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June 9, 2011

BY HAND

Hon. Robert E. Gerber, U.S.B.J.
United States Bankruptcy Court
for the Southern District of New York
One Bowling Green
New York, NY 10004

Re: Official Committee of Unsecured Creditors of Motors Liquidation Company v. JPMorgan Chase Bank, N.A., *et al.* Adv. Pro. No. 09-00504

Dear Judge Gerber:

On behalf of JPMorgan Chase Bank, N.A. ("JPMCB"), we write to submit to the Court, as supplemental authority in further support of JPMCB's motion for summary judgment currently pending before the Court in this adversary proceeding, a recent decision rendered by the district court for the Northern District of California. *See Official Committee of Unsecured Creditors v. City National Bank, N.A.*, No. C09-03817 (MMC), 2011 WL 1832963 (N.D.Cal. May 13, 2011) (attached hereto as Exhibit A). The *City National Bank* decision affirms a bankruptcy court decision in *In re A.F. Evans Company, Inc.*, No. 09-41727 (EDJ), 2009 WL 2821510 (Bankr. N.D. Cal. July 14, 2009) (attached hereto as Exhibit B), which JPMCB relied upon in support of its motion for summary judgment.

In *A.F. Evans Co.*, the secured creditor authorized an escrow agent, through a set of escrow instructions, to record UCC-3 termination statements related only to two of three specific partnerships. *See* 2009 WL 2621510 at *1. Instead, the escrow agent filed UCC-3 termination statements which purported to release the secured creditor's security interest in all of the debtor's assets. *Id.* at *2. The bankruptcy court determined that all of the termination statements were not effective and dismissed the action. *Id.* at *3-5.

On appeal, the district court affirmed, holding that the debtor had only authorized the termination of the two partnership interests identified in the escrow instructions. *City National Bank*, 2011 WL 1832963, at *5.

Significantly, the district court found that *In re Pacific Trencher Equipment, Inc.*, 735 F.2d 362 (9th Cir. 1984), on which plaintiff here relies, was inapplicable because it "was decided before the 2001 revision of Article IX of the California Commercial Code and the enactment of sections 9509(d) and 9510(a), which provisions altered the law regarding the validity of financing statements from what it was at the time *Pacific Trencher* was decided. After the revisions, the test for determining the validity of a UCC-3 Amendment is whether it was authorized." *Id.* at *7 fn. 3.

The district court's affirmation of the bankruptcy court's decision in *A.F. Evans* further supports JPMCB's argument that the filing of the UCC-3 at issue in this case is ineffective because it was filed without JPMCB's authority.

Respectfully submitted,

John M. Callagy

Attachments

cc: Eric B. Fisher, Esq. (via e-mail and First Class U.S. Mail w/attachments)

EXHIBIT A

Slip Copy, 2011 WL 1832963 (N.D.Cal.)
(Cite as: 2011 WL 1832963 (N.D.Cal.))

H
Only the Westlaw citation is currently available.

United States District Court,
N.D. California.
OFFICIAL COMMITTEE OF UNSECURED CREDITORS, Appellant,
v.
CITY NATIONAL BANK, N.A., Appellee.

No. C09–03817 MMC.
May 13, 2011.

Maxim Boris Litvak, Pamela Egan Singer, Pachulski Stang Ziehl & Jones LLP, San Francisco, CA, for Appellant.

Frank Thomas Pepler, Pepler Mastromonaco LLP, Erin Jane Illman, DLA Piper LLP, San Francisco, CA, for Appellee.

ORDER AFFIRMING DECISION OF BANKRUPTCY COURT

MAXINE M. CHESNEY, District Judge.

***1** Before the Court is appellant Official Committee of Unsecured Creditors' ("Committee") appeal from the bankruptcy court's order of July 9, 2009 and memorandum decision of July 14, 2009 (collectively, "Bankr.Order"), granting City National Bank's ("CNB") motion for an order directing A.F. Evans Company, Inc. ("debtor") to remit to CNB 87.5% of the proceeds from the debtor's sale of its interest in AFE–Pioneer Associates, LP ("AFE–Pioneer"). Having reviewed the briefs filed in connection with the appeal, the Court rules as follows.

BACKGROUND[FN1]

FN1. The following facts are derived from the parties' respective Designations of Items to be Included in the Record, and, unless otherwise noted, are undisputed.

On March 5, 2009, the debtor filed a voluntary Chapter 11 petition. (*See* Bankr.Order at 4). Nearly all of the debtor's personal property, including a partnership interest in AFE–Pioneer, was encumbered by a security interest held by CNB as security for a revolving line of credit provided by CNB to the debtor, and which interest CNB perfected by filing with the California Secretary of State a financing statement pursuant to California Commercial Code § 9501 ("UCC–1 financing statement"). (*See id.* at 2.) On April 9, 2009, as part of the debtor's bankruptcy proceedings, the bankruptcy court entered an order authorizing the debtor to sell its interest in AFE–Pioneer and remit 87.5% of the proceeds from the sale to CNB, and gave the Committee an opportunity to object. (*See id.* at 5.) On May 5, 2009, the Committee objected to the sale, asserting that CNB's entire interest in the debtor's property had been terminated five months earlier, in January 2009, in the course of a prior sale by the debtor of two unrelated entities, Westgate Housing Associates, L.P. ("Westgate") and Greenery Housing Associates, L.P. ("Greenery"). (*Id.* at 2.) The events relevant to the Committee's objection are set forth below.

