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On Anonymous UCC-1 Filings

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Background

It is common knowledge in the finance industry that lenders placing liens on collateral (other than on land) generally must file a UCC-1 financing statement. Lenders file mortgages, of course, when the collateral is land. It is less well understood, however, that factors, merchant cash advancers ("MCAs"), and other purchasers of accounts receivable also must file UCC-1 financing statements to "perfect" their ownership interest in the accounts that they buy. They must do this because Article 9 of the Uniform Commercial Code (UCC)—which one might think applies only to secured loans—actually applies whether accounts receivable are being purchased or merely put up as collateral. See 9-109 (a).[1] Thus, it does not matter whether a receivables financing is structured as a loan or a purchase, a UCC-1 must still be filed in both instances.

It is also well understood that the UCC-1 filing must get the name of the debtor[2] precisely right. A debtor's name, if it is a company, should be set down in writing on the face of the UCC-1 precisely as it appears on the debtor's charter or other foundational documents. Care should be taken to mirror the use of capital letters, spacing, periods, and commas found in the founding documents. A DBA or trade name may not replace a borrower company's legal name. See 9-503(a)(1). If a debtor is a human being, the rules generally require the name on the UCC to precisely match the name found on the debtor's driver's license.

Much less precision, however, is required for other items of information found on the face of a UCC-1. Generally, this is because the UCC-1 filing system is supposed to be a "notice" system. See Comment 2 to 9-502. The notice theory is that once the debtor's name is accurately depicted on the UCC-1, any party wishing to find out more about the transaction and interests in question is on notice as to whom they can contact to get more information. The UCC-1, which is only one page long normally, cannot and need not describe either the related loan transaction or the body of collateral with great detail. Inquirers can simply contact the debtor or the secured party of record that is named on the face of the UCC-1 and get the supplemental information that they may need. For this reason, for example, Section 9-504 of the UCC allows a security interest on all assets of a debtor to generically state just that: "all assets."

Once the debtor's name is right—and it always has to be—getting the name of the secured party precisely correct becomes less important. The improper double-pledging of assets is prevented once any potential new lender contemplating a financing realizes that somebody else already has a first claim on a debtor's assets. The precise name of that somebody else is less important, at least initially. The precise nature of the debt secured is also less important, again at least initially. As comment 3 to UCC

9-210 explains:

> A financing statement filed under Part 5 may disclose only that a secured party may have a security interest in specific types of collateral. In most cases the financing statement will contain no indication of the obligation (if any) secured, whether any security interest actually exists, or the particular property subject to a security interest. Because creditors of and prospective purchasers from a debtor may have legitimate needs for more detailed information, it is necessary to provide a procedure under which the secured party will be required to provide information. [emphasis added].

Because a UCC-1 focuses on getting the precise name of the debtor correct and leaves other details to future voluntary investigation, other information can be less precisely offered on the face of the UCC-1. A secured lender, for example, is allowed to write in the name of a "representative" in the secured lender's space of the UCC-1 form. UCC 9-502(a). The representative need not be an actual lender. A purely representational relationship of the named secured party need not even be disclosed on the UCC-1 form. UCC 9-503(d).

In fact, the very definition of "Secured Party" found in the UCC at 9-102(73)(E) states that a secured party can be a mere agent or representative "in whose favor" a security interest is created. This might not be the actual lender. Section 9-511 of the UCC allows for a secured party to name either itself or a representative to be the "secured party of record" found on the face of the UCC-1 form. Thereafter, whether a mere representative of the secured lender, or the actual secured lender itself, the "secured party of record" will be the primary contact for the secured party and responsible for undertaking the secured party's duties and responsibilities under the UCC. A "secured party of record" remains the primary contact for the secured lender until it is replaced. Thus, at any given time, there is always at least one secured party of record on duty as primary contact for the lender. UCC 9-511(b) and (c).

The Trend Towards Quasi-Anonymous UCC-1 Filings

Why is the discussion above relevant here? In the last ten years, factors and secured lenders have faced market pressure from other nonregulated creditors, such as MCAs. The MCA lenders have often used their competitors' public UCC-1 filings to discover the identity of their competitor's clients. If ABC factoring company is listed on 50 different UCC-1s filed nationally as the secured party, the 50 debtors found on those UCC-1s are, essentially, a published list of ABC's clients. The MCA lenders then target those same 50 clients with competing financial products and, in doing so, steal a client list and the investment that went into vetting those clients.

Normally, once a UCC-1 filing statement is filed against an asset type such as "equipment" or "inventory" any subsequent lender who loans against such same collateral can only take a junior position. This is a function of the UCC's so-called "first to file or perfect" rule found in the priorities section of the UCC at 9-322(a)(1). The first to file or perfect rule dissuades other lenders from stealing

a lender's client because new lenders can only obtain junior positions, and junior positions often cannot give a lender or financier economic security. Unfortunately for factors, MCA lenders have found a loophole in this logic by focusing on just cash and particularly on checking accounts.

