

Legal Alert

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Michael R. King
mking@gbllaw.com
602-256-4405

QUESTION: HOW IMPORTANT CAN THREE LITTLE LETTERS AND A PERIOD POSSIBLY BE?

ANSWER: IF THE THREE LETTERS AND PERIOD SPELL “INC.”, THEY CAN MAKE ALL THE DIFFERENCE IN THE WORLD!

“Don’t sweat the small stuff” may be good advice in many contexts. With due respect to Richard Carlson, when working with legal documents, attention to the detailed “small stuff” can make or break you, however.

Suna Bros. Inc. (“Suna Bros.”) lost \$310,925 worth of property by not including “Inc.” in a UCC-1 financing statement filed with the Virginia State Corporation Commission! *Tyringham Holdings, Inc. v. Suna Bros. Inc.*, 354 B.R. 363 (U.S. Bankr. Ct. E.D. Va. 2006). How could that happen? What went wrong? Why would any court make such a bizarre ruling?

Suna Bros. consigned 65 pieces of jewelry to Tyringham Holdings, Inc. (“Tyringham”). The parties signed a consignment agreement dated October 18, 2004. The consignment agreement said that Suna Bros. would have a security interest in the consigned inventory. Suna Bros. thought it had perfected the security interest by filing a UCC-1 financing statement with the Virginia State Corporation Commission on June 10, 2005. Unfortunately, the financing statement filed by Suna Bros. listed the debtor’s name as “Tyringham Holdings.” The public records of the Virginia State Corporation Commission list Tyringham as “Tyringham Holdings, Inc.,” however.

Of course, everything falls apart when your debtor files bankruptcy. In the Chapter 11 bankruptcy proceedings of Tyringham, the Official Committee of Unsecured Creditors wanted to knock out the secured claim by Suna Bros. The failure to include the term “Inc.” allowed the committee to sell the jewelry free and clear of the lien claimed by Suna Bros.

At trial, Suna Bros. presented evidence that a number of UCC searches were performed by private search companies including Corporation Service Company, Access Information Services, Inc., and UCC Retrievals, Inc. Those searches using just the words “Tyringham Holdings” disclosed the Suna Bros. financing statement on the public record. So, if the public could find the information on the public record, what was the problem?

Unfortunately, the bankruptcy judge agreed with the Unsecured Creditors Committee. Although “noise words” are removed or ignored in searching electronic databases for financing statements, the Court said that “Inc.” was not a “noise word.” Suna Bros. argued that the term “Inc.” was a “noise word.” The International Association of Corporation Administrators not only includes “Inc.” as a “noise word,” but it also lists “Limited,” “Ltd.,” “Corporation,” “Corp.,” “Company,” and “Co.,” as “noise words.” So, Suna Bros. said that it

did everything right and that searches of the public record disclosed its security interest in the jewelry. The Virginia State Corporation Commission did not adopt the full list of noise words from the International Association of Corporation Administrators, however. The Virginia Administrative Code says:

“Noise words” include, but are not limited to, “an,” “and,” “for,” “of,” and “the.” The word “the” always will be disregarded and other noise words appearing anywhere except at the beginning of an organization name will be disregarded. Certain business words are modified to a standard abbreviation: company to “co,” corporation to “corp,” limited to “ltd,” incorporated to “inc.”

So, how did the bankruptcy judge decide that “the financing statement is seriously misleading and is ineffective to perfect Suna’s security interest”? Well, the filed financing statement should have the name of the corporate debtor as it is indicated on the public records of the company’s jurisdiction of organization.

On the other hand, where the requirements for a UCC-1 financing statement are “substantially satisfied,” a financing statement will be effective, “even if it has minor errors or omissions.” The only time that minor errors or omissions should invalidate a financing statement is when those errors or omissions make the UCC-1 financing statement “seriously misleading.” How could the failure to include “Inc.” possibly be “seriously misleading?” After all, the private search services all found the financing statement without any problem.

An employee of the Virginia State Corporation Commission provided an “official search” which was certified by the State Corporation Commission using the correct name of “Tyringham Holdings, Inc.” That official certified search failed to disclose the Suna Bros.’ financing statement. Thus, the search using the correct corporate name and the standard search logic actually used by the State Corporation Commission did not find the Suna Bros. financing statement. So, the Court said the financing statement was seriously misleading and did not perfect the security interest in the jewelry. Suna Bros.’ security interest in the jewelry was ruled to be unperfected and the Unsecured Creditors Committee got to sell the jewelry free and clear of any lien.

What should the secured creditor have done differently? The Court said:

Little more is asked of a creditor than to accurately record the debtor’s name, and according to the statute, failure to perform this action clearly dooms the perfected status of a security interest.

The little things clearly do matter! Even if you think something is a minor error or omission, you run the risk that a court will disagree. Get it right in the first place by double-checking the public record!

If you have any questions or concerns about secured transactions or ways to make sure you are including the proper information in legal documents, please call me.