At the time of the January 2009 sale, CNB possessed a security interest in Westgate and Greenery, and, in exchange for a share of the sale proceeds, agreed to amend the UCC–1 financing statement to relinquish its interest in them. (*Id.*) In that regard, to facilitate the release of CNB's interest in Westgate and Greenery, the debtor sent to CNB proposed escrow instructions for the parties' escrow agent, First American Title Insurance Co. ("First American"), along with two proposed financing statements amending CNB's UCC–1 financing statement ("UCC–3 Amendments"). (*Id.* at 3.)

The proposed escrow instructions directed First American to release CNB's interest in Westgate and Greenery. (*Id.*) The two proposed UCC–3 Amendments deleted CNB's interest in Westgate and Greenery, respectively, from the collateral covered by CNB's UCC–1 financing statement. (*Id.*) Specifically, the UCC–3 Amendments contained a check mark in Box 8, labeled "Amendment (Collateral Change)," as well as a detailed description of the collateral CNB was releasing (*see* Appellant's Designation of Items to be Included in the Record on Appeal ("A. R.") Ex. 2 ("Litvak Decl.") at Ex. B), one of the proposed UCC–3 Amendments relinquishing CNB's interest in Westgate, and the other relinquishing CNB's interest

in Greenery (*id.*). Box 2 of each UCC–3 Amendment, labeled "Termination," and which indicates an intent to completely terminate a security interest, was not checked. (*Id.*) Thereafter, on January 8, 2009, CNB vice president Jerry McDermott signed and, through a CNB administrative assistant, submitted to First American the two letters of escrow instruction and the two UCC–3 Amendments. (Bankr.Order at 3; *see also* A.R. Ex. 3 ("McDermott Decl.") ¶¶ 10–11.) [FN2]

> FN2. In its July 14, 2009 order, the bankruptcy court found McDermott had caused the UCC–3 Amendments to be submitted "in the exact form proposed by the debtor, without any check mark in box no. 2." (Bankr.Order at 3.)

***2** On January 28, 2009, First American filed the UCC–3 Amendments with the California Secretary of State. (*Id.*) Box 8, marked "Amendment (Collateral change)," was, as before, checked on both Amendments. (*Id.* at 4.) Both Amendments, however, now also had a check mark in Box 2. (*Id.* at 3–4.) Box 2 reads:

> Termination: Effectiveness of the financing statement identified above is terminated with respect to security interest(s) of the Secured Party authorizing this Termination Statement.

(*Id.* at 4; *see also* A.R. Ex. 2 at Ex. E.) CNB discovered the error and, on February 6, 2009, filed two additional UCC–3 Amendments, stating CNB had not authorized the termination of its security interest in any assets of the debtor other than Westgate and Greenery. (Bankr.Order at 4.)

Based on the above-described events, the Committee, as noted, objected to the remittance of proceeds from the AFE–Pioneer sale to CNB, arguing that the first two UCC–3 Amendments, filed with Box 2 marked, terminated CNB's entire security interest in all of the debtor's property. (*See* A.R. Ex. 2.) With its objection, the Committee submitted a declaration, attaching thereto the various versions of the UCC–1 and UCC–3 statements discussed above. (*See* A.R. Ex. 2 (Litvak Decl.).) Thereafter, on June 12, 2009, CNB filed a motion for an order compelling the debtor to remit to CNB 87.5% of the proceeds pursuant to the parties' earlier agreement, and, in support thereof, submitted a declaration by Jerry McDermott. (*See* A.R. Ex. 3.) On June 25, 2009, the Committee filed an opposition to the motion, based on its assertion that CNB's security interest had been terminated (*see* A.R. Ex. 4), and requested the bankruptcy court hold an evidentiary hearing and also afford the Committee an opportunity to file an adversary proceeding to discover what individual checked Box 2 of the UCC–3 Amendments (*see* Bankr.Order at 2; A.R. Ex. 4 at 13–14).

On July 2, 2009, the bankruptcy court heard oral argument on CNB's motion and, on July 14, 2009, granted the motion, finding CNB's security interest had not been terminated. (*See* Bankr.Order at 8.) The Committee thereafter filed a timely notice of appeal.