A UCC-1 filing alone cannot guarantee a first-priority security interest in a checking account. Instead, first-priority is only guaranteed through "control" of checking accounts. UCC 9-327(1). And the UCC also generally protects anyone who receives money from a checking account by stripping the liens off all funds received. UCC 9-332.

Because "control" of a checking or savings account trumps an earlier filed UCC-1 filing, MCA lenders can finance a borrower even after the borrower has already pledged all of its collateral to someone else.[3] To pay themselves back, MCAs take automatic withdrawals from the debtor's checking accounts. The money leaves the account lien-free by effect of UCC 9-332. This leaves other lenders or financiers not only with their collateral base weakened, but also with the prospect of a financially anemic client whose main corporate checking account is chronically drained of working capital.

To prevent their client lists from being poached by competitors, factors and other secured lenders have resorted to using DBA's and the names of representatives in their UCC-1 filings. The author also suspects, based on anecdotal evidence and nothing more, that some lenders are inventing dummy names to shroud their identities. Any number of corporate service providers now also provide service as the public representatives of secured lenders who would prefer to be anonymous. In this way, the ultimate identity of the party or parties claiming liens on a debtor's assets remain shrouded in secrecy. The secrecy prevents parties doing research on a competitor's UCC-1 filings from reverse engineering a competitor's client list.

The Issues: A Real Life Example of the Problems with Anonymous UCC-1 Systems

But anonymous filings of liens cause real problems and are inconsistent with the entire structure of the UCC. Even filings that are not entirely anonymous can create problems when significant barriers or hurdles are placed between an information seeker and information. For example, the author once found a number of UCC-1 blanket filings made against all assets of a client's company. The client's officers and directors had never heard of the party claiming the liens, and that party was later revealed to be a mere representative of a secured party that wished to remain anonymous. Upon calling the named representative, the author was told that the secured party did not necessarily wish to reveal its name and would not initially comment on the nature of the debt or the reason for the UCC-1 filing. The author was encouraged to go online and fill out a PDF "request" form to communicate with the lender, but at all times communicating through the representative and using a secured "portal" that would preserve the lender's anonymity. The author was told that it was then the anonymous secured party's "option" to place itself in contact with the debtor. Not all service companies even use a portal to link lien filers with information seekers. Some merely rely on employees – employees who might be overworked and

poorly incentivized to deal with information requests – to call the underlying lender and inform them that they need to respond to a request for information. No follow up procedures are necessarily put in place.

The problem was that the author was working for a company that was merely attempting to find out who was making a false claim of holding a lien on the company's assets. In that sense, the author was not making a request at all, but rather exercising his client's statutory rights to obtain an "accounting" from a putative secured creditor. Quite clearly–this being the United States of America–one should have the right to call up people who have made public claims on one's own property and ask them for justification.

UCC Section 9-210(b)–which is the UCC section that gives debtors the right to ask for an accounting –applies to a secured party "other than a buyer of accounts." A party receiving a request is supposed to comply within 14 days. True, it later turned out that the would-be lienholder was a factor who almost assuredly would have claimed to be exempt from reporting as a "buyer of accounts."[4] Without an understanding of who the lienholder was, however, and with the duty to provide accountings not disclaimed by the "portal" representative, the client would have had no way of knowing that it was not entitled to an accounting. The client would have no inkling that the secured creditor was even a factor.

As was only learned later, the anonymous UCC-1 filings were made in preparatory contemplation[5] of a financing that never actually came to fruition. There was no financing or factoring, hence no obligation, hence no security interest. A security interest can only exist at all if the secured party has not given "value" under UCC 9-203(b). The would-be lender simply forgot to releases its UCC-1 pre-filings after it decided not to do the deal. Only the claim of a blanket lien on all the client's assets remained, to become, a long-term blemish for the client company.

It took the threat of litigation to learn the identity of the party claiming the lien, which, in turn, revealed that no actual financing had ever been received in connection with the lien. That, in turn, finally caused the lien to be released after a great deal of time and money had been spent to gain the release.

The client/debtor in this example is not the only party who has a legitimate "need to know" who held the mystery lien and what collateral, precisely, had been pledged to the mystery lienholder. Under Section 9-315, a secured party's lien on particular collateral items will follow the collateral even if it transferred or sold to a third party, although the rule is subject to numerous exceptions described in Comment 2 to this Section 315. Thus, unless an exception can be found, it may be hard for a party seeking to buy assets from a debtor, especially when not in the ordinary course of business, to gain confidence that it will receive clean title. Without knowing about the previous financing that had once encumbered particular assets, it becomes harder to buy those assets, or lend against them. There can be no confidence that all previously existing liens have been released or are no longer valid.

