community BANKER

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Welcome to the January/ February issue of the COMMUNITY BANKERS' ADVISOR.

The ADVISOR is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

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The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

YOU ARE ASKING . . . .

Q: Elouise and her daughter want to open a personal checking account with two signatures required for withdrawal. Can the account be opened this way?

A: An account can be opened this way because there is no law prohibiting it. Do you really want to open an account this way? This will require extra inspection of each check's signatures, as well as the issues created by requests for debit cards or honoring ACH and other electronic charges to the account. Banks that do allow a personal checking account requiring more than one signature for withdrawals usually add an extra account fee for the extra work involved and, most importantly, have an account agreement that limits the bank's liability.

This and That

Below are a few interesting cases we've come across in our recent reading.

In re Eyerman, 517 B.R. 800 (Bankr. S.D. Ohio 2014) - The court found that husband and wife who guaranteed the debts of two LLCs that they owned had *not* granted a security interest in their *personal* property to secure the debts. That was because each security agreement identified the "borrower" as one of the LLCs and the guarantors signed only as a

"member" of the LLCs -- not as individuals. Although a filed financing statement identified the guarantors as additional "debtors", the financing statement didn't have the language granting a security interest and so it did not meet the requirements of a "security agreement." (*i.e.* language showing an intent to create a security interest, that describes the collateral, and is signed by the debtor.) Even if the promissory note and filed financing statement were together sufficient to indicate an intention by individual guarantors to grant a security interest, the documents' only description of the collateral as "certain business assets" is insufficient to reasonably identify what was covered.

What caught our eye: Know your borrower! If you intend to take a guaranty from individuals and secure it with their personal property, be sure that you have the parties correctly identified! It might very well not be fixed by cobbling the note and financing statement into a security agreement.

Royal Jewelers Inc. v. Light, 2015 ND 44, 859 N.W.2d 921. Steven was a customer of Royal Jewelers for several years. In September 2009, he owed about $40,000 on his open credit account with Royal Jewelers; later that year, he purchased a wedding ring for Sherri on his open credit account with Royal Jewelers. Royal Jewelers' charge receipt for the ring identified Steven's open credit account number and a purchase price of $55,050 on the invoice (nice ring!). The charge receipt granted Royal Jewelers a security interest in the ring.

The three brothers who own Royal Jewelers also own GRB Financial, a separate corporation that operates as an indirect lender taking assignments of loans from retailers, including Royal Jewelers. In December 2010, Royal Jewelers, with Steven's consent, assigned his debt with Royal Jewelers and the security for that debt to GRB Financial. Steven and GRB Financial executed a note modification agreement changing repayment terms, extending the maturity date of a prior note modification agreement between the parties and pledging nine additional items as security for modification, as described in an attached exhibit. The exhibit was not separately signed by Steven, but included the ring on a list of nine items. Steven died in February 2012; Royal Jewelers and GRB Financial sued Sherri individually and as personal representative of Steven's estate, claiming that GRB Financial had a valid security interest in the ring and was entitled to foreclose upon it.

After a bench trial, the district court found, among other things, that Steven's gift of the ring to Sherri *was* subject to Royal Jewelers' security interest in the ring and that GRB Financial, as an assignee of Royal Jewelers, had a valid and enforceable security interest in the ring. Sherri claimed the district court erred in finding GRB Financial had a valid and enforceable security interest in the ring; however, the invoice for Steven's purchase of the ring states the ring was subject to a security interest, and the security interest followed the ring. In other words, when in December 2010 Royal Jewelers, with Steven's consent, assigned his debt and the security interest to GRB Financial, the security interest trotted along. Sherri also claimed that the note modification agreement signed by Steven in December 2010 did not properly authenticate the agreement describing the collateral under N.D.C.C. § 41-09-13(2)(c)(1) because he did not *separately* sign the exhibit identifying the various secured collateral, including the ring. N.D.D.C. § 41-09-13(2)(c)(1) provides:

> "2. Except as otherwise provided in subsections 3 through 9, a security interest is enforceable against the debtor and third parties with respect to the collateral only if:. . . .c. One of the following conditions is met:(1) The debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned."

The North Dakota Supreme Court noted that the plain language of that statute requires a debtor to authenticate a security agreement providing a description of the collateral. Under the UCC, "authenticate" means "to sign." N.D.C.C. § 41-09-02(1)(g). N.D.C.C. § 41-09-08(2) says a description of collateral is sufficient if it reasonably identifies the collateral and may include a specific listing or any other method by which the collateral is objectively determinable - in plain English, if it's clear what the collateral is. The Court found that there is *no* requirement that a debtor separately sign an exhibit attached to and referenced in a signed security agreement. Steven signed the December 2010 note modification agreement which referenced an attached exhibit listing assets pledged as security for the note. The Court agreed that Steven granted a valid security interest in the ring and the ring had not been fully paid for in December 2010. GRB Financial received an assignment of that security interest from Royal Jewelers in December 2010, and so GRB Financial had a valid, enforceable, and "forecloseable" security interest in the ring.

What caught our eye: Although the UCC requires that the debtor must authenticate or sign the security agreement, there is no requirement that the debtor must separately authenticate or sign an *exhibit* referenced by the security agreement, even though that exhibit contains the description of the collateral. It is common for lenders to reference collateral in an exhibit attached to a security agreement, and we sleep better knowing that the North Dakota Supreme Court says that's ok.

In re Salander-O'Reilly Galleries, LLC, 506 B.R. 600 (Bankr. S.D.N.Y. 2014) - This case rocked the art world - not typically an industry obtaining loans in North Dakota. A New York bankruptcy court determined competing claims of lenders and the consignor of the famous Botticelli painting, *Madonna and Child* (painted in 1485). Kraken, the owner of the painting, consigned it to SOG art gallery. After SOG filed for bankruptcy, several things snarled Kraken's efforts to have the painting returned. First, when Kraken consigned the painting to SOG, it failed to comply with the provisions of the UCC that require a consignor of goods to file a UCC-1 financing statement, giving public notice of that interest, "perfecting" the consignment and making it enforceable against third parties. Under the UCC, in a consignment, the consignee (here, SOG) is "deemed to have rights and title to the goods identical to those the consignor (here Kraken) had or had power to transfer." N.D.Cent.Code § 41-01-09(1) (U.C.C. § 9-319). Kraken, as the consignor, had only a purchase-money security interest in the Botticelli. *See* N.D.Cent.Code § 41-01-09(2)(ii) (U.C.C. § 1-201) and N.D.Cent.Code § 41-09-03(d) (U.C.C. § 9-103). Kraken *could* have and *should* have perfected its purchase-money security interest by filing a financing statement, thereby preventing SOG's other creditors from obtaining superior rights to the painting.

Additionally, 11 U.S.C. § 544 provides that a bankruptcy trustee has the rights of a lien creditor and is empowered to avoid unperfected liens. This allowed the SOG bankruptcy trustee to have priority over Kraken's unperfected consignment interest in the Botticelli. Third, the Trustee additionally stood in the shoes of SOG's secured lender, whose loan to SOG was secured by a security interest in substantially all of SOG's assets. The lender had assigned its lien to the Trustee. Ultimately, Kraken got its painting back based on the court's interpretation of SOG's loan agreement.

What caught our eye: Though this dealt with a painting worth about $10 million, this case is a reminder that an Article 9 consignment is treated as a purchase money security interest, requiring a UCC financing statement.

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