STANDARD OF REVIEW

This Court has jurisdiction over the instant appeal under 28 U.S.C. § 158(a). In reviewing a final order of a bankruptcy court, a district court reviews the bankruptcy court's factual findings for clear error and its legal conclusions de novo. *See In re Southern Cal. Plastics, Inc.*, 165 F.3d 1243, 1245 (9th Cir.1999). "[B]ankruptcy courts have wide discretion in deciding whether to take oral testimony at an evidentiary hearing" or whether to decide a motion on affidavits. *In re Nicholson*, 435 B.R. 622, 636 (9th Cir.2010). Similarly, "[d]ecisions regarding continuances and discovery are reviewed for abuse of discretion." *In re Khackikyan*, 335 B.R. 121, 125 (B.A.P. 9th Cir.2005); *see In re La Sierra Fin. Serv., Inc.*, 290 B.R. 718, 734 (B.A.P. 9th Cir.2002) ("A bankruptcy court has wide latitude in controlling discovery.").

DISCUSSION

***3** The Committee makes four arguments on appeal: (1) the bankruptcy court erred by essentially "grant[ing] summary judgment in favor of CNB" (Appellant's Br. at 7:28–8:1); (2) the bankruptcy court erred by "concluding that CNB's delivery of instructions to First American, as escrow agent, was not 'authorization' to file amendments" terminating CNB's interest in AFE–Pioneer (*id.* at 10:10–13); (3) the bankruptcy court erred by concluding CNB "was not bound by any mistakes (or modifications) that may have been made by First American" (*id.* at 12:8–10); (4) the bankruptcy court erred by concluding the amendments "should be construed as minor errors that were not seriously misleading" (*id.* at 14:16). The Court addresses each argument in turn.

A. Evidentiary Hearing

At the outset, the Committee contends the bankruptcy court erred by not allowing it additional time for discovery and by not holding an evidentiary hearing to determine who checked Box 2 of the UCC–3 Amendments.

Rule 9017 of the Federal Rules of Bankruptcy Procedure incorporates Rule 43 of the Federal Rules of Civil Procedure, which in turn, provides: "When a motion relies on facts outside the record, the court may hear the matter on affidavits or may hear it wholly or partly on oral testimony." *See* Fed.R.Civ.P. 43(c). A bankruptcy court need only provide an evidentiary hearing, however, where "disputed material factual issues" are presented. *See* Fed. R. Bankr.P. 9014(d); *see also id.* Advisory Committee Note (2002) (stating "if the motion cannot be decided without resolving a disputed material issue of fact, an evidentiary hearing must be held").

The Committee argues that the bankruptcy court granted the equivalent of summary judgment despite the presence of a genuine dispute of material fact. To establish a genuine dispute, a party must "do more than simply show that there is some metaphysical doubt as to the material facts." *See Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986) (discussing showing necessary to defeat summary judgment under Rule 56 of Federal Rules of Civil Procedure); Fed. R. Bankr.P. 7056 (incorporating Rule 56 of Federal Rules of Civil Procedure); Fed. R. Bankr.P. 9014(c) (applying Rule 7056 of Federal Rules of Bankruptcy Procedure to contested matters). Once the moving party has shown the absence of a genuine issue of material fact, the opposing party must "go beyond the pleadings and by [its] own affidavits, or by the depositions, answers to interrogatories, and admissions on file, designate specific facts showing that there is a genuine issue for trial." *See Celotex Corp. v. Catrett*, 477 U.S. 317, 324, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986) (internal quotation and citation omitted). Where facts sufficient to oppose a motion are unavailable to the opposing party, it must "show[ ] by affidavit or declaration that, for specified reasons, it cannot present facts essential to justify its opposition." *See* Fed.R.Civ.P. 56(d).

*4 Here, as noted, CNB submitted McDermott's declaration, in which he averred that he submitted the UCC–3 Amendments to First American with only Box 8 marked. (A.R. at Ex. 3.) The Committee did not object to the declaration nor did it provide any evidence to the contrary. Nor did it submit an affidavit or declaration showing that, for "specified reasons, it [could not] present facts essential to justify its opposition." *See* Fed.R.Civ.P. 56(d); *see also In re Lewis*, 97 F.3d 1182, 1187 (9th Cir.1996) (finding opposing party's "conclusory arguments unsupported by factual statements or evidence do not meet [ ] burden" to produce "some significant probative evidence" (internal quotation and citation omitted)).

Consequently, the Committee fails to show the bankruptcy court abused its discretion in deciding the motion on the evidence presented rather than holding an evidentiary hearing. Further, as set forth below, the Committee fails to show the bankruptcy court abused its discretion in denying a continuance to allow the Committee to engage in discovery.

"In reviewing a denial of a motion to continue, [courts] consider four factors: diligence of the requesting party, usefulness of the continuance, inconvenience to the court and the other side, and prejudice from the denial." *In re La Sierra*, 290 B.R. at 734.