Anonymous UCC filings make it difficult to impossible to discern the nature of the debt or other obligation was that had given rise to the UCC-1 in the first place. Can a particular account be purchased or was it already sold? Is the old loan for $10,000 or $10 million? Is this piece of equipment pledged? Who really has claims on a particular body of inventory when all UCCs mention only lots or subclasses of inventory? Likewise, parties seeking to provide refinance money to a debtor can be left relatively clueless as to how large the original loan to be refinanced really is, or who holds it.

Analysis

The Uniform Commercial Code is set up and designed to make the practice of commerce transparent, logical, fair, and as simple as possible–subject to the natural complications that arise in business transactions. In this way, these laws facilitate commercial transactions and help boost the economy, which is obviously a laudable policy goal.

The practice of filing anonymous UCC-1s or using "portals" for purposes of communicating–or not communicating–with the outside world, is contrary to the entire structure and purpose of the UCC. Inquiring about a lien is not supposed to be like asking for a favor. "Maybe we'll tell you about our claim and maybe we won't" is not an acceptable answer. "We'll tell you about our lien when we are ready" is not an acceptable answer. Anonymity, as illustrated above, creates a drag on commerce and efficient markets. Anonymity leads to violations of the UCC, such as by anonymous secured parties whose agents refuse to provide accountings. Anonymity stifles refinancing transactions which efficiently allocate capital because it deprives refinancers of the information that they need for proper due diligence. Anonymity potentially assists in the creation of false liens on private property, which depresses the value of such property, or its utility as collateral.

Even when the barrier created by anonymity is finally overcome, the waste of time and money that was incurred in the exercise cannot be recouped. The need for speed in modern transactions is thwarted. It took weeks to learn the identity of the mystery lienholder, whose representative finally begrudgingly called the author to reveal the nature of its undeserved lien.

But what of the legitimate need of lenders and financiers to keep their customer lists from being poached? Here, it would seem, a system that initially shrouds the identity of the ultimate financier makes sense. But only if a system can be devised whereby legitimate requests for information by parties with a valid need to know can be quickly honored. This would, one would think, be a relatively easy system to create but might require a more robust cooperation from the servicing companies serving as agents for parties filing UCC-1s. As an example of how just one theoretical system might work, every debtor against whom a UCC-1 had ever been filed might be allowed to set up a username and password that would allow it to verify its own identity, so that it could more quickly and easily obtain verification that the liens that had been filed against its own assets were valid. Otherwise, the UCC itself could be in want of a revision that would add reporting duties and obligations for those who

hold themselves out as agents for filers. Even when a full accounting is not warranted, a threshold justification for the very existence of a lien should never be withheld.

In sum, a problem exists here, and it needs to be dealt with. While no reasonable person would insist that the publication of one's customer list was the price to be paid for using the UCC system, the need for transparency in business transactions is too great to justify the increasing trend towards anonymous or quasi-anonymous filings.

NOTES

[1]. This article will cite to the generic UCC promulated by the American Law Institute and not any version adapted by a particular state.

[2]. The seller of accounts receivable is a "debtor" for purposes of the UCC. The third party who is actually supposed to pay on the account is the "account debtor."

[3]. For an in-depth analysis of the ways in which second-in-time lenders can usurp the collateral of first-intime lenders, see Stephen J. Brown, Senior Secured Bank v MCA: A Recurrent Financial Feud and How to Better Control the Damage Done, 40 MI Bus L J 36 (Summer 2020).

[4]. The exemption from UCC Section 9-210(b) for parties "buying" accounts will only beg "true sale" questions that determine the treatment received by factors in bankruptcy and other courts. A "recourse" factor or MCA will face difficulties arguing that it is a really a "buyer" of accounts that is exempt from giving an accounting. This article at times refers to both factors and MCAs as "lenders" merely as a convenience to the reader. Both groups would object to that term. Both groups prefer to think that they buy accounts and are not creditors. The question of whether any given financial transaction is truly a sale or perhaps a disguised loan is determined normally by a complicated multi-factored economic analysis that is beyond the scope of this article. See, e.g., LaSalle Nat'l Bank Ass'n v Paloian, 406 BR 299, 340 (ND Ill 2009). In sum, certain factors or MCAs are likely "lenders" while others are not.

[5]. Prefiling of UCC-1s before a loan is ever made is an acceptable and widely used business practice. When closing does not actually occur, however, the prefiled UCC-1s are normally terminated, and knowing who the initial filer was is certainly helpful to such termination. Anonymity makes it difficult to discern even if a particular UCC-1 was a prefiling, and the inability to directly communicate with a secured lender makes investigation difficult.