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Creditors' Corner

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GENERAL ASSET DESCRIPTION IN FINANCING STATEMENT PROTECTS LIEN ON SPECIFIC COLLATERAL ERRONEOUSLY DESCRIBED

The United States Eighth Circuit Court of Appeals recently confirmed the importance of using a "catch-all" description of assets in a financing statement to provide additional protection to secured lenders. The Court also highlighted that when creditors confront prior financing statements with general collateral descriptions, the creditor should further investigate prior security agreements to determine what specific property is subject to a prior lien.

In *ProGrowth Bank, Inc. v. Wells Fargo Bank, N.A.*, competing creditors claimed debtor's annuity contract with Fidelity & Guaranty as collateral. Wells Fargo filed its financing statement first which contained a general description of its collateral as "all of the Debtor's right, title, and interest in and to, assets and rights of the Debtor, wherever located and whether now owned or hereafter acquired or arising." The Wells Fargo statement also specifically identified the annuity contract, but mistakenly stated the issuer of that contract was Lincoln Benefit Life, not Fidelity & Guaranty. The second creditor, ProGrowth, filed a subsequent financing statement specifically listing the Fidelity & Guaranty annuity as collateral.

After debtor defaulted to both lenders, ProGrowth claimed a prior lien interest over the Fidelity & Guaranty annuity. The Court disagreed and found that the general collateral description in the Wells Fargo financing statement was sufficient to protect a lien, so long as the underlying security agreement actually identified the correct annuity. The court also found that the error in identifying the wrong issuer of the annuity was not "seriously misleading" given the presence of the catch-all provision. The court stated that the financing statement's function is not to specifically "identify the collateral and define property which the creditor may claim… but rather to provide notice that a person *may* have a security interest in the collateral." A subsequent creditor unsure what has been covered in a prior financing statement needs to further investigate any corresponding security agreements.

BANKRUPTCY COURT UPHOLDS MORTGAGE WITH INCOMPLETE LEGAL DESCRIPTION AGAINST TRUSTEE'S STRONG-ARM POWERS

While the Bankruptcy Court of Minnesota has been unfavorable to lenders that have sought to protect mortgages that contain erroneous legal descriptions from the trustee's strong-arm powers, Judge Kishel in *Ries v. Ibach* recently preserved a flawed mortgage. The issue is typically whether the legal description as recorded would have provided the trustee, as a hypothetical bona fide purchaser, with constructive notice under state law of the mortgage. The court in *Ries v. Ibach* ruled that if an error in the legal description is apparent then the subsequent purchaser is on constructive notice that there may be an interest against the property and must make further inquiry.

In Ries *v. Ibach*, the lender recorded a mortgage which omitted from its legal description the section, township and range information and therefore did not identify any specific parcel within the county. The Court ruled this was a patent and apparent error, and that any potential purchaser seeing the mortgage in the grantor – grantee index would be on constructive notice of the potential interest and need to inquire further to determine the mortgagee's true interest. Inquiry in this case would have led a potential purchaser to the actual warranty deed in the grantor-grantee index with the correct legal description, and the purchaser could also inquire of the grantor of the mortgage to confirm whether the grantor intended to provide a mortgage on the parcel at issue. As a result, the trustee could not set aside the mortgage under its strong-arm powers.

Judge Kishel also suggested in a footnote that the court's previous standard to define an apparent defect may have been erroneous and too restrictive under state law. Judge Kishel's criticism suggests that the court will take a more liberal view of identifying apparent errors in the future, which will provide more protection for mortgagees against trustees.

9TH CIRCUIT CASE LIMITS USE OF ASSET SALES IN BANKRUPTCY TO STRIP-DOWN JUNIOR LIENS

In 2008, the Ninth Circuit Bankruptcy Appellate Panel held that some aspects of a bankruptcy sale order may be appealed and even undone even though there was no stay pending an appeal. *Clear Channel Outdoor, Inc. v. Knupfer,* 391 B.R. 25 (B.A.P. 9th, 2008). There are strategic advantages to asset sales under Section 363(f) of the Bankruptcy Code as they purport to enable an invulnerable way to sell assets and acquire good title to those assets free of junior interests, without resorting to state law foreclosure procedures. For example, in this case the senior lender acquired debtor's secured assets on a credit bid, which cut off the junior lender, Clear Channel, on summary findings that the statutory requirements were met. On review, the BAP found that while it could not undo the sale on appeal, it undid the finding that the sale stripped the junior lien.

The BAP held that a free and clear sale under Section 363(f)(5) requires an actual showing – more than a mere summary recital – that a nonconsenting lienholder could be compelled in an equitable or legal proceeding to accept a monetary payment for less than they are owed. In this case, the BAP did not find that such a proceeding existed under California law. This case could potentially make Section 363 sales more difficult if adopted by other courts. The attorneys at Mackall, Crounse and Moore can help a prospective buyer or lender think through sale motions, sale orders and the evidence to be presented at a Section 363 sale hearing to make sure that any sale is able to withstand attack.

BOND DEFAULT RATES CONTINUE TO RISE

Standard & Poor's expects that U.S. speculative grade bond default rates will escalate through September of 2009 coming off a twenty-five year low at the end of 2007. Through October of 2008, seventy-five companies have defaulted globally. Of those defaults sixty-five were domiciled in the U.S., two were from each Canada, Hong Kong and Mexico and one from each of France, Germany, Iceland and the U.K. These increases in defaults are expected to be primarily in the U.S. and scarce elsewhere. The U.S. speculative-grade default rate is expected to peak at 7.6%.

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