Here, the Committee was aware of the relevant facts potentially at issue since at least since May 5, 2009, nearly two months prior to the hearing on CNB's motion, when the Committee filed its initial objection to the proposed AFE–Pioneer sale and distribution. That objection commenced a contested matter under Rule 9014 of the Federal Rules of Bankruptcy Procedure and opened the door to nearly all the discovery tools offered by the Federal Rules of Civil Procedure. *See* Fed. R. Bankr.P. 9014(c) (providing for application of Part VII Bankruptcy Rules, which, in turn, incorporate Rule 26 and Rules 28–37 of Federal Rules of Civil Procedure). Indeed, even prior to May 5, 2009, the Committee had the right, upon motion and order of the bankruptcy court, to examine CNB and First American regarding the UCC amendments. *See* Fed. R. Bankr.P.2004. At no point prior to the bankruptcy court's decision, however, did the Committee conduct any discovery with respect to the matter nor did it file an adversary proceeding. "Denial of a continuance is appropriate where the complaining party does not commence discovery

early enough in the proceedings." *See In re La Sierra*, 290 B.R. at 734 (upholding denial of continuance where plaintiff "did not indicate how additional time and investigation would yield the required evidence" and failed to diligently pursue discovery).

Moreover, the Committee fails to show how discovery would have assisted it, either as a factual or legal matter, in defeating CNB's motion, nor does it show how it has "suffered actual and substantial prejudice" as a result of the denial of a continuance. *See id.* The only relevant "unknown fact" identified by the Committee was the Committee's speculation that, after McDermott provided the UCC–3 Amendments to a CNB administrative assistant with instructions to deliver the materials to First American, the administrative assistant altered the documents. The Committee neither provided then, nor provides now, any reason why such an employee, assigned a ministerial task, would alter the documents or otherwise intermeddle in their processing. The Committee's "speculat[ion] that discovery would enable it to demonstrate" grounds for defeating the sale and distribution, *see Martel v. Cnty. of L.A.*, 56 F.3d 993, 996 (9th Cir.1995), is not sufficient, *see id.*.

***5** In sum, the bankruptcy court did not abuse its discretion by declining to hold an evidentiary hearing or grant a continuance.

B. Authorization to Terminate Security Interest

The Committee next argues the bankruptcy court erred in determining that First American was not acting within the scope of its authority when it filed the erroneous UCC–3 amendments.

It is well established that a principal is bound by the acts of an agent acting within the scope of the agent's authority. *See* Cal. Civ.Code § 2330; *Goddard v. Metro. Trust Co. of Cal.*, 82 F.2d 902, 904 (9th Cir.1936). The California Commercial Code defines the scope of an agent's authority with respect to the filing of financing statements. In particular, "[a] filed record is effective only to the extent that it was filed by a person that may file it under Section 9509." *See* Cal. Com.Code § 9510(a). Under § 9509, as relevant hereto, "[a] person may file an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement only if ... [t]he secured party of record authorizes the filing." *See* Cal. Com.Code § 9509(d).

Here, the Committee, relying on CNB's instructions to First American, argues CNB gave First American broad authorization to file any "appropriate amendments" to CNB's UCC–1 financing statement and, consequently, that First American was acting as CNB's agent in all matters relating to CNB's security interest in the debtor's property. (Appellant's Br. at 10:25–27.) The language on which the Committee relies, however, when read in context, does not support the Committee's characterization thereof. The phrase "appropriate amendments" is qualified as follows:

> ... City National Bank hereby releases all of its right, title and interest in [Westgate and Greenery] and authorizes the filing of appropriate amendments to [the] UCC Financing Statement ...
>
> (*See* A.R. Ex. 2 at Ex. C.)

The bankruptcy court reasonably construed such instruction to mean that the only "appropriate amendments" authorized by CNB were amendments that relinquished CNB's interest in the two properties identified therein. The filing of a form that would completely terminate CNB's interest in the remainder of the debtor's property was not within the scope of the limited authority CNB granted to First American, and CNB thus was not bound by First American's filing of the UCC–3 Amendments with Box 2 checked.

Accordingly, the Committee fails to show the bankruptcy court committed clear error in finding First American was not acting within the scope of its authority when it filed the UCC–3 Amendments terminating CNB's security interest in all of the debtor's assets.

C. Mistake/Modification

The Committee further contends that, even if First American was not expressly authorized to file a UCC amendment terminating CNB's interest in the entirety of the debtor's property, the bankruptcy court erred in not finding CNB was bound by First American's "mistakes" or "modifications." (*See* Appellant's Br. at 12:8–10.)

*6 An escrow's agency is "a limited agency" and construed "strictly in accordance with the escrow instructions." *See* Lee v. Title Ins. & Trust Co., 264 Cal.App.2d 160, 162, 70 Cal.Rptr. 378 (Cal.Ct.App.1968); *see also* Montgomery v. Bank of Am. Nat'l Trust and Sav. Ass'n, 85 Cal.App.2d 559, 563, 193 P.2d 475 (Cal.Ct.App.1948) (holding deed altered after transmission to escrow holder void and party to escrow not bound by alteration). "The law is well established that a delivery by an escrow agent contrary to the terms of a deposit in escrow is void and of no force or effect." Geenzweight v. Title Guarantee & Trust Co., 1 Cal.2d 577, 581, 36 P.2d 186 (1934).

