



# Commercial Financial Services Brief: February 2012

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## COMMERCIAL FINANCIAL SERVICES BRIEF: RECENT LESSONS FOR SECURED LENDERS

One of the seemingly consistent rules of law is that lenders will be held to a standard that most other people and businesses cannot meet—i.e., "Thou Shalt Make No Mistakes." Two recent cases from around the country illustrate how courts have little room for forgiveness (or for offering redemption) when it comes to secured lenders.

### The Case of the Unsecured Note

In the case of the unsecured note, a lender extended various loans to a sole proprietor over a period of several years. At the time of the death of the borrower, there were five outstanding promissory notes. Four of the notes referred to various financing statements filed by the lender in the "collateral" section of the note form. One note, however, contained a statement which ultimately proved disastrous for the lender: "this loan is unsecured." In an action brought by various creditors seeking to determine the priority of several security interests in the liquidation proceeds of the decedent's business, the lender noted several security agreements contained cross-collateralization provisions permitted by the UCC and argued that these provisions clearly supported its contention that all of the outstanding indebtedness was secured by the decedent's assets.

The Ohio Court of Appeals ruled that the language in the note was "express and unequivocal." The court concluded that the language in the note was an exception to the more generally applicable cross collateralization provisions contained in the security agreements. And, while the security agreement presumably was intended to secure all indebtedness, the inclusion of the specific language in the note was viewed by the court as a later and more specific statement of the parties' intent to limit the scope of the security agreement. As a result the indebtedness evidenced by the problem note was held to be unsecured.

The lesson for lenders to take away from this case is to be very careful in filling in the blanks in form documents whenever you have a lending relationship which is based upon multiple promissory notes. This case illustrates just one of the potential problems for lenders. For example, sometimes lenders refer to a pre-existing mortgage in the collateral section of their notes. If the mortgage does not refer to the note, most courts will not recognize the mortgage as collateral for the later note. Consistency between documents is



critical! Inconsistency can be fatal.

### **The Case of the Incorrect Driver's License**

The case of the incorrect drivers' license should strike terror into the hearts of all lenders. There, a bank established a lending relationship with a sole proprietor known to the bank as "Bennie A. Miller" in 1995. The bank filed financing statements naming the debtor as "Bennie A. Miller" and filed timely continuation statements for several years. In December 2010, the debtor and his spouse filed a chapter 13 bankruptcy petition. In connection with that case, the debtor filed a lawsuit seeking to set aside the bank's security interest in his business assets on the ground that the financing statements filed by the bank were ineffective because the debtor's birth certificate listed his name as "Ben Miller."

The bank argued that all of the debtor's business and personal records, including his driver's license, Social Security card, tax returns, deed to his personal residence, and bill of sale for the purchase of his business used the name Bennie A. Miller. As a result, argued the bank, its financing statements were effective. The court disagreed. It held that the debtor's legal name was Ben Miller, as set forth on his birth certificate. As a result, the bank's financing statement was ineffective.

What could the bank have done? For the Illinois court which considered the case of the inaccurate driver's license, the only way to address the problem presented would be to obtain and review the individual debtor's birth certificate. But not many borrowers will welcome this additional requirement. And, there is no guarantee that a different court would follow the ruling of the Illinois court. Filing a financing statement using multiple names (i.e., "Ben Miller" as well as "Bennie A. Miller") is the only other solution. But that is exactly what the 2001 revisions to the UCC were designed to limit.

The good news, if there is any, is that Minnesota has enacted revisions to the UCC which will take effect on July 1, 2013, permitting a lender to rely upon the name used on a driver's license or other state issued identification card. Under these revisions, the outcome of the case of the incorrect driver's license would be different. Until then, however, secured lenders must be vigilant and, if there is any suggestion the debtor has used a different name than that shown on her driver's license, include both names in their financing statements.

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