017). See § 30A.02[5][a].

Future rents as damages. One court explained that liquidated damages clauses have been rejected where the lessor received all future revenue and full possession of the property with the ability to re-rent or sell, because the liquidated damages placed the lessor in a far better position than it would have been if the contract had never been breached. See Ultra Grp. of Cos. v. S & A 1488 Mgmt., 357 Ga. App. 757, 849 S.E.2d 531 (2020), at § 30A.02[9][b][iii].

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VOLUME 1

Revision

☐	1 thru 3	1 thru 3
☐	Title page.	Title page

VOLUME 1A

Revision

☐	Title page.	Title page
☐	7-1 thru 7-65	7-1 thru 7-71

VOLUME 1D

Revision

☐	Title page thru vii	Title page thru vii
☐	30-1 thru 30-215	30-1 thru 30-145
☐	No Material removed	30A-1 thru 30A-89 (file preceding 31-1)
☐	TC-1 thru TC-347.	TC-1 thru TC-363
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