Here, as discussed above, the bankruptcy court reasonably determined First American's authorization as an escrow agent was limited to the filing of amendments relinquishing CNB's interest in Westgate and Greenery only. First American's authority was strictly limited by the instructions CNB provided. *See* Lee, 264 Cal.App.2d at 162, 70 Cal.Rptr. 378. The filing of a UCC–3 Amendment altered to terminate CNB's entire security interest is not "a mere violation of the principal's instructions regarding the manner in which [that] authority should be exercised," but, rather, "a complete departure from the agent's authority." *Cf.* Goddard, 82 F.2d at 904 (finding in suit against agent for conversion, where agent authorized to make loan but "neglect[ed] to take the so-called security," agent still acting within scope of authority and no cause of action stated).

Accordingly, the Committee fails to show the bankruptcy court erred in finding CNB was not bound by First American's filings.

D. "Seriously Misleading"

Lastly, the Committee argues the bankruptcy court erred in finding the UCC–3 Amendments were not "seriously misleading."

The test for whether an error is "seriously misleading" is "whether it would indicate to an interested third party the possible existence of prior encumbrances on the collateral." *See* In re Munger, 495 F.2d 511, 512 (9th Cir.1974). According to the Committee, the UCC–3 Amendments as filed by First American would lead a potential creditor to believe there was no prior encumbrance on AFE–Pioneer, and, consequently, were effective to terminate CNB's interest in AFE–Pioneer.

Citing *In re Pacific Trencher Equip., Inc.*, 735 F.2d 362 (9th Cir.1984), the Committee argues an erroneously checked termination box on an amendment to a financing statement is, as a matter of law, both seriously misleading under the UCC and thus binding on CNB. In *Pacific Trencher,* a secured creditor had intended to file a UCC form releasing its interest in certain assets of the debtor, *see id.* at 363, but instead mistakenly marked the "Termination" box rather than the "Release" box, *see id.* The Ninth Circuit found the form at issue therein was seriously misleading and, as such, effectively terminated the secured creditor's interest. *See id.* at 364. The Ninth Circuit further found the amendment could not be construed as terminating the secured party's security interest in only those items specifically listed on the form because the form then in use did not provide for a partial termination unless a box labeled "Release" was checked. *See id.* at 364–65.

*7 *Pacific Trencher,* however, is distinguishable on its facts. As the bankruptcy court observed, *Pacific Trencher* entailed an error made by the secured party itself, not, as here, by an individual or entity lacking authority to file the erroneous document. The effect of a lack of authorization thus was not before the *Pacific Trencher* court.[FN3] Additionally, in *Pacific Trencher,* as the bankruptcy court further observed, only the "Termination" box was checked, leaving no room for ambiguity. *Id.* at 365. Consequently, there was nothing in the form to alert potential creditors of the secured party's interest once the termination was filed. In the bankruptcy court's words, there was no "red flag." (*See* Bankr.Order at 11:2.) Here, by contrast, each of the two UCC–3 Amendments contained, on its face, inconsistent statements. The placing of check marks in both Box 8 and Box 2, as well as the detailed information in the former, constituted discrepancies of sufficient significance to alert potential creditors of a prior encumbrance on the debtor's interest in AFE–Pioneer, particularly where two such Amendments were filed when only one was needed to accomplish a termination of CNB's entire interest. In sum, the UCC–3 Amendments were confusing, but they were not seriously misleading.

FN3. As the bankruptcy court also noted, *Pacific Trencher* was decided before the

> 2001 revision of Article IX of the California Commercial Code and the enactment of sections 9509(d) and 9510(a), which provisions altered the law regarding the validity of financing statements from what it was at the time *Pacific Trencher* was decided. After the revisions, the test for determining the validity of a UCC–3 Amendment is whether it was authorized. *See* Cal. Civ.Code §§ 9509(d), 9510(a). As discussed above, First American was not authorized to terminate CNB's security interest.

Accordingly, the Committee fails to show the bankruptcy court erred in finding the altered filings were not seriously misleading.

CONCLUSION

For the reasons stated, the order of the bankruptcy court granting CNB's motion is hereby AFFIRMED.

IT IS SO ORDERED.

N.D.Cal.,2011.
Official Committee of Unsecured Creditors v. City Nat. Bank, N.A.
Slip Copy, 2011 WL 1832963 (N.D.Cal.)

END OF DOCUMENT

EXHIBIT B

Not Reported in B.R., 2009 WL 2821510 (Bkrtcy.N.D.Cal.), 69 UCC Rep.Serv.2d 1115
(Cite as: 2009 WL 2821510 (Bkrtcy.N.D.Cal.))

H

United States Bankruptcy Court,
N.D. California.
In re A.F. EVANS COMPANY, INC., Debtor.

No. 09–41727 EDJ.
July 14, 2009.

West KeySummary**Bankruptcy 51 ⚿3033**

51 Bankruptcy
51IX Administration
51IX(A) In General
51k3032 Compromises, Releases, and Stipulations
51k3033 k. Judicial Authority or Approval. Most Cited Cases

Bankruptcy 51 ⚿3078(2)

51 Bankruptcy
51IX Administration
51IX(B) Possession, Use, Sale, or Lease of Assets
51k3067 Sale or Assignment of Property
51k3078 Application of Proceeds
51k3078(2) k. Liens in General. Most Cited Cases

A Chapter 11 debtor was required to remit to a creditor 87.5% of the proceeds the debtor realized from a court-approved sale of its partnership interest in a limited partnership. At the date the debtor filed its Chapter 11 petition, the creditor held a valid, perfected security interest in the debtor's partnership in the limited partnership. Thus, pursuant to the court-approved cash collateral stipulation between the creditor and the debtor, the creditor was entitled to the remittance.

Chris D. Kuhner, Eric A. Nyberg, Kornfield, Nyberg, Bendes and Kuhner, Oakland, CA, Mark P. Levy, Levy, Levy and Levy, Larkspur, CA, Howard J. Weg, Peitzman, Weg and Kempinsky, LLP, Los Angeles, CA, for Debtor.

MEMORANDUM DECISION—MOTION REQUIRING DEBTOR TO REMIT SALES PROCEEDS

EDWARD D. JELLEN, U.S. Bankruptcy Judge.

A. *Introduction*

***1** City National Bank ("CNB") has moved for an order requiring A.F. Evans Company, Inc., the above debtor (the "debtor"), to remit to it 87.5% of the proceeds the debtor realized from the court approved sale of its partnership interest in AFE–Pioneer Associates, LP ("AFE–Pioneer"). Pursuant to a court approved cash collateral stipulation between CNB and the debtor, CNB is entitled to the remittance if, at the date of the debtor's chapter 11 petition herein, it held a valid, perfected, security interest in the debtor's partnership interest in AFE–Pioneer.

CNB's motion is opposed by the Official Committee of Unsecured Creditors (the "Committee"), which contends that any security interest CNB may have had in the debtor's partnership interest in AFE–Pioneer is avoidable or had been terminated by the date of the debtor's chapter 11 petition. Alternatively, the Committee contends that genuine issues of material fact are present, and that the court should set an evidentiary hearing to resolve such issues.

The court holds that at the date of the debtor's chapter 11 petition herein, CNB held a valid, perfected, security interest in the debtor's partnership interest in AFE–Pioneer. The court has therefore granted CNB's motion by order filed July 9, 2009.

B. *Facts*

Except as hereafter noted, the facts are undisputed. Prior to the filing of debtor's chapter 11 petition herein, CNB financed debtor's operations through a revolving line of credit. The line was secured by a security interest in substantially all the debtor's personal property, including the debtor's partnership interest in AFE–Pioneer.

On August 9, 2004, CNB perfected its security interest in the debtor's personal property by filing a UCC–1 financing statement with the California Secretary of State. In December 2008, the debtor wished to sell two partnership interests, not at issue herein, in partnerships called Westgate Housing Associates, L.P. ("Westgate") and Greenery Housing Associates,

L.P. ("Greenery"). To facilitate the sale, the debtor requested CNB to release its perfected security interest in the two partnership interests in consideration of a payment of $37,500 at the closing of each of the two sale escrows. The request did not extend to the debtor's interest in AFE–Pioneer.

To facilitate the closing, the debtor sent CNB proposed escrow instructions, for Westgate and Greenery, respectively, directed to the debtor and First American Title Insurance Co. ("First American"), and two proposed UCC–3 Amendment statements. The proposed instructions included an exhibit containing a description of the collateral to be released upon payment to CNB of the agreed upon sums. These descriptions were limited to Westgate and Greenery and did not include any reference to AFE–Pioneer.

The proposed UCC–3 Amendment statements that the debtor sent to CNB provided for deletion of Westgate and Greenery from the collateral covered by CNB's UCC–1 financing statement. The official UCC–3 form includes a blank box, box no. 2, which a filer can check if a filer wishes to terminate the entirety of a prior security interest. Significantly, the termination boxes in the proposed forms the debtor submitted to CNB were not checked.

***2** On January 8, 2009, CNB caused the two signed letters of escrow instruction, accompanied by two UCC–3 Amendment statements, to be submitted to First American. The letters and the two UCC–3 Amendment statements were in the exact form proposed by the debtor, without any check mark in box no. 2.

The escrows for the sale of debtor's interests in Westgate and Greenery closed, and two UCC–3 Amendment statements were recorded on January 28, 2009 in connection with the closings. These UCC–3 statements both referenced CNB's original UCC–1 financing statement, and included an "X" in box no. 2. Box no. 2 reads as follows:

> Termination: Effectiveness of the financing statement identified above is terminated with respect to security interest(s) of the Secured Party authorizing this Termination Statement.

In addition, both UCC–3 Amendment statements included a checkmark under box no. 8, headed "Collateral Change." In box no. 8, if selected, a filer can check one of four smaller boxes indicating whether the collateral described in box 8 is being deleted, added, restated, or assigned. On each of the two UCC–3 Amendment statements at issue herein, the "describe collateral deleted" option had been checked, followed by a description of the debtor's interest in, respectively, Westgate and Greenery. The verbiage of the descriptions was identical to that set forth in CNB's letters of instructions dated January 8, 2009.

CNB contends that someone, without authority, checked the termination boxes in the UCC–3 Amendment statements after CNB had transmitted them with its escrow instructions to First American, and that its security interest was not terminated except to the extent of Westgate and Greenery. The Committee does not so concede.

In any event, after CNB discovered what had been recorded, it filed two more UCC–3 Amendment statements on February 6, 2009, which stated that CNB had not authorized the termination of its security interests in any assets of the debtor other than Westgate and Greenery.

On May 5, 2009, the debtor filed its voluntary chapter 11 petition herein. Thereafter, this court approved a stipulation between the debtor and CNB, which in essence, required the debtor to remit to CNB 87.5% of the proceeds of various assets, when sold, subject to the right of the Committee to object based on any alleged defects in CNB's security interest. On March 12, 2009, the debtor filed a motion seeking court authority to sell its interest in AFE–Pioneer. The court granted the motion, subject to the debtor's obligation to remit 87.5% of the proceeds to CNB, and subject to the Committee's right to object to the remittance.

The sale of AFE–Pioneer has closed. CNB has filed a motion for an order compelling the debtor to remit to it 87.5% of the sales proceeds. The Committee has filed an objection, contending that the above-described UCC–3 Amendment statements recorded January 28, 2009 operated to terminate CNB's security interests in the debtor's property, including its partnership interests in AFE–Pioneer. CNB disagrees.

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C. *Discussion*

***3** California Commercial Code § 9513(d) (West 2002) [FN1] provides:

> Except as otherwise provided in Section 9510, upon the filing of a termination statement with the filing office, the financing statement to which the termination statement relates ceases to be effective.

Section 9510(a) provides:

> A filed record is effective only to the extent that it was filed by a person that may file it under Section 9509.

Section 9509(d) provides:

> A person may file an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement only if either of the following conditions is satisfied: (1) The secured party of record authorizes the filing ...

The Committee argues in reliance on § 9513(d) that the filing of the UCC–3 Amendment statements with the termination boxes checked terminated CNB's security interest.

The Committee further argues with reference to §§ 9510(a) and 9509(d) that, as a matter of general agency law, a principal, here CNB, is bound by the acts of its agents acting within the scope of the agent's authority. *Goddard v. Metropolitan Trust Co. of California*, 82 F.2d 902 (9th Cir.1936). The Committee further argues that First American was CNB's agent for purposes of the AFE–Pioneer partnership sale, and accordingly, that even if First American checked the termination boxes in error, CNB is bound by that mistake and is therefore deemed to have authorized First American to terminate its security interest in all the debtor's personal property.

The court takes no issue with the general proposition that a principal is bound by the acts of an agent acting within the scope of the agent's authority. Nor does the court disagree that, for purposes of determining what a secured party did or did not authorize within the meaning of § 9509(d), law other than the Commercial Code may determine the issue. *See* Uniform Commercial Code, official comment to § 9–509.

However, the court does take issue with the applicability of the foregoing principles to the undisputed facts present here.

First of all, according to the uncontroverted declaration of Jerry McDermott, a Vice President of CNB, First American was not acting within the scope of its authority when and if it attempted to terminate CNB's security interest in any assets other than Westgate and Greenery. According to Mr. McDermott's Declaration dated June 11, 2009, the escrow instructions and UCC–3 Amendment statements that the debtor requested CNB to submit, and which CNB did submit, to First American in order to release its security interest in Westgate and Greenery, had only the "delete collateral" boxes checked, followed by a description of Westgate or Greenery, and did not have the termination boxes checked. Declaration of Jerry McDermott filed June 12, 2009, Paragraphs 8 and 9. Clearly, CNB did not, in fact, authorize First American to terminate its security interest as to assets other than Westgate and Greenery.

***4** Moreover, according to Mr. McDermott:

> CNB had no input and no influence regarding establishing an escrow for the Westgate–Greenery transactions at First American Title Insurance Company. The escrow was established by the Debtor or by the purchaser of the Westgate–Greenery partnership interests prior to preparation by the Debtor of the escrow instructions and enclosures that I was provided by [the debtor]....

Declaration of Jerry McDermott filed June 12, 2009, Paragraph 7.

> CNB was not involved in any way with the selection of the escrow agent, has not engaged or employed the escrow agent, and has not had any contact whatsoever with the escrow agent (either in writing or verbally) with regard to the filing of the subject financing statement amendments or the Westgate–Greenery sale, excpdt for my delivery of the escrow instructions and their enclosures as described in Paragraphs 6 and 7 above.

Declaration of Jerry McDermott filed June 12, 2009, Paragraph 12.

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Therefore, First American was not CNB's agent, except for the limited purpose of handling the closing of the escrow for the debtor's sale to the buyer of the Westgate and Greenery partnership interests. And First American was not acting within the scope of its very limited authority from CNB when it recorded a UCC–3 Amendment statement in a form other than that which CNB had authorized.

It follows that CNB was not bound by First American's unauthorized modification to the UCC–3, if indeed the modification was by First American. Sections 9509(d) and 9510(a). *See also, Montgomery v. Bank of America Nat. Trust and Savings Ass'n.*, 85 Cal.App.2d 559, 193 P.2d 475 (1948) (a party to an escrow was not bound by the escrow holder's unauthorized alteration of a deed, which deed was rendered void by the alteration).[FN2]

The Committee cites *In re Pacific Trencher & Equipment, Inc.*, 735 F.2d 362 (9th Cir.1984) as authority to the contrary. In *Pacific Trencher,* the secured party had filed a UCC form with the apparent intention of releasing its security interest in certain, but not all, of the debtor's assets. Unfortunately for the secured party, it mistakenly checked the "termination" box rather than the "release" box. The termination box read "The Secured Party certifies that the Secured Party no longer claims a security interest under the Financing Statement bearing the file number shown above."

The lower courts held that the filing of the termination statement terminated the secured party's security interest. On appeal to the Ninth Circuit, the secured party argued that it should be entitled to reform the termination statement, or alternatively, that the termination statement should be construed as a partial termination of its security interest, based on the collateral description that the secured party had included in the form. The Ninth Circuit rejected these arguments, noting "Given the language of this form, there is no possibility of construing a partial termination of items listed in a financing statement." *Id.* at 364.

***5** *Pacific Trencher* is distinguishable for several reasons. First, the error in *Pacific Trencher* was the secured party's error, and did not involve an unauthorized act by an escrow agent. This is particularly significant because the Ninth Circuit decided *Pacific Trencher* prior to the enactment of §§ 9509 and 9510, which specifically address the affect of an unauthorized UCC filing. One treatise noted as follows with respect to the purpose of these provisions:

> Revised Section 9–510(a) also addresses a related, but distinct, problem. What is the status of a record that was filed by a person entitled to file by revised Section 9–509 but the content of which goes beyond that which was authorized? ... Revised Section 9–510(a) provides that a filed record is effective only to the extent that it was filed by a person entitled to do so under revised Section 9–509. As the comment makes clear, the "only to the extent" language is present to nullify records to the extent that they go beyond the actual or deemed authorization that entitled the filer to file them.

9B *Hawkland's Uniform Commercial Code Series* (West 2001), at pp. Rev. Art. 9–794–Rev. Art. 9–795, § 9–509:4.

In addition, the UCC form at issue in *Pacific Trencher* had only one box, the termination box, checked. The Ninth Circuit opined on that basis that the form could not reasonably be construed to effect a partial termination of the secured party's security interest. Here, however, each of the UCC–3 forms at issue had two boxes checked—the termination box plus the release of collateral box. Clearly, checking a release of collateral box would be superfluous in a case where a secured party wished to terminate a security interest in its entirety. Thus, the ambiguity here is patent, whereas the form at issue in *Pacific Trencher* was unambiguous.

The presence of this ambiguity is material because of § 9506(a), which provides:

> A financing statement substantially satisfying the requirements of this part is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading.

Under this provision, the test of whether an error is not seriously misleading is "whether it would indicate to an interested third party the possible existence of prior encumbrances on the collateral." *In re Munger*, 495 F.2d 511, 512 (9th Cir.1974). Here, CNB's financing statements, as amended by the

UCC–3 Amendment statements, each with two conflicting boxes checked, would raise a red flag for any person conducting a search alerting such person of the possibility that a full termination may not have been intended.[FN3]

D. *Conclusion*

For the foregoing reasons, the court has issued its order granting CNB's motion.

FN1. California enacted numerous amendments to Division 9 of the California Commercial Code (Secured Transactions), effective July 1, 2001. Unless otherwise noted, all further section references herein are to the California Commercial Code as so amended.

FN2. Given this conclusion, the court need not address the effect, if any, of the UCC–3 Amendment statements CNB filed on February 6, 2009.

FN3. In addition, given the fact that a single UCC–1 filing can be terminated only once, the redundancy of two UCC–3 Amendment statements being filed with box 2 checked, each describing different collateral in box 8, would have raised an additional red flag to any person searching the records.

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